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# The Growth of Islamic Finance in the Non-Islamic World

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Non-Muslim countries in Europe and Asia are keen to promote Islamic finance and some are now actively making the necessary regulatory and legislative changes in order to ensure that their domestic companies and institutions, faced with the credit crunch at home, are able to access liquidity in the Middle East without facing the tax or regulatory hurdles that the UK has identified and addressed.

## Introduction

As the conventional markets buckle under the stresses of recent weeks, there is a possible alternative on the horizon. A number of market participants have begun to comment on the relative health of Islamic institutions which did not acquire the toxic assets that are at the heart of the current crisis. The Dow Jones Islamic Market indices have performed well, with the the DJIM Financials Index losing 2.74 per cent and the Dow Jones Citigroup Sukuk Index losing 0.27 per cent during the turmoil in September, at a time when conventional indices have suffered losses of over 20 per cent.

The UK has, in recent years, worked hard to establish London as the international financial centre for Islamic finance through introducing tax and regulatory changes in order to ensure that Islamic finance has “a level playing field” with conventional finance. The Financial Services Authority has, thus far, authorised six wholly Islamic banks and the UK Government is considering whether it should issue a Sharia compliant gilt or bill-like sukuk. The success of the UK, together with the large pools of liquidity available in the Middle East, generated from record oil prices, have encouraged other non-Muslim countries in Europe and Asia to review their legal systems in order to ensure that their institutions are able to access Sharia compliant products.

## France

The French Government organised a round table of key market participants on 14 May 2008 to identify hurdles to the development of Islamic finance products in France. As a result of these efforts, both the French Ministry of Economy, Industry and Employment and the *Autorité des marchés financiers* (the French financial markets regulatory authority), announced on 2 July 2008 significant tax and regulatory changes aimed at promoting Islamic finance in France. These changes relate to the listing of sukuk in France, the tax treatment of Islamic finance transactions and the introduction of trusts (*fiducie*) into French law. There is now talk of a French Government sukuk possibly beating a UK Government sukuk to the markets.



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## Germany

The federal state of Saxony-Anhalt in Germany issued Europe's first Islamic bond in July 2004 and there is increasing interest in Islamic finance from the private sector, for example, the Munich based FWU Group won the award for Best Takaful Operator in 2007. Although the Government has not announced that it is looking at legislative changes yet, a number of structures have been developed to address issues such as double real estate transfer tax.

## Italy

The Italian Banking Association and the Union of Arab Banks entered into a Memorandum of Understanding in September 2007 to promote Islamic finance in Italy, including the establishment of Islamic banks in Italy.

## Turkey

Although Turkey has a Muslim population of 72 million, it is run as a secular state and it has applied to join the European Union. Its Islamic finance sector is currently tiny, accounting for less than 5 per cent. of deposits, and the issue of whether Islamic finance should be allowed to grow is highly political. Turkey, however, has the greatest potential for expansion of Islamic finance in Europe and some commentators ultimately expect Istanbul, rather than London, to become the European centre for Islamic finance.

## Japan

The Japanese Government is keen to develop Islamic finance and there has been talk of a quasi sovereign sukuk issue by the Japan Bank for International Cooperation for several years now. On December 18, 2007, the Japanese Financial Services Agency proposed that the Japanese banking regulations should be amended to allow subsidiaries of banks to offer Islamic finance products and it is hoped that these changes will be approved by the year end. According to reports, Toyota has announced plans to issue a sukuk in the Malaysian market for its auto leasing and loans business and Daiwa Asset Management has launched the Sharia Japan 100 Index which includes Japan's top 100 Sharia compliant companies.

## Hong Kong

The Hong Kong Monetary Authority has formed a working group to establish the necessary laws, tax systems and other regulations to put Islamic finance on an equal footing with its conventional counterpart. The Hong Kong Airport Authority is proposing to issue a sukuk by the end of this year and there is also talk of an issuance by the Hong Kong government itself.



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Hong Kong is seeking to position itself as the intermediary for structuring and marketing Islamic finance products to meet the needs of businesses in mainland China and Middle Eastern investors, although it is facing competition from Singapore, which is also aiming to be the centre for Islamic finance in Asia.

## Conclusion

We expect that the current global financial situation will see increasing attention being paid to Islamic financial solutions and the interest shown by some countries in promoting Islamic finance is likely to acquire a sense of urgency. The principles underlying Islamic finance, where capital must be deployed in a genuine commercial activity and full disclosure is required in order to avoid uncertainty as to the nature of the contract that the parties are entering into, are likely to be an integral part of any reformation of the conventional system that is sure to follow the current crisis.

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