About TheCityUK

TheCityUK is the industry-led body representing UK-based financial and related professional services. In the UK, across Europe and internationally, we promote policies that drive competitiveness, support job creation and ensure long-term economic growth. The industry contributes over 10% of the UK’s total economic output and employs 2.3 million people, with two thirds of these jobs outside London. It is the largest tax payer, the biggest exporting industry and generates a trade surplus almost equivalent to all other net exporting industries combined.

About Trowers & Hamlins LLP

Trowers & Hamlins is an international law firm. Clients choose us for our ideas, insight, passion and courage. With them we’re building a better built environment. Working alongside them in the space where culture, communities and commerce meet to maximise opportunities and deliver lasting change.

Bridging the gap between the public and private sectors. Connecting individual needs with services from governments and businesses. Steering the conversation and leading the thinking, worldwide.

From our bases in the UK, Middle East and Far East we support some of the world’s most innovative organisations and authorities with informed legal expertise and unrivaled sector experience.
THE UK IS THE TOP WESTERN CENTRE FOR ISLAMIC FINANCE

1ST

5 FULLY SHARIA-COMPLIANT BANKS LICENSED IN THE UK

BANKING ASSETS OF AROUND $4.7BN

ASSETS OF UK-BASED INSTITUTIONS THAT OFFER ISLAMIC FINANCE SERVICES TOTALLED AROUND $6BN IN 2017

120 ISLAMIC FINTECH FIRMS GLOBALLY

1ST SOVERIGN GREEN SUKUK WAS ISSUED IN 2018

72 SUKUK HAVE BEEN LISTED ON THE LONDON STOCK EXCHANGE = $53BN

THE GLOBAL MARKET FOR ISLAMIC FINANCE SERVICES INCREASED BY 6.5% BETWEEN 2016 AND 2017

TO $2.4TRN

THE UK IS THE WORLD’S LARGEST PROVIDER OF ISLAMIC FINANCE COURSES = 80
As the Economic Secretary to the Treasury, I am committed to strengthening and maintaining Britain’s position as the world’s preeminent centre for financial services. I am therefore delighted to introduce the TheCityUK’s latest Islamic finance report, which reaffirms the UK’s status as the leading Western hub for Islamic finance.

It has been Government policy for almost 20 years to provide a level playing field for both conventional and Islamic finance within the UK. This policy has been a trigger for change, encouraging our domestic Islamic finance sector to flourish and attracting global emulation of English law for Sharia compliance standards.

I am thrilled that British expertise continues to be at the forefront of market innovation in a commercial environment strongly supported by Government. This can be seen in London and across the UK through the growth of our centres of excellence in Islamic education, FinTech, banking and insurance.

This report provides an excellent foundation for understanding the progress that has been made in Islamic finance. I want to congratulate the UK Islamic finance sector on its continued success and innovation, and I look forward to the significant strides we will make together.

John Glen MP
Economic Secretary to the Treasury
Islamic finance is a specialist area that presents exciting growth opportunities for UK-based financial and related professional services. This report summarises global trends in Islamic finance with a particular focus on the development of the UK market. The industry’s increasing importance for Islamic and other investors around the world is evidenced by its steady growth in recent years. Potential future growth prospects are robust, supported by global demographic trends. Sharia (Islamic law) compliant banking assets make up 6% of the world’s banking assets, but globally, approximately one in four people are Muslim. The scope for growth is obvious.

As a leading Western centre for Islamic finance, the UK has been at the forefront of key developments, as illustrated by the findings of this report. The number of UK-based institutions that offer Islamic finance services is many more than other Western countries. Five fully Sharia-compliant banks are licensed in the UK. The London Stock Exchange (LSE) is a key global venue for the issuance of sukuk (Islamic bond).

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 and insurance providers, together with international law, accountancy and consultancy firms.

There is a growing global demand for skills as Islamic finance expands. British 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 five professional institutions and 80 Islamic finance courses on offer.

The government, regulators and our industry should continue to work together, not just to grow the sector and maintain the UK’s preeminent position in Islamic finance, but also to become a leading player in setting international Sharia-compliant standards. Major developments have included the removal of double tax and extension of tax relief on Islamic mortgages and the reform of arrangements for issues of debt. We look forward to continuing our work with the UK government to encourage inward investment via Islamic finance and associated services; to use our interactions with other governments and international business to facilitate growth and job creation; and to build on the advantage we have as the leading Western centre for Islamic finance.

Miles Celic
Chief Executive Officer, TheCityUK
The UK is, and will remain, the key jurisdiction for Islamic finance in Europe and very few of the other European jurisdictions have come close to matching London’s strengths in all aspects of Islamic finance. While Islamic finance brings its own challenges, the fact that London is the leading financial and professional services centre means that much of the development and innovation, which is a constant part of the evolving industry, is led from here, especially when coupled with the strength and predictability of English law underpinning financing structures.

It is very interesting to see Islamic finance being applied in tackling some of the areas of public need and concern in the UK, for example large build-to-rent and mixed use projects in Birmingham and Edinburgh. We are also pleased to see investors emphasising the socially responsible aspect of their investments with the flexibility of Islamic financing techniques being used in new and exciting areas, such as green sukuk which widens the investor base to include environmentally conscious investors.

We have had an active interest in Islamic finance since the 1980s, through our presence in the Middle East, but our practice really started in 1992/93 when we advised a Kuwaiti Islamic finance Institution on the structuring of its first ever Sharia-compliant leveraged UK commercial real estate fund. In the early 2000s, a renewed interest in the UK from Gulf-based investors saw us working on their UK and European investment funds.

Since then, our offices in the UK, Abu Dhabi, Dubai, Bahrain, Oman and Kuala Lumpur have worked together to create innovative structures which have been adapted to meet the different tax and local law restrictions for Sharia-compliant transactions as well as covering key issues such as development, construction, planning, environmental concerns, corporate, tax and dispute resolution. We are also pleased to have been able to contribute to the development of the legal infrastructure for Sharia-compliant products. For example, we worked with regulators in Jordan and Oman to develop sukuk regulations and played a part in the creation of the International Islamic Liquidity Management Company, an essential part of the Islamic finance sector’s infrastructure.

Advice from the professional firms in London has a large part to play in the more usual Islamic jurisdictions and we look forward to working with them as they grow and develop.

We are very pleased to sponsor TheCityUK’s ‘Global trends in Islamic finance and the UK market 2019’ report.

Neill Gibson
Partner, Trowers & Hamlins LLP
Global trends in Islamic finance and the UK market 2019

The UK Islamic finance market

• The UK’s profile as the leading Western centre for Islamic finance has continued to grow in recent years. Institutions in London and across the UK have been providing Islamic finance and related professional services for nearly 40 years.

• The Islamic Finance Country Index, published by Edbiz Consulting, ranks the Islamic banking and finance industry of countries globally. The 2018 Index ranks the UK 17th out of 48 countries, putting it first in Europe and first among non-Muslim-majority nations, ahead of the US (19th), Switzerland (27th), Canada (28th), Germany (38th) and France (40th).

• The number of institutions located in the UK offering Islamic finance services is estimated to be far ahead of other Western countries. Assets of UK-based institutions that offer Islamic finance services totalled around $6bn (equivalent to £4.7bn) in 2017.

• An important feature of the development of the UK as a centre for Islamic finance has been a range of supportive governmental policies which have created a fiscal and regulatory framework intended to broaden the market for Islamic finance products. The Islamic finance sector operates under legislation that applies to all sectors, enabling a level playing field for both Islamic and conventional financial products. The Bank of England announced in 2017 that it was establishing a Sharia-compliant facility (SCF) to support Islamic banks in the UK. In September 2018, the Bank also announced that it will set up an Alternative Liquidity Facility, a legal entity to house the SCF.

• 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, business start-up financing and an interest-free alternative to conventional student loans.

• There are currently five fully Sharia-compliant banks licensed in the UK, more than any other Western country. Total Sharia-compliant banking assets in the UK were around $5.5bn (equivalent to £4.1bn) in the first half of 2018. There are many conventional banks and institutions that provide Islamic finance services from a UK base.

• The London Stock Exchange (LSE) is a key global venue for the issuance of sukuk. A total of 72 sukuk have been listed on the LSE with a total value of $53bn.

• Net assets of Islamic funds in the UK amount to $700m (equivalent to £543m). A total of three Sharia-compliant exchange traded funds (ETFs) are listed on the LSE.

• The UK is a Western leader in supporting infrastructure and environment for Islamic finance. Services in the UK are offered by financial intermediaries, asset managers, insurance providers and international law, accountancy, and consultancy firms.

• There is a growing demand for skills as Islamic finance expands. The UK is one of the world’s largest providers of Islamic finance education.

EXECUTIVE SUMMARY

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The global context

• The global market for Islamic finance, as measured by Sharia-compliant assets, increased by 6.5% between 2016 and 2017, reaching a record $2.4trn. Global assets of Islamic finance grew by an average of 7.1% annually during the period 2012-17. The market is expected to reach $3.8trn by 2023.

• Considerable potential exists for the expansion of Islamic finance. The global Muslim population numbering around 1.8 billion accounts for approximately a quarter of the global population, but Sharia-compliant banking assets make up 6% of the world’s banking assets.

• More countries are looking to expand their Islamic finance offering. New Islamic finance institutions have been reported in a number of countries including: Australia, Kazakhstan, Kenya, Morocco, Nigeria, Oman, Pakistan, Russia and South Africa. This offers opportunities for the existing lead countries in Islamic finance and will also provide fertile ground for future growth of the industry.

• Banking, which accounts for 71% of Islamic finance assets, and sukuk (17%) are the most established forms of Islamic finance. Other assets, including funds (4%) and takaful (2%), represent the remainder.

• Global Islamic banking assets totalled $1.7trn at the end of 2017, up 2.7% year on year. The sector’s assets remain concentrated in the Middle East region and a few Asian countries. Assets of sukuk and takaful reached $426bn and $46bn respectively in 2017. Some new countries have entered into the sukuk market; for example, Morocco issued its first sukuk worth $116m in October 2018.

• Green sukuk represents the intersection of green finance and Islamic finance. Green sukuk is a Sharia-compliant security similar to a bond that is used to fund environmentally-friendly projects; the security increases the supply of capital from investors to finance green projects. Asia is at the forefront of this new type of financing: a Malaysia-based, Chinese-owned renewable energy firm, Tadau Energy, issued the world’s first green sukuk in March 2017, and Indonesia issued the first-ever sovereign green sukuk in February 2018.

• The Islamic fund market was the most rapidly growing Islamic finance sector between 2016 and 2017, having expanded by 21% to reach $110bn in assets by the end of 2017. However, compared to the conventional fund management market, the Islamic fund sector is still relatively small.

• FinTech in Islamic finance is only in the early stages of development, but the future outlook is bright. There were around 120 Islamic FinTech firms globally as of the end of 2017. Although the development of Islamic FinTech has been most prominent in Muslim countries, the UK is also well positioned in the market, due to its competitive advantages in both financial services and technology.
THE UK ISLAMIC FINANCE MARKET

Market share and growth trends in key sectors

The UK’s position as the leading Western centre for Islamic finance has grown in recent years, although institutions in London and other UK cities have been providing Islamic finance and related professional services for nearly 40 years. As the sector has developed, the breadth of Islamic products and services offered in the UK has grown and is increasingly competing with offerings of conventional financial institutions.

It is difficult to fully capture the size of the Islamic finance sector in the UK; some transactions combine elements of both Islamic and conventional financing. In the Islamic financial system, the mobilisation of funds must be through contracts permissible by Sharia, such as mudarabah, wakalah, murabahah, ijarah, musharakah, istsina and salam. Islamic finance products are structured based on either one or a hybrid of these contracts. Hybrid contract structures typically involve multiple contracts and/or multiple parties to complete the transactions and are being used, for example, by the Islamic banks to gain a strong position, meet Sharia compliance, and to be as attractive and competitive to customers as conventional banks. The presence of such transactions in the market demonstrates the UK-based financial and related professional services industry’s adaptability, allowing it to provide innovative services to meet new and evolving demand.

For example, in December 2017, Spartan UK, the Newcastle based re-rolling plant of Metinvest Holding, a steel and mining company with its headquarters in the Ukraine, secured a £15m, 12-month Sharia-compliant commodity trade finance facility, with Bank of London and the Middle East acting as lead arranger, coordinator and investment agent. London-based 90 North Real Estate Partners in February 2018 completed the sale of Lenovo’s headquarters campus in the US for $135.3m. The buyer was Mumtalakat Holding Company, Bahrain’s Sovereign Wealth Fund, in partnership with Sentinel Real Estate Investment Corporation. 90 North Real Estate Partners executed the sale in conjunction with its partner, Dubai based Arzan Wealth.

Measurement difficulties notwithstanding, the Islamic Finance Country Index published by Edbiz Consulting ranks the Islamic banking and finance sector of countries globally, based primarily on the number of Islamic banks (22% weighting), number of Islamic banking and financial institutions (20%), Sharia supervisory regime (20%), and Islamic financial assets (14%), among other factors. The 2018 Index ranks the UK 17th out of 48 countries, putting it first in Europe and first among non-Muslim-majority nations, ahead of the US (19th), Switzerland (27th) Canada (28th), Germany (38th) and France (40th).

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**Case Study:** Trowers & Hamlins supports an innovative cross-border hybrid Islamic finance transaction

One recent example of innovation in the market was Warba Bank KSCC’s acquisition of the Kia Distribution Centre in Immingham, UK. This was a cross-border deal for Warba, a Kuwaiti Sharia-compliant bank, to acquire a UK real estate asset, funded by the London branch of another Kuwaiti Sharia-compliant bank, NBK. It represented Warba’s most recent entry into the UK commercial property market, and utilised an offshore structure to optimise the acquisition and holding of the asset.

Due to it being an acquisition of the existing property-owning offshore special purpose vehicle, rather than the acquisition of the property itself, and in view of the seller’s requirement to limit its liability in respect of any warranties and indemnities provided to the purchaser, the transaction required the first Sharia-compliant warranty and indemnity insurance policy ever issued by a UK insurer in the London M&A market to be put in place at completion. The policy was taken out with AIG UK and its strategic partner Cobalt Underwriting.

Corporate, Islamic finance, real estate, tax and other teams from across Trowers & Hamlins’ Bahrain, London and Manchester offices delivered specialist and targeted local advice to Warba Bank KSCC.

This is a genuinely innovative development in both the London M&A and Sharia-compliant markets. For the first time ever, Sharia-compliant investors into the UK now have a takaful product which finally levels the playing field with conventional investors. Given the significant length of time for which Sharia-compliant Gulf institutions have been investing into UK commercial property through an M&A acquisition structure, the transaction was notable for bringing a new product to the market and for establishing greater flexibility moving forward for Sharia-compliant clients all over the world investing into the UK.
The number of institutions located in the UK offering Islamic finance services is estimated to be nearly double the number located in the US, and far ahead of other Western countries. Assets of UK-based institutions that offer Islamic finance services totalled around $6bn (equivalent to £4.7bn) in 2017.2

Islamic financing activities started in the UK in the 1980s. This included wholesale liquidity of Islamic banks being placed through banks located in London. These banks utilised metals made available by member firms of the London Metal Exchange (LME) as physical asset support for the liquidity management transactions. The LME continues to be an important avenue for the growth of Islamic finance globally. It is a leading metal exchange, and a significant volume of liquidity management transactions concluded by Islamic finance institutions are supported by metals on LME warrant.

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, business start-up financing and an interest-free alternative to conventional student loans.

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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 two decades which have created a fiscal and regulatory framework intended to broaden the market for Islamic finance products. This includes the removal of double tax and extension of tax relief on Islamic mortgages and the reform of arrangements for issues of debt. The Islamic finance sector operates under legislation that applies to all sectors – enabling a level playing field for both Islamic and conventional financial products.

The Islamic finance sector in the UK has benefitted from the depth and breadth of the conventional financial and related professional services industry. In addition, a concentration of intermediaries that facilitate services to Islamic institutions helps enable interbank and capital market functioning, thereby contributing to the UK’s competitive advantage in this sector.

London is not only the leading international centre for financial services, but also a world leader in professional services, such as legal, accounting and management consulting. Taken together, this financial and related professional services ecosystem - which is an integral part of the UK’s global competitiveness - is another reason why Islamic finance institutions have chosen to locate in the UK.

London has the leading share of trading in many international financial markets, including foreign exchange and over-the-counter derivatives trading, international bank lending, and international insurance. London and the wider UK is also Europe’s premier centre for management of sovereign wealth funds, hedge funds and private wealth. The UK’s financial services trade surplus of $88bn (equivalent to £68bn) in 2017 was nearly the same as the combined surpluses of the next three leading countries (the US, Switzerland and Luxembourg). When the estimated trade surplus for related professional services – legal services, accountancy and management consultancy – is also taken into account, this figure climbs to around $107bn (equivalent to £83bn).\(^3\) For legal services alone, trade surplus was £4.4bn in 2017.\(^4\)

Indeed, specific examples of UK-based corporates’ international activity – including in some of the biggest markets for Islamic finance – demonstrate the types of activity that contribute to this trade surplus and reinforce the premise that the UK’s Islamic finance leadership among Western countries is not only based on its ability to attract inward investment and overseas business, but also about its exports. For example, HSBC offers Sharia-compliant products and services in Malaysia and Saudi Arabia; Trowers & Hamlins offers legal services for Islamic finance in Abu Dhabi, Bahrain, Dubai, Oman and Malaysia; Linklaters offers Islamic finance services in the UAE and Singapore; Freshfields Bruckhaus Deringer offers legal services for some Muslim countries, such as Bahrain, Iran, Saudi Arabia, the UAE and Indonesia; and Eversheds Sutherland offers legal services for Islamic finance through its global offices.


KEY FEATURES OF THE UK ISLAMIC FINANCE SECTOR
The UK is a global centre for Islamic finance. Key features of UK Islamic finance:

• The UK offers one of the most attractive regulatory and tax systems for Islamic finance anywhere in the world. The success of the UK’s sovereign sukuk in 2014 was a significant milestone in the development of the UK and global Islamic finance industry.

• Five fully Sharia-compliant banks are located in the UK. This is more than in any other Western country. Additionally, many foreign banks access Islamic finance through the London markets or London-based teams for specific initiatives (treasury, trade finance, property finance, agency desks for corporate financing/lending).

• The depth and breadth of London’s capital markets, which provides companies and issuers of financial products with access to a wide pool of investors and secondary market liquidity.

• The LSE, which is a key global venue for the issuance of sukuk. As of January 2019 over $53bn had been raised through 72 issues. Three Sharia-compliant ETFs are also quoted on the LSE. The LSE also launched its Islamic Finance Market Index in 2013.

• The fact that London is home to over 200 international law firms. TheCityUK estimates at least 25 of these firms, including major global partnerships, have established dedicated Islamic finance units. Smaller firms across the UK are also active in the sector. Many Islamic contracts are governed by English law.

• The UK’s largest accounting, consulting and professional service firms all have Islamic finance departments providing trusted advisory services to UK and international clients.

• Qualifications in Islamic finance are offered by five professional institutes and the UK offers 80 Islamic finance courses.

• The use of Islamic finance for major infrastructure projects in London and across the UK. Current trends suggest that the role of Islamic finance in funding infrastructure development will continue to grow in the years ahead.
Banking

Al Baraka International was the first Islamic bank in the UK, launched in 1982. In addition, a number of investment banks provided Sharia-compliant products to their Middle Eastern clients beginning in the 1980s.

There are currently five fully Sharia-compliant banks licensed in the UK, more than in any other Western country. Total Sharia-compliant banking assets in the UK were $5.5bn (equivalent to £4.1bn) in the first half of 2018. There are also more than 15 conventional banks and institutions that provide Islamic finance services from a UK base.5

- Al Rayan Bank is a retail bank and effectively the only Islamic bank with a high street presence having five branches, ten offices6 and over 80,000 customers.7 The bank offers a wide range of Sharia-compliant financial products in the UK.

- The Bank of London and The Middle East (BLME) is an independent wholesale Sharia-compliant UK bank based in London. BLME’s offering spans corporate banking, treasury and wealth management that comprises private banking and asset management.

- QIB (UK), a subsidiary of Qatar Islamic Bank, offers a range of Sharia-compliant banking, financing and investment services. It presents real estate financing opportunities to an array of clients ranging from sovereign wealth funds to institutional investors; provides banking services to high net worth individuals; and offers expertise in property finance and sharia-compliant investments.

- Gatehouse Bank not only offers savings products but is also involved in real estate investment. For example, in January 2018 the bank announced it was purchasing the 176,000 square foot Greyhound Park Phase II in Chester.

- Abu Dhabi Islamic Bank (ADIB) is pursuing an ambitious growth strategy. ADIB already operates a large branch network in the Middle East, including Egypt, Iran, Saudi Arabia and Qatar. ADIB UK limited was established to bring the bank’s services to clients in the UK – the only country outside the Middle East where ADIB has operations.8

A long-standing challenge faced by the Islamic banking sector is its ability to ensure its banks have sufficient liquidity to meet Basel III liquidity rules. This is due to the limited stock of assets Islamic banks can hold that are both high quality and Sharia-compliant. The Bank of England announced in 2017 that it was establishing a Sharia-compliant facility (SCF) to provide UK Islamic banks with greater flexibility in meeting Basel III requirements, by allowing them to place deposits at the central bank on a non-interest-bearing basis. The launch date for the SCF has not yet been confirmed, but as part of the implementation of this project, the Bank formally incorporated a new subsidiary in December 2018. This is called the Bank of England Alternative Liquidity Facility, and will be used to segregate the SCF from the Bank’s other interest-based activity.

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THE BANK OF ENGLAND’S SHARIA-COMPLIANT FACILITY AND THE UK SOVEREIGN SUKUK

The announcement in 2017 by the Bank of England on establishing a Sharia-compliant facility and the subsequent announcement in 2018 of the creation of a new subsidiary—the Bank of England Alternative Liquidity Facility—was welcome news for the UK’s Islamic finance sector.

Also related to the future of the UK’s Islamic finance sector is a decision by HM Treasury on the UK sovereign sukuk. The current UK sovereign sukuk is due for redemption in July 2019. The CityUK understands that (at the time of this report’s publication) HM Treasury is assessing the possibility of a second issuance. In autumn 2018, following receipt of an informal paper from HM Treasury seeking to identify the wider value and benefits of the 2014 UK sovereign sukuk, TheCityUK arranged a series of meetings and consultations with all the UK Islamic Banks (UKIBs), other UK based international banks with an interest in the sovereign sukuk, major financial institutions, and leading UK legal firms working on sukuk issuance.

Key findings from the consultations were:

If a sukuk is not available for the UKIBs and finance institutions, it would be difficult, if not impossible, for them to meet regulatory requirements. Like all banking institutions, Islamic banks have a regulatory requirement to hold liquidity buffers of sterling denominated high-quality liquid assets. The UK Islamic banking system currently lacks a fully efficient suite of instruments to manage its liquidity and satisfy regulatory stipulations. This has had implications for how well the sector is able to support jobs, sustain growth and generate tax revenues. It would be made worse if the sukuk is not reissued. Without the sukuk, the UKIBs have a regulatory compliance problem that cannot be resolved immediately. The Band of England’s liquidity provision is not likely to address the problem in its entirety as we understand it will have a different regulatory and balance sheet classification, it is also unlikely to be available before the UK sovereign sukuk becomes due for redemption. When it is available the facility will ease the situation, but unless there is another AAA issuer of sterling-denominated paper, there is no alternative access to those assets other than through the UK sovereign sukuk.

UK Government Departments have, for the past 20 years, worked to develop and implement policy and legislation to achieve a level playing field for Islamic finance in the UK. This has given the UK a leading position in global Islamic finance, which should be maintained and nurtured as we look to develop business with new markets. Additional to the regulatory problems for the UKIBs, not to re-issue would send a negative message to the UK/Global Islamic finance industry and also to foreign investors, undermining the UK’s position as the leading western centre for Islamic finance.

From our consultations it became apparent there may be legal/technical difficulties with the sovereign sukuk, especially if it is to be reissued. TheCityUK stands ready to assist HM Treasury with any deliberations regarding the next stage. We hope that a positive announcement on a second UK sovereign sukuk will be made soon and we look forward to the launch of the Sharia-compliant facility.
THE UK GOVERNMENT STRATEGY FOR THE DEVELOPMENT OF ISLAMIC FINANCE IN THE UK

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 conventional firms that offer Islamic finance services.

The development of Islamic finance has enjoyed cross-party political support over the past decade. There have been two key policy objectives. Firstly, to establish and maintain London as the leading Western hub for 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 recently reformed All Party Parliamentary Group, chaired by Naz Shah MP and co-chaired by Lord Sheikh, confirms Parliament’s support for the sector and the growth of Islamic finance in the UK.

The establishment of an enabling fiscal and regulatory framework in the UK for Islamic finance over the past decade has been key to facilitating these policy objectives. Initiatives have included:

• The removal 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 sukuk 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 Conduct Authority (FCA) to ensure that regulatory treatment of Islamic finance is consistent with its statutory objectives and principles.
Sukuk

Sukuk are issues of Islamic notes that are compliant with Sharia law and are an alternative to conventional bonds. Sharia law prohibits the payment or receipt of interest while allowing financing for trading in or the construction of specific and identifiable assets. The sukuk market is an essential part of the Islamic finance market. The securities are sought by a wide range of investors including sovereign wealth funds, central banks and domestic and international financial institutions.

The UK was the first Western nation to issue a sovereign sukuk, in 2014. One of the UK government’s objectives in issuing the sukuk was to bring Islamic finance into the mainstream. By showing that a sterling sukuk was viable it encouraged acceptance of sukuk as an asset class by investors who might not previously have considered it.

As a major centre for international bonds, London is an important centre for the issuance and trading of sukuk. The London Stock Exchange (LSE) is a key global venue for the issuance of sukuk; the Main Market and the Professional Securities Market are the two avenues for Islamic fundraising on the LSE. Compared with the Main Market, the Professional Securities Market offers less strict regulatory requirements, allowing issues of debt securities and sukuk to be more flexible. More specifically, the issues are only governed by the rules of domestic Generally Accepted Accounting Principles (GAAP), but do not have to follow the requirements of International Financial Reporting Standards (IFRS). Unlike other major exchanges, the LSE does not charge an annual fee to issuers, making the listing venue competitive and cost efficient.

Two different forms of sukuk – asset-based and asset-backed securities – are available. In the case of a shortfall in payments, asset-based investors have recourse to the originators but asset-backed investors do not, because only asset-backed have full legal ownership of the underlying asset.9 As of January 2019, 72 sukuk had been listed on the LSE with a total value of $53bn (Figure 2). Sukuk issuance reached $8.6bn, a record high, in 2018.10

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Key milestones for the LSE have included the GE Capital sukuk, the first listed sukuk by a US corporate (2009), and the Kuveyt Turk sukuk, the first by a European bank (2010). The first UK corporate sukuk was issued in 2010 by International Innovative Technologies. In April 2017, the Islamic Development Bank issued its sukuk on the LSE, raising $1.3bn – the largest sukuk issuance to date. In February 2018, Al Rayan Bank issued a £250m sukuk, the largest sterling-denominated sukuk in history. In December 2018, a $300m sukuk was listed by SENAAT, an industrial investment holding company based in the UAE in the exchange. This is the first international senior unsecured sukuk launched by SENAAT.

The UK government-backed export credit guarantee agency underwrote its first sukuk, providing cover for a $913m sukuk issued by Dubai’s Emirates Airline, shortly after the UK government announced that UK Export Finance was planning to provide Sharia-compliant support for UK exporters in 2014.

### Funds

The UK is one of the largest markets in the world for fund management. It has a strong international orientation and attracts significant overseas funds. The global fund management sector continues to expand as an emerging global middle class lives longer, saves for the future and wants to invest. UK-based firms operate in one of the most open markets in the world for fund management and are in a prime position to gain new international business.
A total of three Sharia-compliant ETFs are listed on the LSE. Although ETFs trade like single shares, investors can use them to access and invest into country and sector indices without purchasing each of the constituent stocks, indicating the index tracking funds offer benefits of cost efficiency. Using data from Thomson Reuters’ Islamic Finance Development Report, TheCityUK estimates that net assets of Islamic funds in the UK amounted to around $700m (equivalent to £543m) as of the end of 2017.

The Islamic Investment Bank (IIB) European Investment Company, now part of Rasmala and formerly the European Islamic Investment Bank (EIIB), has its headquarters in London. It is authorised as an investment firm rather than a bank. It offers its customers Sharia-compliant treasury and capital markets, asset management, private banking, trade finance, correspondent banking, and advisory and corporate finance services.

The UK has consolidated its position as the leading global centre for the management of funds on behalf of overseas clients in recent years. This has been one of the key reasons why many Islamic finance institutions have chosen the country as their base of operations. Forty percent of total funds managed in the UK, or £3.1trn, come from overseas clients. The UK government is committed to ensuring the country remains an open and competitive market for international investment.

**Takaful**

Similar to mutual insurance, takaful is a risk sharing entity that allows for the transparent sharing of risk by pooling individual contributions for the benefit of all subscribers.

With the launch of the Islamic Insurance Association of London (IIAL) in 2015, the UK set the stage to play a more active role within the global takaful market. IIAL was launched to support the work of those in the UK insurance and reinsurance markets that are transacting Islamic finance. As one of the largest insurance markets in the world, and the leading global centre for wholesale insurance and reinsurance, the UK has the potential to support the growth of takaful business in the coming years.

London is the preeminent home of speciality underwriting capacity and expertise. It also has a reputation and history for innovation, both in product design and approach. The UK takaful sector has been gathering pace recently. For example, in October 2017, AIG UK (part of American International Group) announced it had worked with Cobalt Underwriting to issue the first £5m Sharia-compliant Warranty and Indemnity (W&I) Insurance Policy.
The UK’s Islamic finance ecosystem

The UK has an extensive pool of expertise offered by one of largest concentrations of legal, regulatory and tax specialists in the world.

**Law firms**: the UK is a major global provider of the specialist legal expertise required for Islamic finance. It is home to over 200 international law firms. TheCityUK estimates at least 25 of these firms, including global partnerships, have established a dedicated Islamic finance capability. The majority of Islamic contracts are governed by English law which provides a flexible framework for traditional Islamic financing structures. It also gives the parties confidence that their agreements will be enforced by the English courts.

**Other professional services firms**: the major professional services firms have established Islamic finance teams 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 academic and professional qualifications for the global industry. In absolute numbers, the UK is by far the largest provider of Islamic finance courses in the world providing 80 courses as of 2017. It is ahead of both Malaysia (59) and Indonesia (57); for more information see Figures 3 and 4.

**Figure 3**: Number of Islamic finance courses by country, 2017

*Source*: Thomson Reuters
The Islamic finance sector also needs research and peer-reviewed journals in order to discover and develop solutions to problems, create new products and services, and bring knowledge and depth to the business. In terms of the total number of published research papers between 2015 and 2017, the UK ranks third, with 57 published research papers, behind Malaysia (327) and Indonesia (129).\textsuperscript{13}

Courses in Islamic finance are offered by the Association of International Accountants (AIA), Chartered Institute of Management Accountants (CIMA), Chartered Institute for Securities and Investment (CISI), and the Institute of Islamic Banking and Insurance (IIBI). Many universities and business schools offer an Islamic-based MBA or similar qualification.

The UK Islamic Finance Council (UKIFC) has developed a Scholar Professional Development Programme in conjunction with 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 Bank Negara Malaysia (BNM), that country’s central bank. In terms of Islamic finance courses and degrees, the UK has outpaced the centres of Islamic finance among Muslim-majority countries in recent years. Universities and institutions located in the country are increasingly opening their doors to Islamic finance degrees and courses, as the UK works towards maintaining its position as the leading provider of Islamic finance education not only in the Western world but also globally.

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\textsuperscript{13} Thomson Reuters, ‘Islamic finance development report 2018’, (25 November 2018), p.32
EXAMPLES OF ISLAMIC FINANCE EDUCATION IN THE UK

General Islamic finance foundation
- CIMA: courses are available at different levels covering certificates, a diploma and an advanced diploma. The certificates are designed for candidates new to Islamic finance, with the Advanced Diploma being the highest level. The diploma is awarded upon completion of all four certificates.
- CISI: the Islamic finance qualification provides a basic introduction to Islamic finance instruments and how they are applied in different segments of the financial sector. Although the course does not have any prerequisites, it is most suited to candidates with a background (educational or work experience) in finance.
- IIBI: a variety of certificates, diplomas and postgraduate diploma courses are offered by IIBI in combination with a number of events and workshops. IFS School of Finance appears to be among the few offering an undergraduate level course. Their offering consists of two modules ‘Foundation in Islamic Banking and Finance’ and ‘Practice of Islamic Banking and Finance’. Both are level four modules and can be taken in combination with other modules as part of the Professional Certificate in Banking.

Takaful
- CIMA: courses are available at different levels covering certificates, a diploma and an advanced diploma. A specific certificate in banking and takaful is among the offerings.
- IIBI: a variety of certificates, diplomas and postgraduate diploma courses are offered by IIBI which includes a specific takaful module.

Sukuk
- CIMA: courses include a certificate in accounting for Islamic finance institutions.
- IIBI – The Advanced Diploma in sukuk is designed for those already working in the Islamic finance sector who wish to obtain a sound grasp of both Sharia rules as they apply to securitisation and the structuring of sukuk.

Postgraduate research
- Many UK-based universities offer Islamic studies as part of their curriculum, generally in the areas of law, Islamic studies (religion and civilisation), and economics. Islamic finance is typically offered as a module within the business schools and not as an individual programme. The most well-known for offering Islamic finance is the University of Durham (School of Government and International Affairs), which also conducts a summer school and has many doctoral students in the field. In addition, both Oxford and Cambridge offer Islamic studies, although this is more in the field of law and politics than in finance. The London Business School also offers an online MA in Islamic finance that lasts for one year.
The School of Oriental and African Studies offers a variety of Islamic finance related courses at all levels, although their focus is, again, more on law. However, the breadth of the programme appears suitable for those aiming to become, for example, an in-house Sharia expert.

Newcastle, Reading (International Capital Markets Association (ICMA) Centre at the Henley Business School), Westminster and the University of East London are among the universities offering Islamic law. The University of East London also has an Islamic Banking and Finance Centre. The ICMA Centre offers a Masters level programme in conjunction with International Centre for Education in Islamic Finance of Malaysia.

Islamic finance for accountants

- CIMA: courses include a certificate in accounting for Islamic finance institutions.
- IIBI: the Institute is cooperating with AAOIFI – an international standard setting body for the Islamic finance sector based in Bahrain – on its Certified Islamic Professional Accountant programme in the UK.
- Islamic Scholar Development: the UK Islamic Finance Council in cooperation with the CISI has developed a Scholar CPD Programme designed to enhance their comparative understanding of conventional versus Islamic finance.
THE GLOBAL ISLAMIC FINANCE MARKET

Market size and growth potential

The global Islamic finance market has grown rapidly in recent years. Thomson Reuters estimated that the market for Islamic finance services, as measured by Sharia-compliant assets, totalled around $2.4trn at the end of 2017, up 6.5% on the previous year. Global assets of Islamic finance grew by an average of 7.1% annually during the period 2012-17. There was only one year of decrease in Islamic finance assets during that period (Figure 5).14

Figure 5: Global Islamic finance assets ($bn)
Source: Thomson Reuters
Note: f = forecast

Sector assets are set to continue to increase in the years ahead, underpinned by domestic demand in emerging economies. According to the Thomson Reuters Islamic Finance Development Report 2018, the market is expected to reach $3.8trn by 2023 (Figure 5). There are around 1,400 institutions registered globally as Sharia-compliant organisations in financial services.

According to data from the Pew Research Centre, the global Muslim population in 2015 (latest available data) was 1.8bn. Representing 24.1% of the world’s population, Muslims are the world’s second-largest religious group, after Christians (31.2%); for more information see Figure 6.15 The Muslim population is forecast to grow at about twice the rate of the non-Muslim population over the next two decades. If current trends continue, the Muslim population will make up 26.5% of the world’s total projected population in 2030 and 29.7% in 2050, highlighting the growth potential of Islamic finance (Figure 7).16

15 Pew Research Centre, ‘Christians remain world’s largest religious group, but they are declining in Europe’, (5 April 2017), available at: https://www.pewresearch.org/fact-tank/2017/04/05/christians-remain-worlds-largest-religious-group-but-they-are-declining-in-europe/
**Figure 6**: Global population by religious group, 2015  
Source: Pew Research Centre

**Percentage of world population**

- Other religions: 0.8%
- Folk religions: 5.7%
- Buddhists: 6.9%
- Hindus: 15.1%
- Unaffiliated: 16%
- Muslims: 24.1%
- Jews: 0.2%
- Christians: 31.2%

**Number of people, billion**

- Christians: 2.3 billion
- Muslims: 1.8 billion
- Unaffiliated: 1.2 billion
- Hindus: 1.1 billion
- Buddhists: 0.5 billion
- Folk religions: 0.4 billion
- Other religions: 0.1 billion
- Jews: 0.01 billion

**Figure 7**: Global Muslim population  
Source: TheCityUK calculations based on Pew Research Centre

- **Muslim population (LHS)**
- **Non-Muslim population (LHS)**
- **Muslim population, % of total (RHS)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Muslim population</th>
<th>Non-Muslim population</th>
<th>Muslim population, % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>1.6 bn</td>
<td>5.3 bn</td>
<td>23.2%</td>
</tr>
<tr>
<td>2020</td>
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<td>5.8 bn</td>
<td>24.9%</td>
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<td>2.2 bn</td>
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<td>26.5%</td>
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<tr>
<td>2040</td>
<td>2.5 bn</td>
<td>6.4 bn</td>
<td>28.1%</td>
</tr>
<tr>
<td>2050</td>
<td>2.8 bn</td>
<td>6.5 bn</td>
<td>29.7%</td>
</tr>
</tbody>
</table>
Geographical distribution

The Middle East and Southeast Asia dominate the Islamic finance market. In terms of Islamic finance assets, Saudi Arabia was the largest market with $509bn assets, followed by Malaysia ($491bn) and the UAE ($222bn); for more information see Figure 8.

**Figure 8:** Islamic finance assets by country, % share, 2017
*Source: Thomson Reuters*

Outside the Muslim world, the market is most developed in Switzerland, the UK, Hong Kong and the US. Islamic finance is, however, moving beyond its historic boundaries into new territories. The customer base in Western countries is not necessarily restricted to Muslims; other customers may be attracted by the ethical basis of Islamic finance. Other markets where Islamic finance is developing include:

- Other countries in the Middle East and Africa such as Egypt, Jordan, Kenya, Morocco, Nigeria, South Africa, Sudan and Turkey.
- Other Asian countries such as Brunei, China, Indonesia and Singapore.
- Developed countries such as Australia and Luxembourg, which are developing as centres for Islamic finance. France, Germany, the UK and the US each have indigenous Muslim populations of up to 5m; Russia has the largest in Europe with 16.5m. Although Islamic finance assets are still primarily in the GCC countries, engagement with the sector, particularly with sukuk issuances in Hong Kong, Luxembourg, South Africa and the UK is important for the further growth and development of the sector.

While scope for the development of the Islamic finance market exists in Western countries, an appropriate legal and regulatory structure needs to be designed and implemented in many jurisdictions. The sector still generally lacks economies of scale, and operates in an environment which often does not appropriately take into account the specific characteristics of Islamic finance.

The growing reach of Islamic finance offers a number of possible benefits. Aspects of Islamic finance practice may reduce the sector’s exposure to unanticipated events in

the conventional financial sector. The system promotes proactive control over financing arrangements that introduce leverage – preferring, where possible, equity-based alternatives on a risk-shared basis that better support economic growth. Moreover, the growing sophistication of Islamic finance means that it could generate new ways of catering to the development needs of Muslim countries, in collaboration with conventional finance or independently. In particular, there is significant potential for Islamic finance services to foster greater financial inclusion of the Muslim population. Large segments of the global Muslim population are currently under-serviced by financial institutions, for example, around 80% of Muslims currently are deemed to be not “financially included”. Some of this under-serving may be driven by the relatively limited penetration of Islamic finance among populations who, for religious reasons, may be unwilling to use conventional financial services.

THE HALAL ECONOMY

Halal is an Islamic Arabic term meaning ‘permissible’. It has both a general and specific meaning. When people use the word in Islamic countries, they usually mean to say what is allowed by Islamic Law. In non-Islamic countries, the word usually refers to food, meaning fit to be eaten by Muslims.

However, halal applies to many products beyond food. There are halal cosmetics and fashions, for example, all of which have also experienced growth that has contributed to the overall sector described as the ‘halal economy’. The growing acceptance of Islamic fashion – often referred to as modest fashion – is just a start. As such products become increasingly mainstream, they will contribute to the growth of the halal economy – of which Islamic finance could be considered a part. Thomson Reuters estimates the global value of halal economy (food and beverage, travel, media and recreation, finance, fashion, pharmaceuticals, and cosmetics) at $2.1trn in 2017.

An often-underestimated factor in the growth of halal is trust in the product; many now look to the halal certification on medicines and cosmetics as a signal of quality. This extends beyond Muslims – for example, with halal meat. The tenets of halal ensure that livestock and cattle do not receive any chemical modification and are reared to be as comfortable and healthy as possible prior to slaughter. There are, therefore, many similarities between the halal and organic markets. Although there are of course many differences as well, both have strict criteria for meat if it is to receive the relevant certification. These criteria appeal to those who pay more attention to what goes into their food, be they Muslim or not. As such, halal products have started to prove popular with some segments of the non-Muslim population, further supporting growth of the sector.

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18 Edbiz Consulting, ‘Global Islamic finance report 2017’, p.43
Sector activity

Islamic finance encompasses a wide range of services. Banking, which accounts for 71% of Islamic finance assets, and sukuk (17%), are the most established forms of Islamic finance. Other assets, including funds (4%) and takaful (2%), represent the remaining 12% (Figure 9). More niche products which may have scope for future development include private equity and private wealth management.

Figure 9: Sharia-compliant assets, % share, 2017
Source: Thomson Reuters

PRINCIPLES AND DEVELOPMENT OF ISLAMIC FINANCE

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.
- Must avoid ‘speculation’ (gharar).
- Prohibition of interest payments (riba).
- Risk and return to be shared among participants.
- Prohibition of finance for activities deemed incompatible (haram), such as the sale of 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 then demand has increasingly driven the development of Islamic finance instruments.

In 1990, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was created to establish industry accounting and auditing standards. The 1990s saw a diversification of potential avenues for Islamic banking. Rising awareness and demand for Islamic products, along with supportive government policies and growing sophistication of financial institutions, have together increased the rate of growth.

The 2000s were the most important decade in global Islamic banking. This was due to the emergence of sukuk and other structured Islamic finance assets along with the proliferation of developing capital markets. Islamic banking has innovated increasingly more sophisticated Islamic finance instruments in recent years that are capable of greater flexibility and enable increased agility in liquidity management.

Banking

The Islamic banking sector consists of all institutions licensed as banks operating in a Sharia-compliant manner, including investment, retail, wholesale and specialised banks. As a result of the prohibition on interest, Islamic banks are funded by non-interest bearing current accounts as well as profit-sharing investment accounts where investors receive a return that is determined by the profitability of the bank or the pool of assets financed by these accounts. Banks do not engage in lending, but in sales, lease, profit-and-loss-sharing financing, and fee-based services. Islamic banks are prohibited by nearly all jurisdictions from undertaking certain types of derivatives, such as foreign exchange forwards and futures.

Islamic finance has grown rapidly over the past decade, and its banking segment has become systemically important in a number of countries across Asia and the Middle East. Global Islamic banking assets totalled $1.7tn at the end of 2017, an increase of 2.7% year on year. Thomson Reuters expects the annual average growth rate of Islamic banking assets will be around 7% during the period 2018-23, up from an annual average of 6.1% during 2012-17. There were 505 Islamic banks, which included 207 Islamic banking windows in 2017.21

Despite the steady growth in recent years, Islamic banking still represents only 6% of global banking assets.22 However, the existence of Muslim populations without access to Islamic finance, as well as a lack of engagement in some financial industries, means Islamic banking has considerable growth potential.

Commercial banks account for the majority of assets, while investment banks made up most of the remainder. The industry’s assets remain heavily concentrated in the Middle East and a select few Asian countries. Growth rates are expected to remain relatively high, as the Islamic banking sector expands in major markets such as Saudi Arabia, Kuwait, Qatar, Malaysia and the UAE.

At the end of 2017, Iran accounted for 28% of global Islamic banking assets with Saudi Arabia (22%) and Malaysia (12%) ranking second and third (Figure 10).23

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22 Ibid.
The extent of the industry’s penetration varies substantially. In Iran and Sudan, all banking sector assets are Sharia-compliant. More than half of banking assets are Sharia-compliant in Brunei and Saudi Arabia. In addition, Islamic banking has now achieved systemic importance (at least 15% market share of total banking assets) in seven other countries: Kuwait, Qatar, Malaysia, the UAE, Bangladesh, Djibouti and Jordan (Figure 11). However, penetration in other countries is more limited, with Islamic banking accounting for around 5% of total banking assets in countries such as Algeria, Bosnia and Herzegovina, Iraq, Kenya, Kyrgyzstan and Tunisia.

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25 Ibid.
Islamic banks are growing more quickly than their conventional counterparts in most major markets. Banks that offer Islamic finance services are increasingly looking to enhance their positions in faster growing regions of the 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.

The specific characteristics of Islamic banking have been addressed by specialised Islamic standard-setting bodies. The industry has two key standard setters: the Accounting and Auditing Organisation for Islamic Financial Institutions, established in 1991, for Sharia accounting and auditing standards, and the Islamic Financial Services Board, set up in 2002, for regulatory and supervisory standards. These institutions have developed a wide range of technical standards and guidance notes. However, application of these standards is not uniform across countries.

The International Islamic Financial Market (IIFM) is the international Islamic finance markets organisation founded in 2002. IIFM’s primary focus lies in the advancement and unification of Islamic finance documents, structures, contracts, instruments, infrastructure and recommendations for the enhancement of the Islamic Capital & Money Market (ICMA). IIFM has developed working groups and initiatives with a number of global capital market associations including the International Swaps and Derivatives Association (ISDA) and ICMA.

**Sukuk**

The sukuk sector has in recent years emerged as an increasingly important element of the Islamic finance landscape. The market has drawn growing interest from sovereigns, multilateral institutions, and multinational and national corporations. The sector has played an important role in infrastructure financing and has been utilised for both public and private projects.

The outstanding value of sukuk has expanded strongly in recent years, reaching $426bn at the end of 2017 (Figure 12). Demand is generally outstripping supply, leading to oversubscription on most issuances and lower yields. According to data from S&P Ratings, global sukuk issuance grew by 37.7% in Q1 2017 compared with Q1 2016, primarily due to the strong growth in sukuk issuance in the GCC.

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The sukuk market has been growing in terms of standardisation and the introduction of longer tenors and new structures. Other factors contributing to the development of this sector include: growing familiarity of global investors with sukuk instruments; increasing Islamic investment liquidity looking for sukuk; and growing retail and corporate demand for Islamic finance services.

Although the sukuk market grew every year and increased by an average of 10.6% annually between 2012 and 2017, the market is still relatively small. The main issuers of sukuk are corporates (which account for around 64.4% of total assets under management), and sovereigns (30.6%); supranationals (2.9%) and government-related entities (2.1%) account for the remainder. Growth in issuance in recent years has been driven by the key markets of Malaysia, Saudi Arabia and the UAE, as well as emerging markets such as Turkey and Indonesia. A growing range of companies are taking the opportunity to seek liquidity at low cost and diversify their funding solutions. Sukuk listings have pointed to more cross-border activity as issuers increased listings on key stock exchanges such as those in Europe, namely the LSE, Irish Stock Exchange and Luxembourg Stock Exchange.

Malaysia, the largest sukuk-issuance country, has announced that its sukuk markets will be opened to retail investors. In addition, some new countries are entering into the sukuk market. For example, Morocco issued its first sukuk, worth $116m, in October 2018. Kazakhstan is also planning its first sovereign sukuk issuance.29

**GREEN SUKUK**

A green bond is a fixed-income financial security sold with a promise to devote the funds raised to environmentally beneficial projects. According to the Green Bond Principles established by the International Capital Markets Association, green bonds are ‘any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance green projects.’

Green bonds were initially designed by large supranational organisations such as the World Bank and the European Investment Bank (EIB). The EIB issued the first Climate Awareness Bonds in 2007. The proceeds of green bonds are used to finance a wide range of activities including renewable energy, energy efficiency, sustainable waste management, sustainable land use, biodiversity conservation, climate change adaptation and clean transportation.30

Developing countries often have limited access to capital to invest in sustainable infrastructure. Green bonds have been identified as a potential source of climate finance for cities, municipalities and low-carbon infrastructure projects across many sectors, and an opportunity for the private sector to help address global development priorities such as the UN’s Sustainable Development Goals.

A sukuk is an interest-free bond that generates returns to investors without infringing Sharia principles. There are commonalities between sukuk and green bonds that can easily be channelled to develop Islamic capital markets and maximise private sector financing for environmental projects:

1. Both raise funds for a specific purpose. The asset-based structure of a sukuk provides investors with a high degree of certainty that the funds raised are only used for the designated purpose; meanwhile, a green bond issuer pledges to use the funds raised for specific environmentally-friendly projects.

2. The values of both are deeply rooted in ethical and socially responsible principles. The assets financed by sukuk exclude investments in gambling, weapons, pork and alcohol.

3. The notion of environmental stewardship, the protection of air, water and land, and the ecosystems that depend on them are intrinsic to Sharia principles.

Green sukuk are Sharia-compliant investment vehicles that fund environmentally friendly projects such as solar parks, bio-gas plants and wind farms. The main objective behind the development of green sukuk is to finance environmentally-friendly initiatives in a Sharia-compliant way. For Sharia-compliant investors, notably in Southeast Asia and the Gulf Cooperation Council region, green sukuk represent an ideal investment that benefits the environment.

Malaysia-based Tadau Energy, which is owned by China’s Edra Power, issued the world’s first green sukuk in June 2017. The capital raised from the sukuk will be used to fund a major Sabah-based solar power project. Malaysia’s central bank, Securities Commission Malaysia and the World Bank Group worked together to launch the green sukuk. In February 2018, Indonesia became the first Asian sovereign to sell green sukuk, raising $1.3bn via a five-year deal. Proceeds will be used for eligible projects ranging from renewable energy to waste management. Indonesia’s sukuk was based on an agency contract known as wakala and also incorporated a green framework assessed by the Centre for International Climate and Environmental Research (CICERO), a non-profit organisation which specialises in green finance.31

Over the next decade, sukuk will likely remain a growing segment of the Islamic finance industry. Some of the factors that are likely to contribute to this include sustained global economic growth, further infrastructure spending and attractiveness of cross-border destinations for fund raising. Sukuk can help close the global funding gap for infrastructure, and an increasing share of issuance has been in this area. The GCC region and especially Dubai is expected to offer investment opportunities in substantial projects, where the sukuk market plays an important role in securing these funds. However, more instruments will be needed in the coming years and the existing products will need to be refined as some sukuk structures are still in development.

Funds

The Islamic funds sector has developed considerably in the past decade. However, it still remains a niche part of the global Islamic finance sector. Thomson Reuters stated that the market for Islamic funds worldwide increased to $110bn in 2017, up by 21% on the previous year. The average annual growth rate was 19.5% during 2012-17 (Figure 13). There were 1,410 funds worldwide at the end of 2017.32

Figure 13: Islamic funds worldwide ($bn)
Source: Thomson Reuters

31 For more detail on the evaluation of green assets, see TheCityUK and Imperial College Business School, ‘Growing green finance’, (September 2017)
Just three countries dominate the global market for Islamic funds: Iran, Malaysia and Saudi Arabia, which together have 87% of assets under management. Islamic funds in Europe accounted for around 3% of the global share in 2016. Key European players include Luxembourg and the UK, which are also key players in conventional fund management. Developments in Asia, Europe and the Middle East demonstrate the ways in which the Islamic fund market is growing. In Malaysia, the state pension fund, the Employee Provident Fund (EPF), established one of the first state-backed pension funds focusing entirely on Sharia investments, Simpanan Shariah. Members of the EPF can convert their conventional EPF savings to a fund that is managed and invested in accordance with Sharia principles. In 2017, there were 13.8m members in the EPF, with 7.1m of them actively contributing to the fund. Total annual contribution was RM65.5bn (equivalent to $15.2bn) in that year and total assets under management were RM791bn (equivalent to $184bn) at the end of 2017. In January 2017, Malaysia also announced the country will make Retirement Fund Inc., or Kumpulan Wang Persaraan (KWAP), fully Sharia-compliant (although there was no update as of February 2019).

The Islamic fund industry will also benefit from healthier Islamic capital markets. The infrastructure development needs of Islamic economies are large and in many cases approaching historic peaks. According to data from the McKinsey Global Institute, $2.5trn was invested in the world’s infrastructure such as transport, power, water and telecoms in 2015. However, their estimate of capital needs for infrastructure by 2035 is $3.7trn per year. With efforts to diversify funding solutions for infrastructure development in general, a growing number of Islamic funds will emerge in the infrastructure space. Islamic finance offers a great deal of potential for global infrastructure development.

**Takaful**

Takaful has been established in its modern form for more than 25 years. Development of a Sharia-compliant insurance sector provides the critical risk-management support needed across the various markets offering Islamic finance services. The global takaful market remains at an early stage of development. Assets under management reached around $46bn in 2017 (Figure 14). The growth momentum in the Islamic banking and sukuk markets has lent support to the development of the takaful sector. The global takaful industry has been growing fast in recent years, with asset growth averaging 8.5% per year between 2012 and 2017. However, large segments of the insurance market in key Islamic finance jurisdictions remain untapped and mainly dominated by conventional insurance providers.

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33 Ibid.
The growth in demand for Islamic insurance over recent years has seen a proliferation of new companies offering Islamic insurance products. The vast majority of these firms are fully-fledged takaful operators, but conventional insurance companies have also entered the market offering takaful window operations. As with traditional forms of insurance, re-insurance of a takaful operation may be used, known as re-takaful.

Saudi Arabia, Iran and Malaysia are the largest global takaful markets, together accounting for 79% of the global market. Other, smaller markets for takaful include Indonesia and the UAE. In some regions supportive regulatory developments are taking place that are likely to help the growth of the sector in the coming years. Regulatory enhancements have, for example, opened new opportunities in growth markets such as Turkey and Indonesia.

The growth of takaful markets is driven by the prospects of the Islamic banking and finance sector in predominantly Muslim countries. Takaful in most markets is still in its infancy, and its potential to replace conventional insurance in leading Islamic finance markets is largely untapped.

The key challenges that the global takaful industry faces include intense competition with conventional insurance providers, low profit margins, low customer awareness, the need for skilled professionals, as well as an enhanced regulatory and prudential framework. With Islamic finance markets projected to post high growth rates in the coming years, and with the development of supporting regulatory infrastructure in key markets, the global takaful industry has significant opportunities for growth.

37 Ibid.
FinTech

FinTech in Islamic finance is still in the early stages of development, but the future outlook is bright, driven by the rapid growth of FinTech generally, increasing awareness of Islamic FinTech, availability of funding and regulatory support. Policies supporting the development of the Islamic FinTech industry include the following:

- A cross-sectoral UK Islamic FinTech Panel was launched in January 2018. The aim of the panel, which includes representation from both industry and the government, is to further advance the UK’s position as a leading global centre for Islamic FinTech.
- Guidelines for crowdfunding and P2P financing regulations were introduced by the Securities Commission in Malaysia in the first half of 2017.
- FinTech Hive, a FinTech accelerator, was created by the Dubai International Financial Centre (DIFC) in January 2017. The aim of the accelerator is to make DIFC a global FinTech hub.
- FinTech sandbox regulations and a dedicated unit that aims to monitor the FinTech sector were created by the Central Bank of Bahrain in 2017.38

On the supply side, technological developments are lowering barriers to entry for entrepreneurs to operate in the Islamic FinTech sector. Larger, more established players are also increasing their offerings in this space. For example, in November 2018, Refinitiv (formerly Thomson Reuters’ financial and risk business) and DDCAP Group (which provides asset facilitation and trade execution services for Islamic financial sector institutions through its ETHOS AFP™ platform) signed a partnership agreement to provide banks and financial institutions with an integrated, fully automated platform for trading of Sharia-compliant treasury transactions. This is a first for the Islamic banking industry and is a notable development in terms of enabling FinTech for Islamic interbank requirements.

On the demand side, Islamic FinTech offers both Muslim and non-Muslim consumers more options to choose financial products that fit their personal needs at lower costs. The growth of both supply of and demand for Islamic FinTech is raising awareness of the growing importance of Sharia-compliant FinTech. For example, the sector has been mentioned and discussed at almost all Islamic finance conferences and seminars in recent years. Some countries, such as Bahrain, Malaysia and the UAE have established regulatory frameworks to encourage the development of Islamic FinTech. In terms of financing, venture capital and private equity companies are providing funds to Islamic FinTech startups that normally face difficulty sourcing capital from conventional finance providers.

After a series of working groups and seminars TheCityUK and Borsa Istanbul produced a report with recommendations for regulatory co-operation while also showing how the use of financial technology can bring access to finance across the Islamic world.39

There were around 120 Islamic FinTech firms globally as of the end of 2017. Although the development of Islamic FinTech has been most prominent in Muslim countries, the UK is also well-positioned in the market, due to its competitive advantages in both financial services and technology. For example, Yielders, a crowdfunding platform focused on residential property investment, received a certificate of Sharia compliance in 2017, making it the UK’s first regulated FinTech company to operate under Islamic principles. In August 2018, Wahed Invest, a US-based halal-focused investment company, launched a digital halal investment platform in the UK. According to data from IFN FinTech, an Islamic FinTech platform, the UK has the second-largest number of Islamic FinTech companies (18), just after Malaysia (21) and ahead of Indonesia and the UAE (15 each); for more information see Figure 15.

Figure 15: Countries ranked by number of Islamic FinTech companies  
Source: IFN FinTech

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CONCLUSION

Islamic finance is a prime example of the ways in which finance meets the needs of individuals, businesses and governments. By facilitating factors as diverse as financial inclusion, infrastructure development and government funding, Islamic finance serves society at large. By leveraging its position as the world’s leading international financial centre, as well as government policies that support the development of Islamic finance, the UK is well positioned to further develop its role as the leading Western centre for this dynamic and fast-growing sector.