TheCityUK

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THE UK: LEADING WESTERN CENTRE FOR ISLAMIC FINANCE

NOVEMBER 2015

TheCityUK

TheCityUK represents the UK-based financial and related professional services industry. We lobby on its behalf, producing evidence of its importance to the wider national economy. At home in the UK, in the EU and internationally, we seek to influence policy to drive competitiveness, creating jobs and lasting economic growth.

Financial and related professional services are the UK's biggest exporting industry. We make a £67bn contribution to the balance of trade, helping to offset the trade in goods deficit. TheCityUK creates market access for its members through an extensive programme of work on trade and investment policy. To achieve this, we work closely with governments and the European Commission to represent member views and help deliver the best outcomes in international trade & investment negotiations. Allied to this, we have a country-focused programme to build relationships and to help open markets where our members see significant opportunities. We also have a strong focus on ways of influencing and delivering regulatory coherence through dialogue with regulators, governments & industry bodies internationally.

1 FOREWORD
from Chris Cummings, Chief Executive, TheCityUK

This report summarises global trends in Islamic finance with a particular focus on the development of the UK market. The industry's growing importance for Islamic and other investors alike around the world is evidenced by its double-digit growth in recent years. Sharia-compliant assets make up only around 1% of the world's financial assets; yet globally, 1 in 5 people are Muslim. Considerable potential therefore exists for expansion of this market.

The UK is the leading Western centre for Islamic finance. It has been at the forefront of key developments in Europe as illustrated by findings of this report. The number of institutions based in London and across the country that offer Islamic finance services is nearly double the number located in the US and far ahead of other Western countries. Over twenty banks, of which five are fully Sharia compliant, are licensed in the UK. The London Stock Exchange is a key global venue for the issuance of sukuk.

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

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

The Government, regulators and our industry should continue to work together not just to grow the sector and maintain the UK's pre-eminent position in Islamic finance but also to become a leading player in setting international Sharia compliant standards. Major developments such as the UK sovereign sukuk, the first outside the Islamic world, and other UK Government initiatives to create a level playing field for Islamic institutions and their clients have been welcome. 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 hub for Islamic finance.

NO.1

THE UK IS THE TOP WESTERN CENTRE FOR ISLAMIC FINANCE.

WITH AROUND 70 EDUCATIONAL INSTITUTIONS, THE UK IS BY FAR THE LARGEST PROVIDER OF ISLAMIC FINANCE COURSES AND DEGREES.

OVER 20 BANKS OFFER ISLAMIC FINANCIAL SERVICES IN THE UK – DOUBLE THE NUMBER IN THE US. THIS INCLUDES FIVE FULLY SHARIA BANKS LICENSED TO OPERATE IN THE UK.

20

$2 TRILLION

THE GLOBAL MARKET FOR ISLAMIC FINANCIAL SERVICES INCREASED BY 12% IN 2014 TO $2 TRILLION. THECITYUK EXPECTS THE MARKET TO TOP $3 TRILLION BY 2018.

THE UK WAS THE FIRST WESTERN NATION TO ISSUE A SOVEREIGN ISLAMIC BOND.

1ST

$4.5BN

ASSETS OF UK BASED INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES TOTALLED SOME $4.5BN AT THE END OF 2014.

30

THE UK IS A WESTERN LEADER IN SUPPORTING INFRASTRUCTURE/ENVIRONMENT FOR ISLAMIC FINANCE. SERVICES ARE OFFERED BY FINANCIAL INTERMEDIARIES, ASSET MANAGERS, INSURANCE PROVIDERS AND OVER 30 INTERNATIONAL LAW, ACCOUNTANCY AND CONSULTANCY FIRMS.

2 EXECUTIVE SUMMARY

The UK Islamic finance market

- The UK's profile as the **leading Western centre for Islamic finance** has grown in recent years, although institutions in London and other cities in the UK have been providing Islamic financial and related professional services **for nearly 40 years**.
- **The UK is ranked above other important centres on its overall Islamic finance offering**. The latest ICD Thomson Reuters Islamic Finance Development Report report gives the UK an index value of 16.2, above the global average of 10.3 and the highest ranking of any non-Muslim-majority country.
- **The number of institutions located in the UK that offer Islamic finance services is 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 some $4.5bn at the end of 2014.
- **Islamic finance plays a significant role in infrastructure development in the UK.** This includes development finance for The Shard, Battersea Power Station regeneration, London Gateway, the Olympic Village and the redevelopment of Chelsea Barracks. Over 6,500 homes in the North-West and the Midlands are currently being financed by a £700 million investment by Gatehouse Bank, a fully Sharia compliant bank. Current trends suggest that the role of Islamic finance in funding infrastructure development will continue to grow in the years ahead.
- An important feature of the development of the UK as a centre for Islamic finance has been a range of **supportive Government policies over the last decade which have created a fiscal and regulatory framework intended to broaden the market for Islamic 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 - hence, there is a level playing field for both Islamic and conventional financial products.
- The Islamic finance retail market has developed in recent years with the launch of a series of Sharia compliant products including individual savings accounts, home purchase plans, a Sharia compliant pension scheme and business start-up financing. The Government is also developing Islamic student financing. **There are now over 100,000 Islamic finance retail customers in the UK**.
- **There are currently five fully Sharia compliant banks licensed in the UK which puts it in the lead amongst Western countries.** Assets of these banks totalled $3.6 billion at the end of 2014. There are also a number of conventional banks that provide Islamic financial services from a UK base. In total, over **20 banks in the UK** offer Islamic finance services. This substantially exceeds the number in any other Western country or offshore centre and is nearly double the number in the US.
- **The UK was the first Western nation to issue a sovereign Islamic bond.** In 2014, the UK Government sold £200m of sukuk, maturing in 2019, to investors based in the UK and in major global hubs for Islamic finance. The UK's first sovereign sukuk was oversubscribed with very strong demand and orders totalling around £2.3 billion.

#1

The UK is ranked as the leading Western centre in terms of its overall Islamic finance offering

- **The London Stock Exchange is a key global venue for the issuance of sukuk.** To date a total of 57 sukuk have been listed on London Stock Exchange with a total value of $51bn.
- In late 2014, the UK Government announced that **UK Export Finance (UKEF) was planning to provide Sharia compliant support for UK exporters**, a further sign of the City's growing role in the global market for Sharia-compliant debt. Shortly afterwards, the UK Government-backed export credit guarantee agency underwrote its first Islamic bond, providing cover for a $916 million sukuk issued by Dubai's Emirates Airline.
- **Net assets of Islamic funds in the UK amount to around $600 million.** A total of four Sharia compliant exchange traded funds (ETFs) and two Sharia compliant exchange trade products (ETPs) are listed on the London Stock Exchange.
- **The UK is a Western leader in supporting infrastructure/environment for Islamic finance.** Services in the UK are offered by financial intermediaries, asset managers, insurance providers and over 30 international law, accountancy, and consultancy firms.
- There is a growing demand for skills as Islamic finance expands. **The UK is by far the largest provider of Islamic finance courses at both the undergraduate and postgraduate level, with offerings at around 70 educational institutions.**

The global Islamic finance market

- The global market for Islamic financial services, as measured by Sharia compliant assets, increased by **12% in 2014 to a record $2 trillion.** Global assets of Islamic finance have tripled since the start of the economic slowdown in 2007. TheCityUK expects the market to top $2.2 trillion by the end of 2015, and $3.0 trillion by 2018. Recent key trends in the industry include landmark debut sukuk issuances by governments and the expansion of Islamic finance into more countries.
- Considerable potential exists for the expansion of Islamic finance. The global Muslim population numbering some **1.6 billion accounts for over a fifth global population**, but Sharia compliant assets make up only around **1% of the world's financial assets**. Less than a fifth of Muslims worldwide currently use Islamic financial products.
- **Banking, which accounts for nearly 80% of Islamic finance assets**, and sukuk 16%, represent forms of Islamic finance that are most well established. Funds with 4% and takaful 1% account for the remainder.
- **Global Islamic banking assets totalled $1.6 trillion at the end of 2014**, having recorded 16% average annual growth between 2008 and 2014. The industry's assets remain concentrated in the Middle East region and a few Asian countries. Assets of Islamic funds and takaful also reached new highs in 2014, at $77bn and $35bn respectively.
- The **sukuk market is the most rapidly growing Islamic finance sector**, having expanded at over 20% per year since 2008 to reach $310bn in assets at the end of 2014. However, compared to the conventional bond market, the sukuk market is still relatively small.
- **More countries are looking to expand their Islamic finance offering**. New Islamic finance institutions in recent years have been reported in a number of countries including: Australia, Azerbaijan, Nigeria, Oman, Pakistan, Qatar and Russia. Leading countries for Islamic finance should provide fertile ground for future growth of the industry.
- Islamic finance has shown resilience at a time when the global economy has slowed. The UK Government recognises the important role that Islamic finance plays in the wider economy. As the leading Western hub and consequently Europe's premier centre for Islamic finance, **the UK is well positioned to capture a growing share of Islamic finance business** in the coming years.

THECITYUK ISLAMIC FINANCE GROUP

At the end of 2014 TheCityUK established an Islamic Finance Market Advisory Group to respond to developments in the UK and internationally in Islamic finance and recommend to UK government policy and trade & investment activity to progress the development and promotion of the sector.

The Group's purpose is to be at the centre of UK thought leadership in Islamic finance; to set the agenda for the development of Islamic finance within the UK and to develop and promote the UK's position as the leading Western centre for Islamic finance.

The group delivers this by producing and deploying content with key policymakers in Government and Parliament as well as in other relevant instances.

The Islamic Finance Market Advisory Group aims to:

- Develop best-in-class messaging on the role of the UK Islamic finance sector in the context of maintaining the size of sector and attracting new business to the UK.
- Develop benchmark regulatory and Islamic finance standards while complying with international regulation on banking and with reference to the ongoing development of global standards within Islamic finance.
- Encourage support for a legislative programme that promotes rather than restricts the global competitiveness of the sector.

3 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 cities in the UK have been providing Islamic financial and related professional services for nearly 40 years. As the industry 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.

The UK is ranked above other important centres for Islamic finance on its overall Islamic finance offering according to the latest ICD Thomson Reuters Islamic Finance Development Report and has been at the forefront of key developments in Europe. The report gives the UK an index value of 16.2, above the global average of 10.3 and the highest ranking of any non-Muslim-majority country. The UK was particularly strong in the Islamic knowledge category (education and research), governance, corporate social responsibility (CSR) and awareness (Figure 1).

The number of institutions based in the UK that offer islamic finance services is nearly double the number located in the US and far ahead of other Western countries. Assets of UK based Islamic finance institutions totalled some $4.5bn at the end of 2014.

Islamic finance plays a significant role in infrastructure development in the UK. This includes, for example, development finance for The Shard, Battersea Power Station regeneration, London Gateway, the Olympic Village and the redevelopment of Chelsea Barracks. Over 6,500 homes in the North-West and the Midlands are currently being financed by a £700 million investment by Gatehouse Bank, a fully Sharia compliant bank. The UK is an attractive destination for foreign investors as shown by foreign ownership of UK shares accounting for more than a half of all UK share ownership.

x2

The number of institutions offering Islamic finance services in the UK is nearly double the number in any other Western country

FIGURE 1
ISLAMIC FINANCE DEVELOPMENT INDICATOR IN SELECTED COUNTRIES

2014	IFDI	Quantiative development						Knowledge	Governance	CSR	Awareness
		Total	Islamic banking	Takaful	Other institut.	Sukuk	Funds				
Western countries											
UK	**16.2**	**4.8**	1.3	0.1	0.5	0.1	22.3	**22.1**	**16.7**	**23.3**	**13.8**
Singapore	**9.8**	**5.5**	1.2	1.3	13.9	9.1	2.0	**4.0**	**28.1**	**-**	**8.1**
Luxembourg	**7.4**	**12.9**	-	0.5	0.8	0.4	62.7	**3.1**	**1.8**	**15.6**	**3.8**
Australia	**5.5**	**1.9**	-	-	9.4	-	0.3	**3.7**	**13.3**	**7.8**	**1.0**
Ireland	**2.1**	**5.8**	-	-	0.3	-	28.9	**1.8**	**0.6**	**-**	**2.5**
US	**2.0**	**8.0**	0.1	-	0.1	8.4	31.3	**1.5**	**-**	**-**	**0.4**
Hong Kong	**0.7**	**0.1**	0.2	-	-	-	0.4	**0.4**	**-**	**-**	**2.8**
Canada	**0.6**	**0.3**	-	-	0.7	-	0.8	**1.7**	**0.1**	**-**	**-**
Switzerland	**0.5**	**0.9**	0.2	-	1.6	-	2.6	**1.4**	**0.1**	**-**	**0.3**
Netherlands	**0.5**	**0.1**	0.2	-	0.1	-	-	**1.6**	**-**	**-**	**1.0**
France	**0.4**	**-**	0.1	-	0.1	-	-	**1.8**	**-**	**-**	**0.4**
Germany	**0.3**	**-**	0.1	-	-	-	-	**0.7**	**-**	**-**	**0.5**
Global leaders											
Malaysia	**93.2**	**74.9**	43.8	47.4	54.1	125.3	103.4	**139.6**	**81.9**	**40.0**	**129.7**
Bahrain	**76.4**	**26.8**	81.2	15.9	27.1	9.2	0.4	**61.7**	**90.0**	**76.4**	**127.3**
Oman	**63.8**	**5.9**	17.9	2.4	-	1.3	8.0	**20.2**	**52.1**	**85.1**	**155.7**
Global average	**10.3**	**6.1**	11.0	5.6	4.3	2.8	6.6	**8.2**	**12.4**	**9.9**	**15.1**

Source: ICD Thomson Reuters - Islamic Finance Development Report 2014

An important feature of the development of the UK as a centre for Islamic finance has been a range of supportive UK Government policies which have created a fiscal and regulatory framework intended to broaden the market for Islamic products. This includes for example the removal of double tax and extension of tax relief on Islamic mortgages and the reform of arrangements for issues of Islamic bonds. The Islamic finance sector operates under legislation that applies to all sectors – hence, there is a level playing field for both Islamic and conventional financial products.

There are over 100,000 Islamic finance retail customers in the UK. 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 (which is an alternative to a mortgage but consistent with the principles of Islamic finance), a Sharia compliant pension scheme and business start-up financing. The Government is also developing Islamic student financing.

The Islamic finance industry in the UK has benefitted from the depth and breadth of the conventional sector. London is the leading global centre for international financial services and this is one of the critical reasons why Islamic financial institutions have chosen to locate in the UK. London has the leading share of trading in many international financial markets including foreign exchange and OTC 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.

KEY FEATURES OF THE UK ISLAMIC FINANCE INDUSTRY

London and the wider UK have become a global centre for Islamic finance. Key features of the UK Islamic finance industry include:

- The UK has created one of the most attractive regulatory and tax systems for Islamic finance anywhere in the world, and the success of the UK's sovereign sukuk in 2014 was a significant milestone in the development of the UK and the global Islamic finance industry.
- Over twenty banks, of which five are fully Sharia compliant are located in the UK. This is substantially more than in any other Western country. Also, 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 provides companies and issuers of financial products with access to a wide pool of investors and secondary market liquidity.
- The London Stock Exchange (LSE) is a key global venue for the issuance of sukuk. To date over $51bn has been raised through 57 issues. Four ETFs and two ETPs are also quoted on the LSE. The LSE also launched its Islamic Finance Market Index in 2013.
- In 2014, the UK Government announced that UK Export Finance (UKEF) was planning to provide Sharia compliant support for British exporters. Shortly afterwards, UKEF underwrote its first Islamic bond, providing cover for a $916m sukuk issued by Dubai's Emirates Airline.
- London is home to over 200 international law firms. Around 25 of these firms have established dedicated Islamic finance units. The majority of Islamic contracts 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 offered by four professional institutes and nearly 70 universities and business schools.
- 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.

Islamic finance has shown resilience at a time when the global economy has slowed and conventional banking in Western countries has been under pressure. The UK Government considers this vibrant and rising sector of vital importance to the success and prosperity of the country. As the leading Western centre and consequently Europe's premier centre for Islamic finance, the UK is well positioned to capture a growing share of global Islamic finance business in the coming years.

Banking

Islamic consumer banking began in the UK in the 1990s when corporations from the Gulf Cooperation Council (GCC) introduced Islamic mortgages (based on the murabahah principle) and offered mortgage financing (based on the ijarah principle) shortly thereafter.

There are currently five fully Sharia compliant banks licensed in the UK, with assets totalling $3.6 billion at the end of 2014. There are also a number of conventional banks that provide Islamic financial services from a UK base. In total, over 20 banks in the UK offer Islamic finance services. This substantially exceeds the number in any other Western country or offshore centre and is nearly double the number in the US (Figures 2 and 3).

- Al Rayan Bank is a retail bank and the only Islamic bank with a high street presence having five branches and around 50,000 customers. 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.

over 20

Over 20 Sharia compliant banks licensed to operate in the UK is more than any other centre

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 financial 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 Europe's gateway to 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 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 Islamic bonds 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 to ensure that regulatory treatment of Islamic finance is consistent with its statutory objectives and principles.

In 2013, the Government launched the UK's first Islamic Finance Task Force. The Task Force supported the development of the UK's Islamic finance sector, helping to increase inward investment and strengthen the economy. It included major industry figures to ensure that the UK's offer is promoted at home and abroad by both the public and private sector.

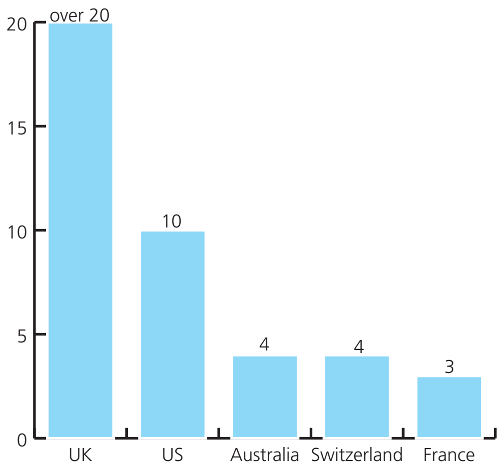
- QIB UK took on its new branding in 2010 to reinforce its identity within QIB's global network. QIB UK offers a range of Sharia compliant financing and investment products for both Islamic and non-Islamic clients alike. It provides Sharia compliant investment banking services including trade finance, private equity and asset management to clients ranging from high net worth individuals to sovereign wealth funds and other institutional investors.
- Gatehouse Bank is a Sharia compliant wholesale investment bank operating in capital markets, real estate, asset finance, treasury business and Sharia advisory services. The bank manages $1.7bn real estate assets across the US and UK. In 2012 the bank issued the UK's first ever real estate backed sterling sukuk Al-Ijarah.
- Abu Dhabi Islamic Bank (ADIB) is pursuing an ambitious growth strategy. ADIB already operates a large branch network in Egypt – and is in the process of extending operations to several markets across the Middle East and beyond. ADIB UK limited was established to bring the bank's services to clients in the UK.

The European Islamic Investment Bank (EIIB) has its headquarters in London but is authorised as an investment firm rather than a bank. The firm offers its customers Sharia compliant treasury and capital markets, asset management, private banking, trade finance, correspondent banking and advisory and corporate finance services.

A long-standing challenge faced by the Islamic banking sector is its ability to ensure its banks have sufficient liquidity due to the limited stock of assets Islamic banks can hold, which are both high quality and Sharia compliant. In 2014, the Bank of England announced that it is assessing the feasibility of establishing Sharia compliant facilities to help Britain's Islamic banks meet their liquidity obligations and expand the services they can offer customers.

FIGURE 2
ISLAMIC BANKS IN WESTERN COUNTRIES

Number located in each country



Source: TheCityUK

FIGURE 3
Islamic banks in the UK

Fully Sharia compliant
Abu Dhabi Islamic Bank
Al Rayan Bank
Bank of London and The Middle East
Gatehouse Bnak
QIB UK

Conventional banks that offer Islamic financial services
ABC International Bank
Ahli United Bank
Bank of Ireland
Barclays
BNP Paribas
Bristol & West
Citi Group
Deutsche Bank
Europe Arab Bank
IBJ International London
J Aron & Co
Lloyd's Banking Group
Royal Bank of Scotland
Standard Chartered
UBS
United National Bank

Source: TheCityUK

Sukuk

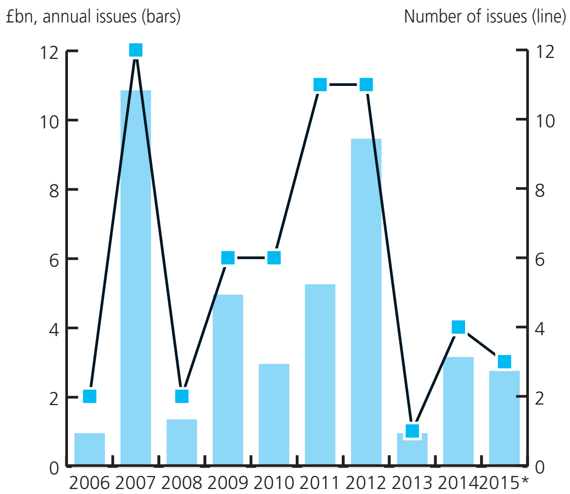
The sukuk market is an essential part of the Islamic finance market, and London as a major centre for international bonds is an important centre for the issuance and trading of sukuk. The outstanding value of international bonds in the UK totalled around $3.3 trillion at the end of 2014, some 15% of the global total and second only to the US. London is also the leading centre for international bond trading with an estimated 70% of secondary market turnover.

The UK was the first Western nation to issue a sovereign Islamic bond. In 2014, the British government sold £200m of sukuk, maturing in 2019, to investors based in the UK and in major global hubs for Islamic finance. Britain's first sovereign sukuk was heavily oversubscribed with very strong demand and orders totalling around £2.3 billion. Allocations were made to a wide range of investors including sovereign wealth funds, central banks and domestic and international financial institutions.

The sukuk was structured on the basis of an al Ijara contract, and was underpinned by three central UK government properties and was listed on the LSE, which introduced an Islamic index in 2013. The LSE is a key global venue for the issuance of sukuk. To date a total of 57 sukuk have been listed on LSE with a total value of $51bn. There are also Sharia compliant institutions quoted on AIM.

Key milestones for the LSE have included the GE Capital sukuk in 2009, the first listed sukuk by a US corporate, and the Kuveyt Turk sukuk, the first by a European bank. The first UK corporate sukuk was issued in 2010 by International Innovative Technologies (IIT).

FIGURE 4
SUKUK LISTINGS AT LONDON STOCK EXCHANGE



* up to August 2015
Source: London Stock Exchange

ISLAMIC FINANCE PRODUCTS ON THE LONDON STOCK EXCHANGE

Sukuk

The LSE 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 Professional Securities Market, which is Exchange-regulated, offers the benefits of listing with more flexible regulatory requirements. It allows the admission of debt securities and sukuk without the requirement for a full prospectus as only listing particulars are required and the disclosure requirements are tailored to wholesale needs as they can be governed by domestic Generally accepted accounting principles (GAAP) rather than International Financial Reporting Standards (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 it is the only major listing venue which does not charge an annual fee to issuers.

ETFs on Islamic Indices

The London Stock Exchange also has a vibrant market in ETFs including 4 Sharia-compliant ETFs based on Islamic indices. 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.

Source: LSE

CASE STUDY: UK government helped Airbus and Emirates with a world first in Islamic financing

UK Government-backed Islamic financing, a world-first in trade support developed by UK Export Finance, has widened the options for buyers of UK exports.

When Emirates wanted to use Islamic finance to fund its purchase of four new Airbus A380s for its fleet, UKEF developed an innovative guarantee for a Sharia compliant sukuk (Islamic bond) in the debt capital markets.

The case was hailed as a new gold standard for Sharia compliant asset finance. It widened the options for buyers of UK exports and boosted the UK's aspiration to become the leading Western hub for Islamic finance.

Through providing support like this, the UK Government is contributing to increasing the UK's exports and making the UK more competitive.

Munawar Noorani, Managing Director, Citi: "This success reaffirms UKEF as the thought leader among European Export Credit Agencies (ECAs) and once again shows UKEF's remarkable ability to innovate in the face of changing market needs."

A challenging task: Financing the sale of large passenger aircraft such as the Airbus A380 poses ever-shifting challenges. Buyers typically require large loans with long repayment terms. Manufacturers require certainty that they will be paid. And the banks asked to arrange the finance do not always have the risk capacity to square this circle, and may turn to ECAs such as UKEF to provide a payment guarantee.

Nearly a third by value of an Airbus 380 carrying Rolls-Royce engines is made in the UK. Therefore UKEF was keen to help if it could, as more than 3,000 companies in the supply chain stood to benefit.

Inventive facility: UKEF support can provide loan guarantees to the banks of purchasing airlines, or guarantees for money raised on the capital markets. However, to meet changing demand, the agency is always looking to add new finance options and in 2015 it developed a facility allowing the airline Emirates to raise funds from investors in Sharia compliant Islamic bonds, known as sukuk. The UKEF guarantee was applied to the issue of US$913 million of trust certificates sold in compliance with the requirements of Islamic scholars. The financing was used to buy four Airbus A380 aircraft, and UKEF can potentially now offer its new product to other overseas buyers of UK exports.

Triple pioneer: The sukuk issuance was reported in the media as a triple world first:

- the first sukuk certificate issuance guaranteed by an export credit agency
- the largest ever debt capital markets offering in the aviation sector with an ECA guarantee
- the first time a sukuk has been issued to raise finance for aircraft prior to their delivery

With the UK government in 2014 also having been the first in the Western world to issue an Islamic bond for sovereign borrowing, this new success is a boost to the UK's aspiration to become the leading Western centre for Islamic finance. Gordon Welsh, UKEF Head of Aerospace, said:

"Islamic finance houses can now join with the existing investor base for UK Export Finance guaranteed financing. "

"Buyers have another reason to look at UK suppliers, and UK exporters know they have an export credit agency that is prepared to innovate and push boundaries to help them."

"We will continue to develop new products in the years ahead, adding to everyone's options in an ever-changing global economy."

"The sukuk issuance shows our determination to be among the most innovative export credit agencies in the global marketplace. This spirit of invention ensures we will remain agile, able to address the varying challenges faced by UK exporters through the economic cycle."

One of the UK Government's objectives in issuing the sukuk is 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 corporates who might not previously have considered it. The UK sovereign sukuk has given the green light to the private sector to do more to help the Government meet the UK's infrastructure and regeneration requirements.

In late 2014, the UK Government announced that UKEF was planning to provide Sharia compliant support for British exporters. Shortly afterwards, the UK Government-backed export credit guarantee agency underwrote its first Islamic bond, providing cover for a $913 million sukuk issued by Dubai's Emirates Airline (see case study on page 12).

Islamic financing activities started in the UK in the 1980s. Wholesale liquidity of Islamic banks was 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.

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. London is the leading centre for international fund management. The global fund management industry is expanding rapidly 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 so are in a prime position to gain new international business.

According to ICD Thomson Reuters, net assets of Islamic funds in the UK amount to around $600 million. A total of seven Sharia compliant ETFs and two Sharia compliant ETPs are listed on the LSE. BLME launched the first Sharia compliant fixed income fund in March 2009 and it remains the only Sharia income fund that is rated A by Moody's, the international rating agency.

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 financial institutions have chosen the country as their base of operations. More than a third of total funds managed in the UK, or some £2.2 trillion, come from overseas clients. Some 40% of the large and medium sized asset management firms in London are owned by overseas investors. The UK Government is committed to ensuring the country remains an open and competitive market for international investment.

PRINCIPLES AND DEVELOPMENTS 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, so as to avoid 'speculation' (gharar). Prohibition of interest payments (riba).
- Risk and return to be shared amongst participants.
- Limitations on sale of financial assets and their use as collateral.
- Prohibition of finance for activities deemed incompatible with Sharia law (haram), such as 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 financial 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 raised the rate of growth.

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

Takaful

With the launch of the Islamic Insurance Association of London (IIAL) in 2015, the UK has set the stage to play a more active role within the global takaful market. Lloyd's, the Chartered Insurance Institute (CII), the London Market Group (LMG), the London International Insurance Brokers' Association (LIIBA) and TheCityUK have become associate members of IIAL. IIAL has been launched to support the work of those in the UK re/insurance 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 pre-eminent 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 with XL Group announcing in March 2015 that together with Cobalt Underwriting it has launched the first Shariah compliant product to be available through Lloyd's of London. Prior to this, Willis in conjunction with Cobalt Underwriting, launched the UK's first Shariah compliant commercial real estate insurance solution. Lloyd's, the insurance marketplace based in London, has recently opened an office in Dubai. It is also in talks with market regulators in Malaysia to set up an office dedicated to takaful.

Supporting infrastructure/environment

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. Over 25 of these firms 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 by enforced by the courts.

Professional services firms The largest four professional services firms – PricewaterhouseCoopers, KPMG, EY and Deloitte - have each 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. The global 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.

UK IS A MAJOR DONOR TO THE INTERNATIONAL FINANCE FACILITY FOR IMMUNISATION SUKUK

The International Finance Facility for Immunisation (IFFIm) raises funds in the international capital markets to accelerate the availability of funds for immunisation programmes and health system strengthening by Gavi, the Vaccine Alliance. IFFIm's financial base consists of legally binding grant payments (approximately $6.3bn) from its nine sovereign donors. Of this, the UK has pledged £1,630 million, or 46% of total pledges based on the prevailing exchange rate at the time of signing of the grant agreement, over a 23 year period. The World Bank is IFFIm's Treasury Manager.

On 27th November 2014 IFFIm issued its inaugural sukuk, raising $500 million for Gavi. This sukuk was the first socially responsible sukuk with funds to be utilised for this purpose. It marks the largest sukuk al-Murabaha issuance in the public markets, and was also the largest inaugural sukuk offering from a supranational. The 3-year sukuk – a financial certificate that complies with Islamic law – provides institutional investors with a socially responsible investment that will help protect tens of millions of children against preventable diseases.

The issue, coordinated by Standard Chartered Bank and working with joint lead managers Barwa Bank, CIMB, National Bank of Abu Dhabi (NBAD) and NCB Capital Company (NCB Capital), matures on 4 December 2017, has an issue price of 100%, and carries a quarterly coupon of +15 basis points over 3-month USD LIBOR.

The sukuk was oversubscribed, even with its unique structure for sukuk market participants. IFFIm achieved strong diversification in its investor base with 85% of the order book coming from new and primarily Islamic investors. The regional distribution of investors was 21% based in Asia, 11% in Europe and 68% in the Middle East and Africa. Banks took 74%, and central banks / official institutions took 26%.

Since its launch, the sukuk has received four awards: Islamic Finance News' Social Impact Deal of the Year 2014, EMEA Finance's Best Supranational Sukuk, Euromoney's Innovation in Islamic Finance and the Financial Times Achievement in Transformational Finance Award.

In absolute numbers the UK is by far the largest provider of Islamic finance courses and degrees in the world (Figures 5 and 6). With 68 educational institutions, it is far ahead of Malaysia (48) in second place. In terms of the total number of published research papers between 2011 and 2013, the UK (with 149 published research papers), is second only to Malaysia (421).

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

The Islamic Finance Council UK 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, that country's central bank.

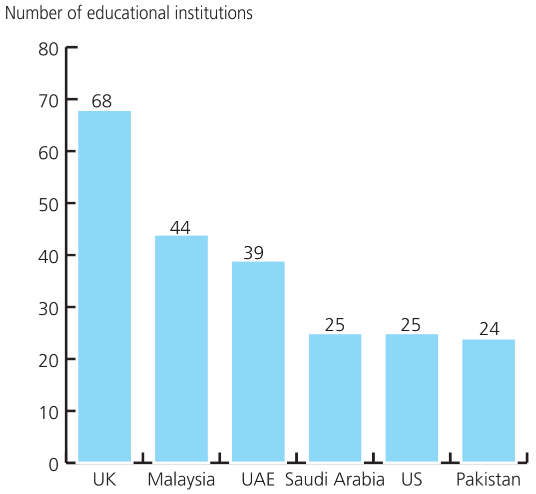
In terms of Islamic finance courses and degrees, the UK has outpaced the centres of Islamic finance among Muslim-majority countries in recent years. Universities and institutions located in the country are increasingly opening their doors to Islamic finance degrees and courses, as the UK country works towards maintaining its position as the leading provider of Islamic finance education not only in the Western world but also globally.

68

With 68 educational institutions, the UK is far ahead of other centres

FIGURE 5

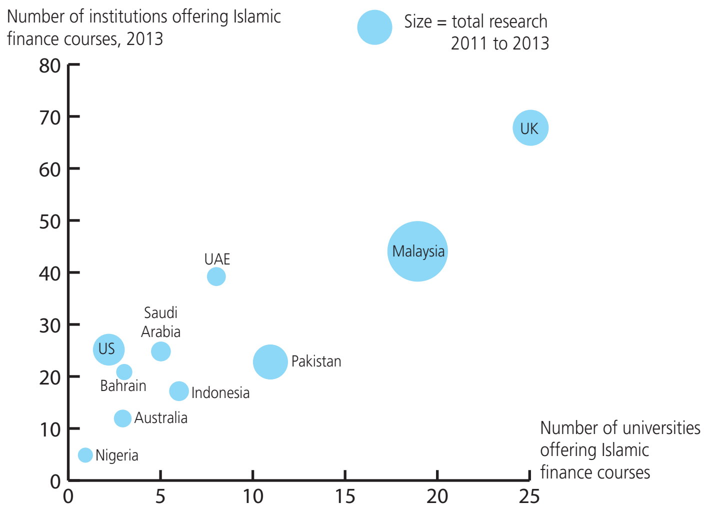
NUMBER OF EDUCATIONAL INSTITUTIONS, BY COUNTRY



Source: ICD Thomson Reuters - Islamic Finance Development Report 2014

FIGURE 6

LARGEST PROVIDERS OF ISLAMIC FINANCE EDUCATION



Source: ICD Thomson Reuters - Islamic Finance Development Report 2014

ISLAMIC FINANCE EDUCATION IN THE UK

Islamic finance foundation courses are available at many different levels:

- *CISI* – The Islamic finance qualification provides a basic introduction to Islamic financial instruments and how they are applied in different segments of the financial industry. Although the course does not have any prerequisites, it is most suited to candidates with a background (educational or work experience) in finance.
- *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 4 certificates.
- *Institute of Islamic Banking and Insurance (IIBI)* – A variety of certificates, diploma and post graduate 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 4 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, diploma and post graduate diploma courses are offered by IIBI which includes a specific takaful module.

Sukuk

- *CIMA* – Courses are available at different levels covering certificates, a diploma and an advanced diploma, including a specific certificate in Islamic capital markets and instruments.
- *IIBI* – Advanced Diploma in sukuk - a course 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 Islamic bonds.

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 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 breath of the programme appears suitable for those aiming to become, for example, an in-house Sharia expert. Newcastle, Reading (ICMA Centre at the Henley Business School), Westminster, Newcastle 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 International Capital Markets Association (ICMA) Centre at the Henley Business School (University of Reading) offers a Masters level programme in conjunction with International Centre for Education in Islamic Finance (INCEIF) of Malaysia.

Islamic finance for accountants

- *CIMA* – Courses are available at different levels covering certificates, a diploma and an advanced diploma, including a specific certificate in accounting for Islamic financial institutions.
- *IIBI* -The Institute is cooperating with AAOIFI – an international standard setting body for Islamic finance sector based in Bahrain is offering its Certified Islamic Professional Accountant (CIPA) programme in the UK.

Islamic Scholar Development

The Islamic Finance Council (IFC) in cooperation with the CISI has developed a Scholar CPD Programme designed to enhance their comparative understanding of conventional versus Islamic finance.

4 THE GLOBAL ISLAMIC FINANCE MARKET

Market size

The global Islamic finance market has grown rapidly in recent years. TheCityUK estimates that the global market for Islamic financial services, as measured by Sharia compliant assets, totalled around $2 trillion at the end of 2014, up 12% on the previous year (Figure 7). Annual growth averaged nearly 20% between 2007 and 2014. This means that global assets of Islamic finance have tripled since the start of the economic slowdown in 2007. Key trends in the industry in 2014 include landmark debut sukuk issuances by governments and the expansion of Islamic finance into more countries. In Europe, Islamic finance is expanding its presence mainly via capital markets, reflecting the region's importance as a centre for global financial activity.

Industry assets are set to continue to increase in the years ahead, supported by the gradual recovery in the global economy. Underpinning this growth is domestic demand in emerging economies and savings accumulated by many oil exporting countries that are seeking to invest in Sharia compliant financial products. TheCityUK expects the market to top $2.2 trillion in assets by the end of 2015, and $3.0 trillion by 2018.

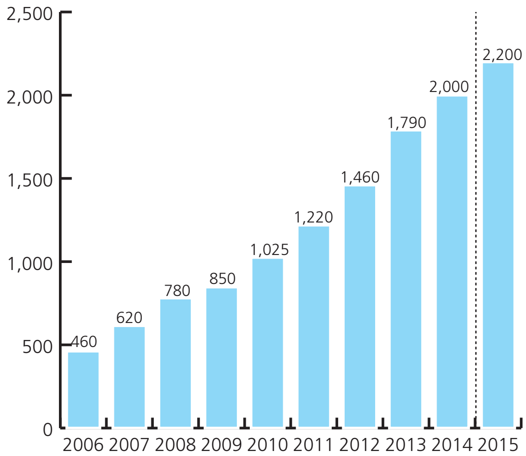
The GCC region accounted for the largest proportion of Islamic financial assets at the end of 2014 as the sector is slowly gaining mainstream relevance in most of its jurisdictions (Figure 8). The region represented around 38% of global Islamic financial assets and was followed by the Middle East and North Africa (MENA) region (excluding GCC) with 35% and Asia 22%. There are some 1,000 institutions registered globally as Sharia compliant organisations in financial services. Of these, around two-thirds are fully compliant, and the remainder operate Sharia-compliant products within a conventional institution.

Whilst the demand for Islamic financial products is growing, The Banker estimates that 80% of Muslims currently have no access to Sharia compliant banking. Globally, the

$2 trillion

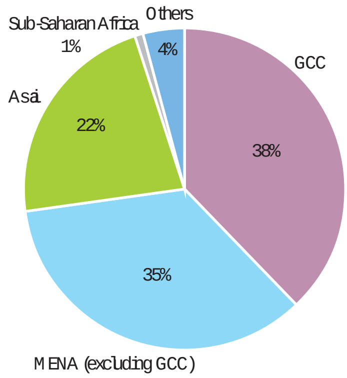
Global Islamic finance assets totalled $2 trillion at the end of 2014

FIGURE 7
GLOBAL ASSETS OF ISLAMIC FINANCE
$bn, assets end-year



Source: TheCityUK estimates

FIGURE 8
ISLAMIC FINANCE BY REGION
% share, end-2014



Source: TheCityUK estimates based on Islamic Financial Services Board - Industry Stability report 2015

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, Muslims will make up 26.4% of the world's total projected population of 8.3 billion in 2030, up from 23.4% of the estimated 2010 world population of 6.9 billion. This highlights the significant growth potential market for Islamic financial services and the potential to foster greater financial inclusion of the Muslim population. Large segments of the Muslim population are currently underserviced by conventional finance – only 24% of adults have a bank account and 7% have access to formal financing.

Broadening geographical customer base for Islamic services The market is currently most developed in Malaysia, Saudi Arabia, Iran and the majority of countries that form the GCC. In terms of assets, outside the Muslim world, the market is most developed in Switzerland, the UK, Hong Kong and the US. The customer base in Western countries is not restricted to Muslims: other customers may be attracted by the ethical basis of Islamic finance.

Indonesia has the largest Muslim population in the world (205m), followed by Pakistan (179m), India (177m) and Bangladesh (149m) (Figures 9 and 10). These four countries account for 44% of the worldwide Muslim population and remain fertile ground for future growth. Islamic finance is however moving beyond its historic boundaries into new territories. Markets where Islamic finance is developing include:

- Other countries in the Middle East and Africa such as Turkey, Sudan, Morocco, Egypt, Jordan, Syria and Nigeria.
- Other Asian countries such as Hong Kong, Singapore, Bangladesh, Pakistan, China and India.
- Western countries such as Luxembourg, Switzerland and Australia are developing as centres for Islamic finance. The US, France, Germany and the UK each have indigenous Muslim populations of up to 5m, although Russia has much the largest in Europe with 16

80%

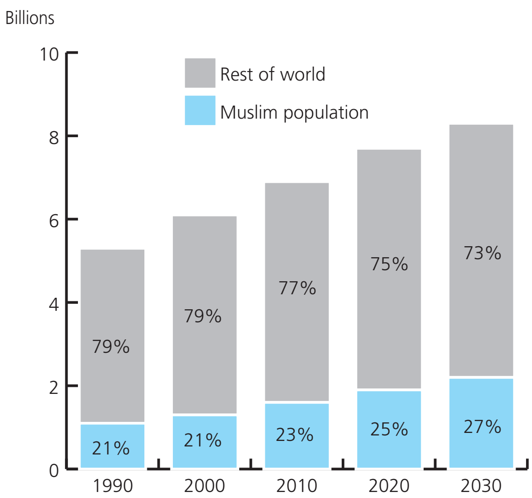
Around 80% of Muslims globally have no access to Islamic banking

FIGURE 9
MUSLIM POPULATION BY COUNTRY

2010 estimate		*% share of country's population*	*% of world muslim population*
Indonesia	204,847,000	*88.1*	*12.7*
Pakistan	179,097,000	*96.4*	*11.1*
India	177,286,000	*14.6*	*10.9*
Bangladesh	148,607,000	*90.4*	*9.2*
Egypt	80,024,000	*94.7*	*4.9*
Nigeria	75,728,000	*47.9*	*4.7*
Iran	74,819,000	*99.7*	*4.6*
Turkey	74,660,000	*98.6*	*4.6*
Algeria	34,780,000	*98.2*	*2.1*
Morocco	32,381,000	*99.9*	*2.0*
Other	537,085,000	*9.4*	*33.2*
World total	1,619,314,000	*23.4**	*100.0*

*% share of world population
Source: Pew Research Center

FIGURE 10
GLOBAL MUSLIM POPULATION



Source: Pew Research Center

million. Although Islamic financial assets are still primarily in the GCC countries,the engagement with the industry, particularly with sukuk in the UK, South Africa, Luxembourg and Hong Kong is important for further growth and development of the industry.

While scope for development of the Islamic finance market exists in Western countries, an appropriate legal and regulatory structure needs to be designed and implemented in many countries. The industry is still largely a nascent one lacking economies of scale, and operating in an environment which often does not appropriately take into account the specific characteristics of Islamic finance.

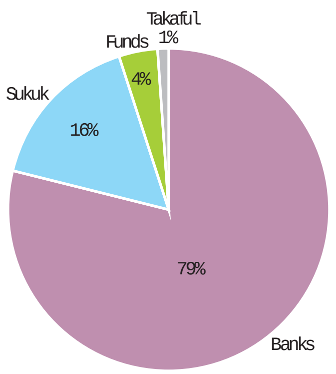
The growing reach of Islamic finance offers a number of possible benefits. Aspects of Islamic financial practice may reduce its exposure to unanticipated events in the conventional financial sector. The system promotes proactive control over financing arrangements that introduce leverage – preferring where possible equity based alternatives on a risk shared basis that better support economic growth.

The growing sophistication of Islamic finance means that it can generate new ways of catering to the development needs of Muslim countries, in collaboration with conventional finance or independently. However, much of the potential of the industry remains to be exploited.

Growth trends and industry activity

Islamic finance encompasses a wide range of services. Banking, which accounts for nearly 80% of Islamic finance assets, and sukuk 16% represent forms of finance that are most well established. Funds with 4% and takaful 1% account for the remainder (Figure 11). Products that may be the subject of innovation include private equity and private wealth management.

FIGURE 11
ISLAMIC FINANCE BY SECTOR
Sharia compliant assets, % share, end-2014



Source: TheCityUK estimates based on Islamic Financial Services Board - Industry Stability report 2015

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 $1.6 trillion at the end of 2014, having increased by 16% per annum between 2008 and 2014. Full Islamic banks account for around 85% of assets, with the remainder accounted for by conventional banks that offer Islamic finance services.

Despite the steady growth in recent years, Islamic banking currently only represents slightly over 1% of global banking assets. However, Muslim populations without access to Islamic finance, as well as a lack of engagement in some financial industries, leaves a large amount of potential for Islamic banking to grow.

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. Overall growth is projected to maintain high rates, as the Islamic banking sector expands in major markets such as Saudi Arabia, Kuwait, Qatar, Malaysia and and the United Arab Emirates (UAE).

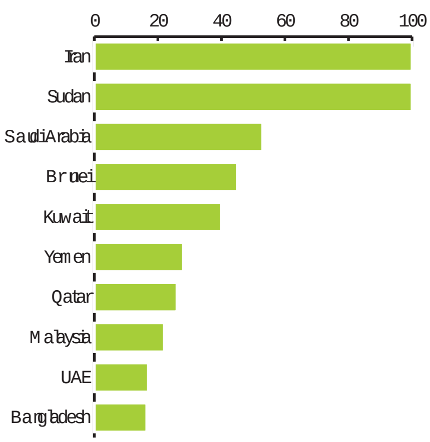
16%

Global Islamic banking assets increased by 16% per annum between 2008 and 2014

FIGURE 12

ISLAMIC BANKING PENETRATION IN SELECTED COUNTRIES

% share, 1H 2014

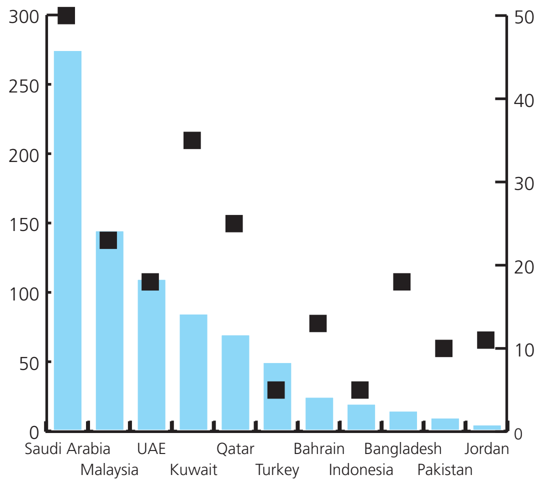


Source: Islamic Financial Services Board

FIGURE 13

ISLAMIC BANKING ASSETS AND MARKET SHARE

$bn, 1H 2014



Source: Islamic Financial Services Board

In 2014 Iran accounted for 40% of global Islamic banking assets with Saudi Arabia (19%) and Malaysia (10%) ranking second and third. The extent of the industry's penetration varies substantially. In Iran and Sudan, all banking sector assets are Sharia compliant. In addition, Islamic banking has now achieved systemic importance (at least 15% market share of total banking assets) in seven other countries including Brunei, Kuwait, Malaysia, Qatar, Saudi Arabia, the UAE and Yemen. However, penetration in other countries is limited with Islamic banking accounting for around 5% of total banking assets in Turkey, Egypt and Indonesia (Figures 12 and 13).

Islamic banks are growing more quickly than their conventional counterparts in most major markets. EY expects the growth rate to rise to over 19% through 2014 to 2019 from 16% in recent years, driven mainly by continued growth in Saudi Arabia and Malaysia. Banks that offer Islamic financial services are increasingly looking to enhance their positions in faster growing core regions of 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 AAOIFI, established in 1990, for Sharia accounting and auditing standards, and the Islamic Financial Services Board (IFSB), 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 financial market's organisation founded in 2002. IIFM's primary focus lies in the advancement and unification of Islamic financial documents, structures, contracts, instruments, infrastructure and recommendations for the enhancement of the Islamic Capital & Money Market (ICMM). IIFM has developed Working Groups and initiatives with a number of global capital market associations including ISDA and ICMA.

Sukuk

Sukuk are issues of Islamic notes that are compliant with the Islamic 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 sector has in recent years emerged as an increasingly important element of the Islamic financial landscape. The market has drawn increasing 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.

Sukuk issues have expanded strongly in recent years, reaching around $120 billion per annum in the past three years (Figure 14). This has brought the outstanding value of sukuk to a record $310bn at the end of 2014. Demand is generally outstripping supply, leading to oversubscription on most issuances and lower yields.

The sukuk universe has been growing in terms of standardisation and the introduction of longer tenors and new structures which has permitted larger issues. Other factors contributing to growth include: growing familiarity of global investors with sukuk instruments; increasing Islamic investment liquidity looking for sukuk; and growing retail and corporate demand for Islamic financial services.

The sukuk market has overtaken Islamic banking as the most rapidly growing Islamic finance sector, having expanded at over 20% per year since 2008. Compared to conventional bond market however, the sukuk market is still relatively small. Main issuers of sukuk are sovereigns (which account for around 45% of total assets under management), followed by corporates (36%) and government related enterprises (20%).

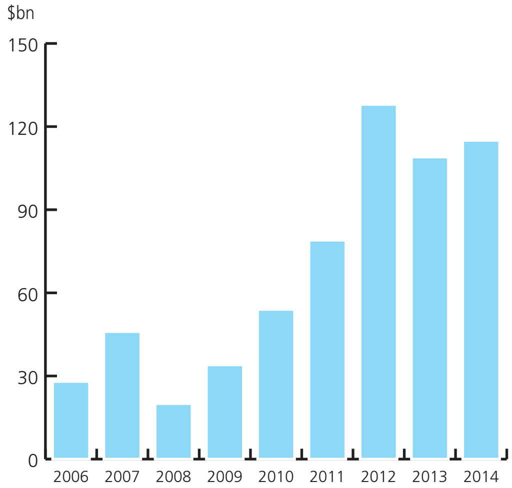
Growth in recent years has been driven by the key markets of Malaysia, Saudi Arabia and the UAE, as well as emerging frontiers such as Turkey and Indonesia. Sukuk listings have pointed to more cross-border activity as issuers increased listings on key stock exchanges such as those in Europe, namely the London Stock Exchange, Irish Stock Exchange and Luxembourg Stock Exchange.

A growing range of companies are taking the opportunity to seek liquidity at low cost and diversify their funding solutions. Increased volumes in recent years have also been supported by the debuts of several new markets in the sukuk sector. In 2014 countries which have entered the global primary sukuk market include the UK, Senegal, Hong Kong, South Africa and Luxembourg: an indicator that sukuk will be more widely accepted by mainstream finance. Hong Kong has returned to the market in 2015 with a successful sale of its second Islamic sukuk bond to raise $1bn.

$120 billion

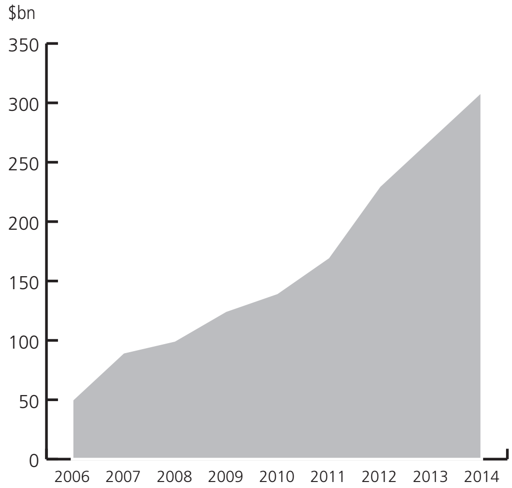
Global sukuk issues totalled around $120bn in each of the last three years

FIGURE 14
ANNUAL SUKUK ISSUES



Source: ISRA, IFIS, Zawya, Bloomberg

FIGURE 15
SUKUK, VALUE OUTSTANDING



Source: Bloomberg, IFIS, Zawya, KFHR, Islamic Financial Services Board

However, the global sukuk market may be heading toward a correction in 2015 after the Central Bank of Malaysia (BNM), one of the largest issuers of sukuk worldwide, stopped issuing earlier this year. According to S&P, in the first half of 2015 BNM's pullback saw total sukuk issuance drop by 42.5% compared with the same period a year earlier. In 2014, BNM alone issued about $45 billion of sukuk. The reason behind BNM's decision was that its sukuk were subscribed to by a broad array of investors, preventing them from reaching their intended end-users (primarily Malaysian Islamic banks for liquidity management purposes). As a result, BNM decided to switch to other instruments restricted to banks.

The fall in oil prices since mid-2014 may encourage sukuk issues in the GCC; in 2015 Saudi Arabia issued their first sovereign sukuk since 2007 to finance the budget deficit. The overall impact of the lower oil price on sukuk issues remains to be seen. In the medium term issuance by sovereign entities may be driven by liquidity needs due to declining oil reserves.

Over the next decade, sukuk are likely to 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, sovereign liquidity needs, 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 huge investments opportunities in substantial projects, where the sukuk market is presumed to play 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 although it remains a niche sector of the global Islamic finance industry. TheCityUK estimates that the market for Islamic funds worldwide increased to a record $77bn in 2014, up around 5% on the previous year (Figure 16). There are around 1,100 funds worldwide, up more than four-fold from 250 a decade earlier. EY estimate that the available pool for Islamic funds is over $500bn and growing, so Islamic funds under management currently represent a small proportion of the potential Islamic market.

Saudi Arabia, Malaysia and the US hold the largest share of the market in terms of domicile. Islamic funds domiciled in Europe account for around 16% of the global share in 2014, up from 12% two years earlier. Key European players include Jersey, Luxembourg and Ireland.

Equity funds account for the largest segment of the market: around 44% of funds, followed by money market 39%, sukuk 7%, mixed assets 5% and real estate 4%. Most Islamic funds are small in scale, with around two thirds of fund managers having less than $100m under management, including a third that have less than $25m.

A key development in the Islamic fund market is Malaysia's $160bn state pension fund, Employee Provident Fund (EPF), which has plans for establishing one of the first state-backed pension funds focusing entirely on Sharia compliant investments. This is a first for state-supported and Sharia compliant pension funds, and may set an example for other countries with Islamic financial services. Further developments have seen the London-based Islamic asset manager Arabesque, developing socially responsible Islamic equity funds, as well as the Islamic Development Bank (IDB) raising money from investors in Saudi Arabia, Bahrain and Brunei to substantially increase the size of its infrastructure fund to $2bn.

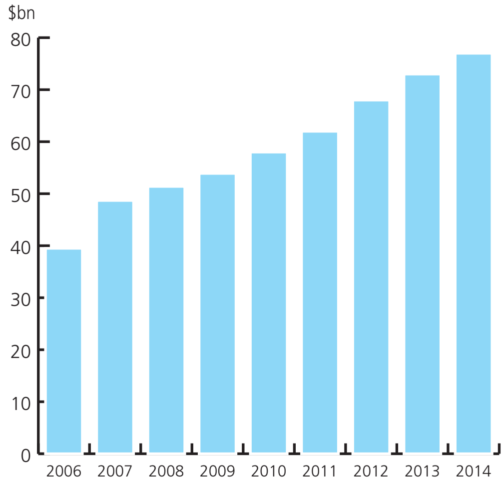
The infrastructure development needs of Islamic economies are large and in many cases approaching historic peaks. Estimates of the world's overall infrastructure investment needs for energy, road and rail transport, telecommunications and water are in the range of $50-$70 trillion through to 2030. With 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

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. 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 supports needed across the various markets offering Islamic financial services.

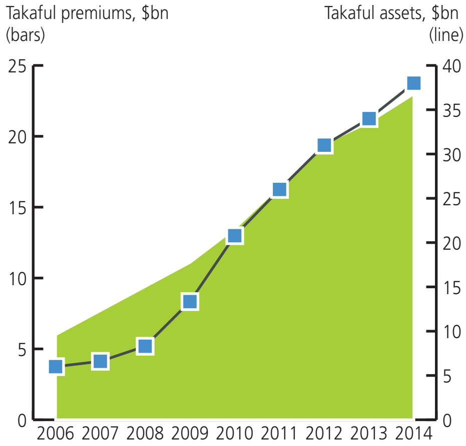
The global takaful market remains at an early stage of development with premiums estimated to have reached around $23bn in 2014 (Figure 17). The growth momentum in the Islamic banking and sukuk markets sectors has lent support to the development of the

FIGURE 16
ISLAMIC FUNDS WORLDWIDE



Source: Ernst & Young; TheCityUK estimates

FIGURE 17
TAKAFUL, GLOBAL MARKET



Source: Ernst & Young; TheCityUK estimates takaful sector. The global takaful industry recorded double-digit growth in recent years, with premiums averaging 16% per year growth between 2008 and 2014. Large segments of the insurance market in key Islamic finance jurisdictions however remain untapped and mainly dominated by conventional insurance providers.

The growth in demand for Islamic insurance over recent years has seen a proliferation of new companies offering Islamic insurance products. The 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, reinsurance of a takaful operation may be used, known as re-takaful. Takaful assets under management totalled around $35bn at the end of 2014. About 7% of this was accounted for by re-takaful.

Saudi Arabia, Malaysia, Iran and the UAE are the largest global takaful markets. These four countries account for 90% of the global takaful market. Other smaller markets for takaful include Bahrain, Qatar, Indonesia, Bangladesh, Jordan and Kuwait. Penetration of takaful is nevertheless low in these and other countries with Muslim-majority populations. In some regions supportive legislation and regulatory developments are taking place that are likely to support the growth of the sector in the coming years. Regulatory enhancements have opened new opportunities in rapid-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, depreciating profit margins, creating customer awareness, the need for skilled professionals, as well as an enhanced regulatory and prudential framework. With Islamic finance markets projected to post double-digit growth in the coming years, and with the development of supporting regulatory infrastructure in key markets, the global takaful industry has significant opportunities for growth.

$35 billion

Global takaful assets under management totalled $35bn at the end of 2014

5 OTHER SOURCES OF INFORMATION

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INFORMATION ON ISLAMIC FINANCE EDUCATION IN THE UK

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www.ifslearning.ac.uk

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www.soas.ac.uk

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www.icmacentre.ac.uk

The Islamic Finance Council UK (IFC)
www.ukifc.com

University of East London
www.uel.ac.uk

Founded in 1998 and headquartered in London, DDCAP Limited ("DDCAP") was the first wholesale, Islamic market intermediary established specifically for the purpose of supporting the growth and development of the Islamic finance industry and it remains a market leader in this sector. The Company provides asset facilitation services across a diverse range of Sharia'a compliant products, asset classes and instruments in both the primary and secondary markets and has been recognised through numerous industry awards for its services.

DDCAP is majority owned and controlled by IPGL Limited ("IPGL"), a private holding company with an interest in a number of financial services companies. IPGL is also a significant shareholder in ICAP plc, a leading markets operator and provider of post trade risk mitigation and information services.

DDCAP has an extensive track record within the Islamic finance industry, employing over 35 professionals with broad and complementary skill sets drawn from diverse financial industry backgrounds. Outside of its London headquarters, DDCAP has global representation with an office in the DIFC in Dubai and a presence in Jeddah, Saudi Arabia. The company is also in the process of further expanding its global footprint with representation in South East Asia.

DDCAP provides Sharia'a compliant asset facilitation and structuring services to over 300 financial sector clients worldwide including central banks, financial institutions and asset managers and funds.

DDCAP recently announced the launch of its significantly upgraded Asset Facilitation Platform (AFP), its award winning electronic platform offering clients secure, unique and highly efficient online real-time transaction processing with coverage 24 hours a day.

Contacts

DDCAP Group

Stella Cox, Managing Director
Lawrence Oliver, Director - Deputy Chief Executive Officer
David Potter, Director

8-10 Grosvenor Gardens
London
SW1W 0DH

Tel: +44 207 863 1250
Email: ddgi@ddcap.co.uk / ddcapresearch@ddcap.co.uk

www.ddcap.co.uk

THECITYUK ISLAMIC FINANCE MARKET ADVISORY GROUP

For more information on the work of our Islamic Finance Market Advisory Group please contact:

Wayne Evans, Senior Adviser, Islamic Finance
wayne.evans@thecityuk.com
+44 (0)20 3696 0120

Philip Jones, Head, Africa, Middle East, Legal Services
philip.jones@thecityuk.com
+44 (0)20 3696 0126

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THECITYUK RESEARCH

For further information about our work, or to comment on the programme/reports, please contact:

Anjalika Bardalai, Deputy Chief Economist
anjalika.bardalai@thecityuk.com
+44 (0)20 3696 0111

Marko Maslakovic, Senior Manager Economic Research
marko.maslakovic@thecityuk.com
+44 (0)20 3696 0112

INTERNATIONAL STRATEGY

For further information on TheCityUK's international work please contact:

Gary Campkin, Director, International Strategy
gary.campkin@thecityuk.com, +44 (0)20 3696 0119

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To find out more about TheCityUK and the benefits of membership visit **www.thecityuk.com** or email us at **membership@thecityuk.com**