ISLAMIC FINANCE & THE UK

BY MARTIN HARRISON

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Part A

Origins of contemporary Islamic Finance

Executive Summary

This report addresses the contemporary origins of Islamic finance, its development in Britain, potential continental European challengers to Britain in the conventional and Islamic finance sectors, and the possible post-Brexit linkages Britain could develop with key international centres of Islamic finance – particularly the GCC states and Malaysia. The report will show that the well-established and globally important role of Britain, and specifically the City of London, in conventional and Islamic finance means that, barring a general flight of capital, companies, and personnel to EU centres or elsewhere, and/or a reduction in domestic governmental support, both sectors have a safe, though not necessarily unchallenged, future.

Origins of contemporary Islamic finance

Islamic finance and economics derive from Islamic legal code that does not differentiate between religious and other aspects of life. A key element is the prohibition of charging interest or riba, and of activities relating to tobacco, alcohol, pork products, and gambling. The sector comprises four main areas: banking, sukuk (Islamic bonds), equity and funds, and takaful (insurance). In the case of banking, Islamic banks "put money actively to work in trade, industry or agriculture and take the risk. Depositors…get a share of the profits earned… under a system known as mudaraba. The bank's profit is called murabah (literally profit-making)."[1] Although early examples of Islamic banks opened in the 1950s and 1960s in South Asia, Egypt, and Malaysia, the first commercial

1 Michael Priest and Rodney Wilson "Finance In The Arab World: Resurgence of old ideas about handling cash", The Times, London, 6 March 1981; Mumtaz Hussain, Asghar Shahmoradi, and Rima Turk "An Overview of Islamic Finance" 2015, IMF Working Paper WP/15/120, International Monetary Fund, Washington D.C.; Katarzyna W. Sidlo "Islamic finance 2017: State of the art and outlook for the future", 15 September 2017, CASE – Center for Social and Economic Research, K4D Helpdesk Report, prepared for UK Government Department for International Development, p.2.

Islamic finance

Islamic finance and economics derive from Islamic legal code that does not differentiate between religious and other aspects of life.

Islamic bank, the Dubai Islamic Bank opened in 1975. The bank was 10% owned by the Kuwaiti government, 10% by the Dubai government, and 80% private. The principal structural driver for contemporary Islamic banking was the influx of petrodollar surpluses into Gulf economies. As a 1981 report noted:

...it was the wealth generated by the...industrial countries' demand for oil that made Sharia banking possible. As they saw their riches increase in the early 1970s a large number of Arab Muslims became unhappy about using conventional financial institutions. Many had previously solved the problem by not using a bank: if you are poor and have little cash there is no need for banks. By the middle of the last decade, however, businessmen and other citizens found that they could not store all their cash under the bed.[2]

The petrodollar surpluses contributed to the launch of the Islamic Development Bank, established in 1974 and opened in October 1975, based in Jeddah with the Saudi government as the largest stakeholder. Over the next thirty years, the Islamic Development Bank helped fund more than $50 billion of projects in Organization of the Islamic Conference member countries. Kuwait Finance House was established by Amiri decree in 1977 to conduct banking and investment services according to Islamic law. At its launch it was 20% owned by the Kuwaiti Ministry of Justice, 20% by the Ministry of Finance, 9% by the Ministry of Awqaf and Islamic Affairs, and 51% by Kuwaiti nationals.

As with its foreign aid policy, instituted soon after independence from Britain in 1961 principally via the Kuwait Fund for Arab Economic Development, Kuwait sought to use its oil wealth to offset its small state vulnerability in order, "to win allies, conciliate enemies and ensure general good will." The 'Islamic' element in the emirate's foreign policy was highlighted by Kuwait's leaders likening aid-giving to the distribution of zakat – giving alms to the less fortunate. In the domestic context KFH quickly became one of the most successful Islamic banks with almost $500 million in deposits by the early 1980s - via involvement in projects such as trade finance, foreign exchange, and property transactions. By the mid-1990s, KFH was still 49% owned by the Kuwaiti government

2 Michael Priest and Rodney Wilson "Finance In The Arab World: Resurgence of old ideas about handling cash", op.cit.

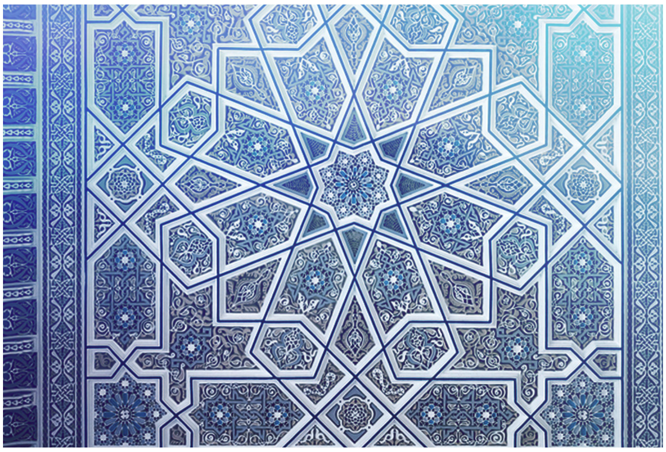
but divided between the General Authority for Minority Affairs, the Ministry of Awqaf and Islamic Affairs, and the Kuwait Investment Authority - the emirate's sovereign wealth fund.[3]

Few Islamic countries initially had Islamic banking operations partly because their banking systems were established during the era of dependence on the West – mainly Britain – and because of the associated complexities of Islamising their economies. With continued expansion of the sector however, some countries began altering their financial structures in order to ensure more comprehensive Islamic banking practices - including Iran, Sudan, and Pakistan. In addition, mindful of commercial opportunities, many Western banks opened so-called 'windows' for Islamic banking despite their parent companies being conventional banks. Simultaneously some Islamic banks, aware of competition from their conventional counterparts, offered products deemed by some Islamic scholars to be incompatible with sharia practice.

Whilst Bahrain and Qatar also opened Islamic banks in 1979 and 1982, Saudi Arabia's initial reluctance to implement a domestic Islamic banking sector was attributed to the notion that by designating one financial sector as Islamic would imply that another sector was non-Islamic and therefore should be abolished. In addition, "...extensive 'Islamic' banking might feed a spirit of doctrinalism and religious over-bidding in other areas of Saudi life..." One of the Saudi ruling family's principal supporters of Islamic finance, Prince Mohammed bin Faisal, the son of King Faisal bin Abdul Aziz (reigned 1964-1975), was instead instrumental in developing Islamic finance abroad. The kingdom's largest Islamic bank, Al Rajhi, was not granted a licence until 1987 and by 1994, Al Rajhi's continued operation was still made conditional on the bank not officially describing itself as Islamic. However, Islamic finance's growing popularity and the pressures of competition played a significant part in the sector's regional expansion.[4] In February 1990, the Islamic Development Bank established an international Islamic accounting standards body in Bahrain - the Accounting and Auditing Organization for Islamic Financial Institutions – responsible for issuing accounting, auditing and sharia standards for financial reporting at Islamic financial institutions. Factors behind Bahrain's selection included its reputation for maintaining a well-regulated financial sector, and its close links to Saudi Arabia enabling it to

3 Michael Priest and Rodney Wilson "Finance In The Arab World: Resurgence of old ideas about handling cash", op.cit.; Susanna Tarbush "Islamic Banking: Economics and the Koran", *The Times*, London, 10 March 1982; Patrick Cockburn "Survey Kuwait – Development Aid – A key element in foreign policy", *Financial Times*, London, 23 February 1983; Margaret Hughes "Survey: Kuwait – Economy – Kuwait Finance House", *Financial Times*, London, 22 February 1984; David Lascelles "Survey of Kuwait: Focus on Kuwait Finance House", *Financial Times*, London, 11 February 1985; Victor Mallet "Survey of Kuwait: Leading Third World Donor – Foreign Aid", *Financial Times*, London, 23 February 1989; Abdul-Reda Assiri *Kuwait's Foreign Policy – City-State in World Politics* (1990, Westview Special Studies on the Middle East), p.10; "Profits rise for Islamic bank in Kuwait", *UPI News Track*, 15 February 1995.

4 Frank E. Vogel "Islamic Governance in the Gulf" in Gary G. Sick & Lawrence G. Potter (Eds.) *The Persian Gulf At The Millennium: Essays In Politics, Economy, Security & Religion* (1997, St. Martin's Press), p.286, 288; Roula Khalaf "Survey of Arab Banking: An inherent contradiction", *Financial Times*, London, 15 December 1994; Rodney Wilson "The development of Islamic finance in the GCC", 2009, Working Paper, Kuwait Programme on Development, Governance and Globalisation in the Gulf States, Centre For The Study Of Global Governance, London School of Economics, p.5, 6.



act as a financial services gateway for its near neighbour. Meanwhile, with the expansion of Islamic finance in different parts of the Islamic world - especially the Gulf region and Malaysia - variations as to what was and was not deemed to be sharia-compliant became more evident.[5]

A key factor behind Gulf-instigated development of the Islamic financial sector was cash surplus from oil wealth. In the case of Malaysia however, Islamic finance was more a means for the state to socially and economically enfranchise its mostly Muslim Malay citizenry, via the New Economic Policy following race riots between Malays and Chinese in 1969, and further refined in policy programmes in the years since. Whilst Islamic finance in Malaysia was ultimately part of a top-down project designed to give socio-political and economic space to Malays, it also required pragmatic implementation and periodic adjustment to accommodate social and economic changes taking place in the country and in regard to international relationships that would support this and other Malaysian economic policies.[6] A 2012 report noted: "Islamic banking may have been born in the GCC, but it grew up in Malaysia." According to the CEO of the Malaysian branch of Kuwait Finance House: "In the Middle East they uphold the Shari'ah principle as a priority versus economic benefit and commercial reason. In Malaysia, we tend to be more skewed towards the commercial. Malaysia has grown into the Islamic financial hub because it is all business."[7] One consequence of this approach was that Malaysia maintained conventional and Islamic banking systems. As Malaysia's then Prime Minister, Dr. Mahathir Mohamad, stated in 2002:

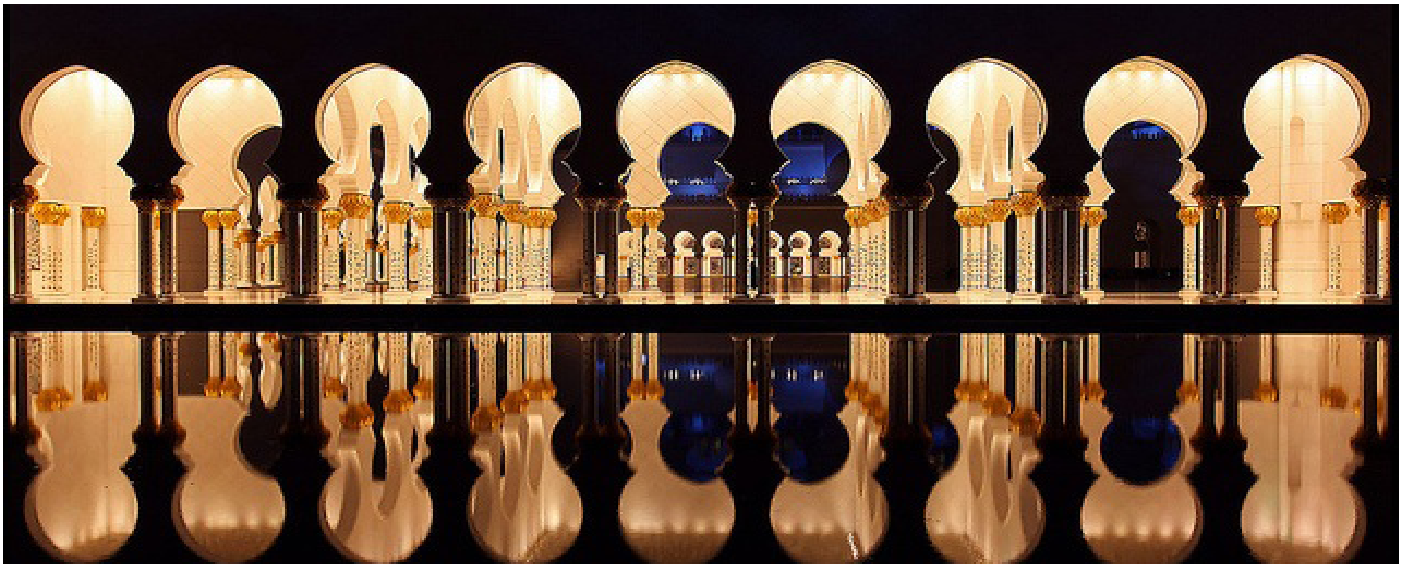
...[T]he international financial system can benefit from the adoption of at least some of the Islamic financial system. The lenders must be prudent and judicious because they would share in the profits or losses. Admittedly much skill and expertise in business will be needed if the system is to work smoothly. These are not easily available today. It is imperative therefore that conventional systems be allowed also, if business and growth is not to be stifled. The option to use the Islamic financial system must be open and voluntary so as not to cause turmoil and economic regression...[8]

5 See for example, Michael Priest and Rodney Wilson "Finance in the Arab World: Resurgence of old ideas about handling cash", op.cit.; Susanna Tarbush "Islamic Banking: Economics and the Koran", op.cit.; Peter Montagnon "Monetary Agency strives to strike the right balance", *Financial Times*, London, 1 June 1982; Roger Cooper "Survey: Arab Banking XVI – Making the system more flexible", *Financial Times*, London, 4 October 1982; Roger Cooper "Survey: Arab Banking and Finance – Islamic Banking: Following the historic route", *Financial Times*, London, 3 October 1983; Roula Khalaf "Survey of Arab Banking: An inherent contradiction", op.cit.; Roula Khalaf "Survey of Islamic Banking: Consensus still sought on important issues", *Financial Times*, London 28 November 1995; "Timeline: Milestones in rise of Islamic finance", *Reuters UK*, 13 April 2009; Mumtaz Hussain, Asghar Shahmoradi, and Rima Turk "An Overview of Islamic finance", op.cit.

6 See for example, Diane K. Mauzy and R.S. Milne "The Mahathir Administration in Malaysia: Discipline through Islam", *Pacific Affairs*, 1983-1984, Vol.56, No.4, pp.617-648; K.S. Jomo "Whither Malaysia's New Economic Policy?", *Pacific Affairs*, 1990-1991, Vol.63, No.4, pp.469-499; Kieran Cooke "Survey of Islamic Banking: Two systems exist side by side", *Financial Times*, London, 28 November 1995; Mark Beeson "Mahathir and the Markets: Globalisation and the Pursuit of Economic Autonomy in Malaysia", *Pacific Affairs*, 2000, Vol.73, No.3, pp.335-351; Khadijah Md. Khalid, "Malaysia's Foreign Policy under Najib: A Comparison with Mahathir", *Asian Survey*, 2011, Vol.51, No.3, pp.429-452; Daromir Rudnyckyj "From Wall Street to 'Halal Street': Malaysia and the Globalization of Islamic Finance", *The Journal of Asian Studies*, 2013, Vol.72, No.4, pp.831-848.

7 "Malaysia: all business?", *Islamic Banking & Finance*, 2 July 2012.

8 "Keynote address by the Prime Minister of Malaysia, Dr. Mahathir Mohamad, at the Inauguration of the IFSB", 3 November 2002, IFSB Press Room, Islamic Financial Services Board, Kuala Lumpur.



In May 2002, Malaysia was chosen as the venue for an international regulatory and supervisory body for Islamic banking. The Islamic Financial Services Board was the result of two years' consultations between governors of various central banks, the IMF, the Islamic Development Bank, and the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions. The governor of the Malaysian central bank was appointed head of its steering committee. Bank governors and officials involved in the IFSB's establishment were from Kuwait, the UAE, Malaysia, Saudi Arabia, Indonesia, Iran, Sudan, Pakistan, Qatar, and Bahrain, with Lebanon as an observer. Whilst the aims of the IFSB included developing universally acceptable sharia-compliant banking practices and encouraging greater transparency by publicising Islamic banks' capital adequacies, regulation ultimately remained the responsibility of member states. One factor behind Malaysia's selection was a successful lobbying campaign by Prime Minister, Mahathir Mohamad, to help make Kuala Lumpur a key international centre of Islamic finance. There was also historical precedent for Malaysian leadership of nascent pan-Islamic institutions. In 1970 during a visit by King Faisal bin Abdul Aziz of Saudi Arabia, Malaysia's then Prime Minister, Tunku Abdul Rahman Al Hajj, was appointed as the first Secretary General of the Organization of the Islamic Conference.[9]

Therefore, we can see that Islamic finance's development had two principal drivers – top-down implemented state policies to partly or wholly Islamise financial systems, and the vast petrodollar surpluses accruing to Gulf oil exporting countries. It is also arguable that a third 'grass-roots' upwards driver included states responding to varying degrees of public demand for greater Islamisation of their financial sectors.

9 "Islamic financial services board to be set", *UPI NewsTrack*, 2 May 2002; Sadna Saifuddin "Islamic financial services board to be based in KL", *Business Times* (*Malaysia*), Kuala Lumpur, 3 May 2002; David Azerand "Regulation – Islamic Banking", *The Times*, London, 8 October 2003; Asmady Idris "Malaysia-Saudi Arabia Relations: Roots, Dimensions, and Prospects", *Middle East Asia Project*, 18 June 2013, Middle East Institute, Washington D.C.; Daromir Rudnyckyj "From Wall Street to 'Halal Street': Malaysia and the Globalization of Islamic Finance", op.cit., pp.843-844.

Part B

Islamic Finance in Britain

Islamic Finance in Britain

Islamic financial services in Britain have been available for more than thirty years -initially directed towards international financial transactions. In the 1980s, the London Metal Exchange provided sharia-compliant deposit facilities in which a buyer purchased commodities on a deferred payment basis and sold them to a third party for a cash payment.[10] By the late 1990s, a Halal Mutual Investment Services company was offering high street deposits to lenders, and the United Bank of Kuwait had launched a Muslim mortgage service. Both had sharia boards of scholars to ensure compliance. Although there was criticism from some Muslim groups that sharia-compliant financial products and services were being offered by non-Muslims, the head of the Sharia Council of Great Britain, Zaki Badawi, rejected this perspective. "If an Islamic financial services company follows certain rules sanctioned by a Sharia board then that's fine. If people follow them, then their behaviour is Islamic."[11] However, the sector in Britain did not begin to take on more formalised and regulatory characteristics until the early 21st century. There were two main reasons for this change:

1. The Labour government with Tony Blair as Prime Minister and Gordon Brown as Chancellor of the Exchequer (Finance Minister) sought to enhance socio-economic inclusion for British Muslims – some of whom lived in economically deprived areas. The 2001 riots in the city of Bradford and the 11 September 2001 US attacks gave added urgency to implementing more inclusive policies.
2. Adjusting the existing domestic legal and regulatory framework to accommodate Islamic finance would potentially bolster Britain's and particularly the City of London's capacity to attract investment from capital surplus Gulf economies. In consequence, it

10 Filippo di Mauro et al. "Islamic finance in Europe", 2013, ECB Occasional Paper, No.146, European Central Bank, Frankfurt, p.28.

11 Keith Nuthall "Banks to offer Halal accounts", *The Independent*, London, 26 April 1998.

would assist London's efforts to enhance its status as a leading global financial centre.[12]

In November 2001, Bolton-based 1stethical was set up to help Muslims raise finance for house purchases via ethical investments and financing based on leasing rather than paying interest. HSBC became the first UK high-street bank to offer sharia-compliant alternatives to mortgages in July 2003 using a sharia-compliant model in which the bank took the property title and leased it back to the customer over 25 years who then paid rent plus payments towards the purchase price.[13]

Birmingham-based Islamic Bank of Britain – the first UK sharia-compliant high street bank opened in London in September 2004. The Bank of England, and specifically its then governor Eddie George,[14] and the Financial Services Authority were involved in its establishment. The bank's £14 million seed capital, required to secure a British banking licence, came from Gulf investors including members of the Qatari Al Thani ruling family, and British Muslims. Its first president was formerly head of Abu Dhabi Islamic Bank. Services offered included sharia-compliant current accounts, debit cards, consumer financing arrangements and mortgages. The bank also planned to expand its operations into mainland Europe within three years.[15] Subsequent government legislation was introduced to provide capital gains tax and stamp duty relief for sukuk (Islamic bond) issuance and sharia-compliant mortgages.[16]

In 2005 Lloyds TSB began offering Islamic finance on the high street, which by June 2006 had become available nationwide via its 2000 branches.[17] Gordon Brown announced amendments to the UK's Finance Act in March 2006 - abolishing double stamp duty on Islamic commercial property deals and addressing anomalies in sharia-compliant leasing transactions.[18] He told a June 2006 Islamic Finance and Trade Conference in London that the city could be a gateway for emerging markets including Muslim countries. "London now has more banks supplying services under Islamic principles than any other Western financial centre."[19] An Anglo-Lebanese initiative, the Islamic Finance Qualification was launched in October 2006 by the British financial body the Securities and Investment Institute and the Lebanese Ecol Superieure des Affairs, backed by the Lebanese central bank and the British government. The qualification, covering technical and religious aspects of Islamic finance, was intended to consolidate Britain's position at the forefront of the global Islamic finance industry.[20]

In 2007, the UK Treasury established the Islamic Finance Expert Group comprising representatives from industry, the Financial Services Authority, and Muslim community organisations.[21] The Bank of London and the Middle East was opened in July of the same

12 Shyamantha Asokan "UK leads in sowing seeds for a sector", *Financial Times*, London, 19 June 2008.
13 Liz Loxton "Billion-pound market - Britain", *The Times*, London 8 October 2003.
14 David Watts "Dilemma that swayed the Bank's Governor", *The Times*, 26 April 2006. For a more detailed assessment of Lord Edward George's role in the development of UK Islamic finance, see also Mushtak Parker "George: Who put Britain on Islamic finance map", *Arab News*, Jeddah, 20 April 2009.
15 Carl Mortished "Britain's first Islamic bank to target Europe", *The Times*, 9 August 2004; Christopher Hope "Islamic law bank given go-ahead to open in UK" *Daily Telegraph*, London, 9 August 2004; Pierre Pratabuy "British Islamic bank planning to cash in on growing market", *Agence France-Presse*, 10 August 2004; "Factbox: Who regulates the Islamic finance sector?", *Reuters UK*, 13 April 2009; "Timeline: Milestones in rise of Islamic finance", *Reuters UK*, 13 April 2009.
16 "Factbox: Islamic finance regulations around the world", *Reuters*, 10 May 2010.
17 Ben Perry "Britain embraces Islamic finance", *Agence France-Presse*, 18 June 2006.
18 Mushtak Parker "Global scramble to jump aboard the bandwagon", *The Times*, London, 26 April 2006.
19 "Britain can be 'gateway' to Islamic finance: Brown", *Agence France-Presse*, 13 June 2006.
20 Roland Jackson "Islamic finance quality standard is launched in Britain", *Agence France-Presse*, 31 October 2006.
21 Filippo di Mauro et al. "Islamic finance in Europe", op.cit. p.30.

In October 2013, Prime Minister David Cameron announced Britain would be the first Western country to introduce an Islamic bond or sukuk.

year - 20% owned by Kuwait's Boubyan Bank - with £175 million in funds at the time of its launch. Other shareholders included members of Kuwait's Al Sabah ruling family, employees, pension funds, and investment companies. BLME offered wholesale banking services to European, Middle Eastern, and North African businesses.[22] In April 2008 Gatehouse Bank became the UK's fifth Islamic bank, joining Islamic Bank of Britain; European Islamic Bank – Europe's first Islamic investment bank - launched in 2005; Bank of London and the Middle East; and European Finance House, the latter being launched in January 2008 and owned by Qatar Islamic Bank.[23]

In October 2012, HSBC announced it was scaling back its global Islamic finance operations in the UK, Bahrain, Bangladesh, Mauritius, Singapore, and the UAE, instead concentrating these services in Malaysia, Saudi Arabia, and Indonesia. The bank had established its Amanah Islamic finance division in 1998. HSBC's decision was seen as a response to growing calls for conventional banks to keep Islamic financial services separate. In February 2011, the Qatari central bank had given conventional banks operating in the emirate until the end of that year to close down Islamic finance operations. Some Islamic scholars had argued conventional banks' efforts to separate their Islamic and non-Islamic operations were insufficient, whilst some Islamic banks claimed the size of conventional banks put them at a commercial disadvantage.[24]

In October 2013, Prime Minister David Cameron announced Britain would be the first Western country to introduce an Islamic bond or sukuk. Addressing the World Islamic Economic Forum in London, he said: "I don't just want London to be a great capital of Islamic finance in the Western world, I want London to stand alongside Dubai and Kuala Lumpur as one of the great capitals of Islamic finance anywhere in the world." The London Stock Exchange also announced plans to launch an Islamic Index identifying companies according to Islamic principles.[25]

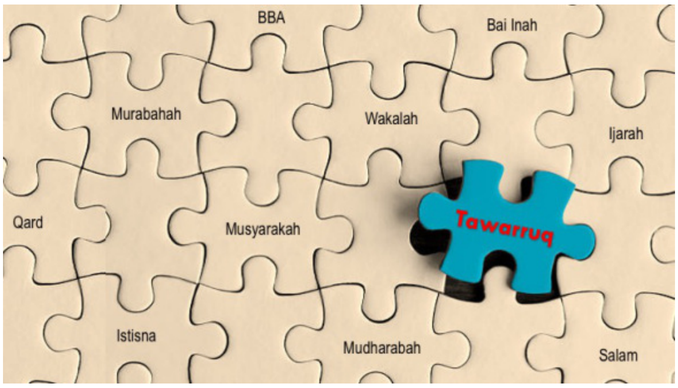
22 Stacy-Marie Ishmael "Wholesale Islamic outlet is London's second", *Financial Times*, London, 8 July 2007; Michael Imeson "Islamic Finance in London: Room for more Sharia compliance", *The Banker*, England, 1 September 2007.

23 David Oakley "Gatehouse to bolster UK's Islamic sector", *Financial Times*, London, 22 April 2008; Rodney Wilson "The development of Islamic finance in the GCC", op.cit., p.28; Filippo di Mauro et al. "Islamic finance in Europe", op.cit. p.30.

24 Magnus Grimond "How to buy and save religiously – Banking", *The Times*, London, 19 November 2005; Shaheen Pasha and Regan Doherty "Qatar slaps conventional banks with Islamic units ban", *Reuters UK*, 6 February 2011; David French "HSBC scales back Islamic business in global review", *Reuters UK*, 4 October 2012.

25 Bernardo Vizcaino "Britain aims to be first Western country to

The Islamic Bank of Britain agreed in December 2013 to a cash offer from Qatar's largest sharia-compliant bank, Masraf Al Rayan. According to Masraf's chief executive, the takeover would assist IBB's plans "by strengthening its balance sheet and position in the market." IBB was previously majority-owned by Qatar International Islamic Bank. The takeover was seen as an opportunity for Masraf to introduce financial products to the UK and continental Europe, and formed part of its expansion moves beyond an increasingly competitive domestic market.[26]



In June 2014, Britain issued a sovereign sukuk, becoming the first non-Muslim country to sell bonds purchasable by Islamic investors and attracting over £2 billion worth of bids, around one third of which went to UK-based Islamic banks. The sukuk deal was structured by HSBC, with Barwa Bank of Qatar, Malaysia's CIMB, National Bank of Abu Dhabi, and Standard Chartered also involved. At the time of the sovereign sukuk launch George Osborne, the UK Chancellor of the Exchequer, said promoting the industry could help Britain to become, "the undisputed centre of the global financial system."[27]

This occurred under the Conservative-Liberal Democrat coalition government of 2010-2015 with David Cameron as Prime Minister. During the last two decades therefore – from the Tony Blair-led Labour government of 1997-2007, the Gordon Brown-led Labour government of 2007-2010, and continuing to the present under coalition and Conservative-led governments - expanding the Islamic finance footprint in the UK has enjoyed cross-party support in order to assist the socio-economic inclusion of British Muslims, whilst supporting the City of London's position as a leading global financial centre.

Having become only the second Western central bank to join the Islamic Financial Services Board in Kuala Lumpur as an Associate Member in December 2015, in February 2016 the Bank of England announced a framework for sharia-compliant deposit facilities in Britain. In so doing, it became the first major Western central bank to allow Islamic banks to access its deposit facility without acquiring interest as would normally occur. A Bank of England statement noted establishing sharia-compliant deposit facilities was the area "of greatest demand, given that a more limited range of liquid market instruments is available to Islamic banks compared with other banks." The British Bankers' Association welcomed the Bank of

issue sovereign Islamic bond", *Reuters UK*, 29 October 2013; George Osbourne "London can lead the world as an Islamic finance hub", *Financial Times*, London, 29 October 2013.

26 Rodney Wilson "The development of Islamic finance in the GCC", op.cit., p.28; "Qatar's Masraf Al Rayan agrees terms of Islamic Bank of Britain offer", *Reuters UK*, 1 December 2013; Santhosh V. Perumal "Masraf Al Rayan expanding global footprint with IBB buy", *Gulf Times*, Qatar, 16 January 2014.

27 David Milliken "Britain's first Islamic bond draws torrent of bids", *Reuters UK*, 25 June 2014; Lucy Burton "UK must remain Islamic finance HQ following Brexit, urges City", *Daily Telegraph*, London, 11 September 2017.

England consultation as potentially playing, "an important role in confirming London as the leading European centre for Sharia compliant financing."[28]

In November 2016, Al Rayan Bank announced it was setting up an office in Scotland offering buy-to-let mortgages.[29] As well as underlining the continued expansion of the Islamic finance sector throughout Britain, Al Rayan's move may have had an additional motive. The results of the June 2016 referendum showed Scotland voted by 62% to 38% in favour of staying in the European Union – the highest regional Remain majority in the UK.[30] Thus establishing a bank base in Scotland may also have been a means for Al Rayan to position itself to benefit from a possible future independent Scotland seeking a different political and economic arrangement with the EU.

In April 2017, the UK's first Islamic financial technology company received full approval from the Financial Conduct Authority. London-based Yielders allowed retail investors to access the property market for as little as £100. The approval was another example of the UK's efforts to retain its status as a global financial centre and hub for Islamic finance and financial technology, and of providing support to prospective UK Muslim house-buyers.[31] As of October 2017, there were more than 20 companies in Britain offering sharia-compliant products, a level surpassing any other Western country. This included five Islamic banks: Gatehouse Bank, Qatari-owned Al Rayan Bank, the Bank of London and the Middle East, Abu Dhabi Islamic Bank, and a unit of Qatar Islamic Bank.[32] Gatehouse Bank was also listed as an Observer Member of the Islamic Financial Services Board in Kuala Lumpur.[33]

28 "The IFSB Admits Six Organisations Into Its Membership", 8 December 2015, IFSB Press Room, Islamic Financial Services Board, Kuala Lumpur; Bernardo Vizcaino "Bank of England joins IFSB Islamic finance body", *Reuters UK*, 9 December 2015; "Bank of England sets out stall for Islamic deposits in first for Western bank", *Reuters UK*, 12 February 2016.
29 Bernardo Vizcaino "Islamic bank Al Rayan forays into Scotland; to add more products", *Reuters UK*, 30 November 2016.
30 "How the EU referendum was won", *Daily Telegraph*, London, 25 June 2016.
31 Jemima Kelly "Islamic fintech firm becomes first to get UK regulatory approval", *Reuters UK*, 10 April 2017.
32 Bernardo Vizcaino, Carolyn Cohn "Britain plans new sukuk deal; Brexit may boost Islamic finance", *Reuters UK*, 2 October 2017.
33 "IFSB Membership – List of Members", Islamic Financial Services Board, Kuala Lumpur.

Part C

Continental European Challengers to the UK

Continental European Challengers to the UK

The principal European Union financial centre is the German city of Frankfurt, and its leaders have sought to lay claim to an increasing role post-Brexit. However, in regard to Islamic finance Germany has made only limited progress in domestic development of this sector. The German state of Saxony-Anhalt raised €100 million via Islamic bonds in 2004, and German banks have been willing to offer sharia-compliant products outside the country, but the national regulatory and legal framework has not yet been adjusted to accommodate Islamic finance. In addition, Germany's Muslim population, primarily of Turkish origin, has historically been inclined to put money into conventional savings banks.[34] The launch of Germany's first fully-fledged Islamic bank did not occur until 2015 when Turkey's largest Islamic bank, Kuveyt Turk, based in Frankfurt opened. Kuveyt, which was 62% owned by Kuwait Finance House, had previously opened a financial services branch in Mannheim in 2010.[35] Thus, the Turkish Islamic finance linkage with Germany was partly Gulf-based. By 2009, KFH had become the largest Islamic bank in Turkey and had more branches in the country than in Kuwait.[36] In 2016, the German bank regulator, BaFin, was reportedly considering joining the Islamic Financial Services Board, and in December 2017 it was granted Associate Member status, becoming the third European regulatory body to be admitted.[37] This could signify a prelude to German regulatory and legal adjustments that would better accommodate domestic Islamic finance.

Being at a comparatively early stage of Islamic financial sector development, it is doubtful Frankfurt could challenge London's primacy unless substantial conventional finance sector

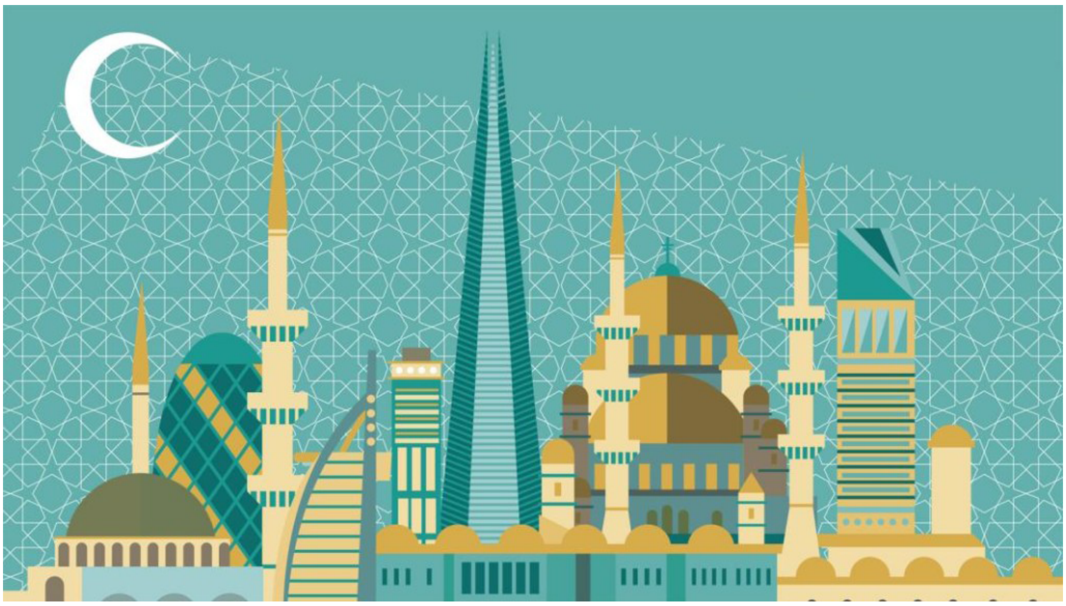
34 Carl Mortished "Britain's first Islamic bank to target Europe", op.cit.; Etienne Balmer "Islamic finance yet to capture Germany's imagination", *Agence France-Presse*, 23 November 2008.

35 "Kuveyt Turk preps July launch of Germany's first Islamic bank", *Reuters UK*, 23 March 2015.

36 Rodney Wilson "The development of Islamic finance in the GCC", op.cit., pp.2-3.

37 Mushtak Parker "Globalisation of sukuk", *New Straits Times*, Kuala Lumpur, 30 May 2016; "The IFSB Admits Eight Organisations into Its Membership", 11 December 2017, IFSB Press Room, Islamic Financial Services Board, Kuala Lumpur.

If London were to lose ground post-Brexit to other major EU financial centres such as Frankfurt or Paris in conventional finance, this might be to Luxembourg's advantage in the Islamic finance sector.



and/or capital re-location occurred as a result of Brexit. This would only be likely on a large scale if companies and investors were unhappy with the terms of a Brexit deal; of an acrimonious 'no-deal' Brexit; or of a changed political and/or economic environment in the UK perceived to be inimical to their continuing presence in the City of London. Further expansion of the Islamic finance sector in Turkey could potentially lead Muslim citizens of Turkish origin to seek more access to such services in Germany. Owing to its geostrategic position between Europe and the wider Islamic world, a 2007 study identified Turkey as a potential long-term successor to London as Europe's leading centre of Islamic finance.[38] Rating agency Fitch reported in 2016 that Turkish Islamic banking offered, "reasonable medium-term growth prospects… because the government aims to increase Islamic banks' market share in total sector assets to 15% by 2025…"[39] However the suspension, perhaps indefinitely, of Turkey's application for EU membership, diminished relations between Ankara and Berlin and indeed with the EU generally, and the outstanding steps required to adjust German regulatory frameworks to better accommodate Islamic finance, could delay or limit progress.

In the case of France, as an EU member with one of the largest Muslim populations, there would appear to be significant potential for a nascent Islamic finance sector. In 2008, France was on the verge of issuing its first licence to an Islamic bank. However, measures to alter financial legislation to facilitate Islamic finance were opposed by some politicians because they undermined the secular nature of the French constitution.[40] As of 2010, France had taken "baby steps" to change taxation rules for financial transactions – having provided guidelines to potentially avoid tax on certain sharia-compliant products. A €1 billion Islamic bond was also under consideration.[41] A 2013 study noted France had six sharia-compliant funds - split comparatively evenly between money market and equity assets. It concluded: "…Islamic finance appears to have good potential to develop further in France. Over the years, the country has established favourable trade flows with a number of close neighbours with large Muslim populations, including Morocco, Algeria and Tunisia. A significant proportion of the French population originates from North Africa, and this has been driving domestic demand for Islamic finance."[42] The November 2017 award to Paris of the European Banking Authority headquarters from London signalled potential future intra-EU competition between conventional finance centres, especially as Frankfurt failed to make the final short list for hosting the European Banking Authority, with Paris and Dublin being the last two candidates.[43]

Luxembourg's economy is heavily reliant on the banking and financial services sector and as a small state in the EU it uses its membership to secure favourable deals to support this sector, including diluting EU efforts to limit the activities of tax havens.[44] The EU Commission

38 Rodney Wilson "Islamic finance in Europe", 2007, RSCAS Policy Papers No.2007/02, Robert Schuman Centre for Advanced Studies, European University Institute, Florence, p.19.

39 "Fitch: Reasonable Medium-Term Prospects for Turkish Islamic Banks", *Reuters UK*, 19 December 2016.

40 David Oakley "London leads in race to be western hub", *Financial Times*, London, 8 December 2009.

41 "Factbox: Islamic finance regulations around the world", *Reuters*, 10 May 2010.

42 Filippo di Mauro et al. "Islamic finance in Europe", op.cit. p.25.

43 "Amsterdam, Paris to host key EU agencies after Brexit", *Agence France-Presse*, 20 November 2017; "Spoils of Brexit: EU's medicines and banking agencies", *Agence France-Presse*, 20 November 2017; Maya Nikolaeva, Huw Jones "Paris watchdog win bolsters its fight for Brexit banks", *Reuters UK*, 21 November 2017.

44 Skander Nasra & Peter Debaere "The European Union in the G20: What Role for Small States?", *Cambridge Review of International Affairs*, 2016, Vol.29, No.1; Baldur Thorhallsson "How Do Little Frogs Fly? Small States in the European Union", 2015, *NUPI Policy Brief* 12/2015, Norwegian Institute of International Affairs, Oslo, p.2.

President, Jean-Claude Juncker, was also a former Luxembourg Prime Minister. The Grand Duchy has one of the longer histories of continental European involvement with Islamic finance – described as being "the laboratory of Islamic finance in Europe, long before the UK." Luxembourg hosted the Islamic Banking System International Holding from the late 1970s, some of whose senior members were pioneers in contemporary Islamic finance, including its managing director Gamal Al Attiyah; the former Kuwaiti finance minister, Abdul Rahman Al Ateeqi, and sharia advisers such as the Islamic scholar Zaki Badawi.[45]

In November 2009, the Banque Centrale du Luxembourg became the first EU member state central bank to gain admission as an Associate Member to the Islamic Financial Services Board in Kuala Lumpur.[46] By 2010, the Grand Duchy was actively promoting itself as a haven for sharia-compliant funds, and signed tax treaties with Bahrain, Kuwait, Qatar, and the UAE. Islamic investors did not have to pay double stamp duty or wealth tax, and were not subject to tax on profits and income.[47] In 2011, Luxembourg and Qatar signed cooperation agreements on bilateral economic, financial, trade, and technical cooperation. In October of the same year, members of the Qatari Al Thani ruling family bought the Luxembourg branch of the troubled Franco-Belgian bank Dexia. The Belgian unit of Dexia, also Luxembourg-based, was purchased by the Qatari Precision Capital investment fund whose business included dealing with Arab firms with sharia-compliant investments. Both developments were regarded as having bolstered the Grand Duchy's role as a centre of Islamic finance.[48] In 2014, Luxembourg issued a sovereign sukuk - becoming the first AAA-rated government to issue a euro-denominated Islamic bond.[49] The Grand Duchy is therefore arguably Britain's most well established continental European challenger post-Brexit for Islamic finance.[50] Along with its history of involvement with this sector, Luxembourg's principal advantages include:

1. Having "a diversified but also highly qualified cross-border labour pool which gives the financial centre a globally recognised position."
2. Being small means the Grand Duchy's "national and regulatory institutions can be easily approached by companies and other institutions."
3. In order to remain competitive Luxembourg has pursued a strategy of innovation within its financial sector.[51]

If London were to lose ground post-Brexit to other major EU financial centres such as Frankfurt or Paris in conventional finance, this might be to Luxembourg's advantage in the Islamic finance sector. This does not preclude Frankfurt, Paris, or other centres from catching up but, at least in terms of Islamic finance, it gives the Grand Duchy an initial advantage over other EU economies. No EU conventional financial centre yet rivals London and early indications of intra-EU contestation make that less likely. In addition, no EU state has such a well-established domestic Islamic finance industry as Britain - serving the wider country

45 Mushtak Parker "Luxembourg promotes as domicile of choice for funds", *Arab News*, Jeddah, 18 May 2009.
46 "The Council of the IFSB admits new members", 23 November 2009, IFSB Press Room, Islamic Financial Services Board, Kuala Lumpur.
47 "Factbox: Islamic finance regulations around the world", *Reuters*, 10 May 2010.
48 "Luxembourg boosts role as Europe's Islamic finance centre", *Agence France-Presse*, 10 October 2011; "Qatar and Luxembourg financial centres boost ties", *UPI Arabic News Service*, 20 January 2012.
49 Bernardo Vizcaino, Carolyn Cohn "Britain plans new sukuk deal; Brexit may boost Islamic finance", *Reuters UK*, 2 October 2017.
50 Arno Maierbrugger "Luxembourg set to take over London's Islamic finance hub position in Europe", *Gulf Times*, Qatar, 28 June 2016.
51 Olivier Walter, Christian Schulz, and Sabine Dörry "Specialised international financial centres and their crisis resilience: The case of Luxembourg", *Geographische Zeitschrift*, 2011, Vol..99, No.2/3, p.139.

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in addition to the City of London, an example of creating a linkage between 'offshore' finance and the wider 'onshore' economy. This is evidenced by the number of UK Islamic finance companies that, whilst sometimes maintaining branches in London, have their origins and headquarters in cities and regions away from the capital.

According to Jason Chuah, Professor of Commercial and Maritime Law at London's City University, and a leading legal expert on Islamic law in a western context, the post-Brexit situation offers significant opportunities. "Careful handling is needed to ensure that disruption to the general financial regulatory framework is minimal…Far too many people are talking about doomsday scenarios and the like for the City of London. On the contrary…Islamic finance providers, including some of the largest Islamic investment funds, have taken the line that Brexit could very well bring about different opportunities especially with the UK being more than ever before, keen to attract inward investment."[52] Britain's departure from the EU does not represent a separation of Britain from the wider international system but of an intra-systemic realignment potentially emphasising agential or sovereign-based internationalism over regional bloc-based internationalism. Given both sides' economic size and geopolitical importance, neither can afford to pursue policies that operate from the premise of excluding the other.

52 "Notes on a smaller island", *Islamic Banking & Finance*, 30 August 2016; "London's Islamic finance future", *Islamic Banking & Finance*, 27 February 2017.

Part D

UK ties with key Islamic finance centres

UK Ties With Key Islamic Finance Centres

Britain relations with the Arab Gulf states date back to the 19th century – with Kuwait becoming independent from Britain in 1961, and Bahrain, Qatar, and the Trucial States (now the UAE) following in 1971. Saudi Arabia has had good relations with Britain since the kingdom was founded by Abdul Aziz Al Saud in the 1920s. Oman has also maintained close ties since the 19th century, and this has continued during Sultan Qaboos' reign since 1970. Many Gulf ruling family members have also been educated in Britain. More specifically, as we have seen GCC member states have been active participants in the British Islamic finance sector, whilst also maintaining significant conventional financial investments in the UK, including via their respective sovereign wealth funds, and property acquisitions. The Abu Dhabi Global Market launched in 2015 opted to use English common law. In so doing, ADGM adopted a similar legal framework to Dubai International Financial Centre. Whilst this decision enabled ADGM and DIFC to reduce costs and more easily engage with each other,[53] it also potentially benefited Britain in terms of legal and administrative cooperation with the two Gulf emirates and/or with the UAE collectively given the relative economic importance of Abu Dhabi and Dubai vis-à-vis their smaller intra-federation neighbours. It would also potentially enable Britain to more easily deal with UAE-based companies from other Islamic countries. Another GCC state finance centre, the Qatar Financial Centre also uses laws and regulations based on English common law.

Although Oman is a comparative newcomer to Islamic finance, there may also be opportunities for UK-Omani cooperation. This is particularly evident because the sector's development in the Sultanate was partly influenced by the need to increase community socio-economic inclusion. In 2007, the head of the Omani central bank said that, "banks should be universal", reflecting a longstanding official view that finance should be secular. A 2009 study noted Oman's reluctance to award Islamic banking licences "for political reasons concerned with limiting the influence of the Ibadi sect…"[54] In addition,

53 "Abu Dhabi financial centre to base rules on English common law", *Reuters UK*, 7 January 2015.

54 Rodney Wilson "The development of Islamic finance in the GCC", op.cit., p.6, 27.

the absence of Islamic finance resulted in investment outflows to neighbouring countries with well-established sectors. With declining oil reserves, the Sultanate's future economic development will increasingly require foreign investment. In conjunction with economic considerations and in the aftermath of the Arab Spring in which protestors' demands included the introduction of Islamic finance, in 2011 Sultan Qaboos authorised the issuing of Islamic banking licences in Oman.[55]

In terms of UK relations with the GCC states compared to EU ties with the six nation Gulf grouping, only France has relations nearing the extent of those of the UK. According to a 2006 study:

Often, the shaping of a collective EU policy towards a particular country or region depends on the existence of a 'champion' within the EU for such an approach. There is no such obvious champion for EU-level relations with the GCC. To the extent that such a policy has been put forward – perhaps most by Britain – has been neither truly wholehearted (in part due to satisfaction with the UK's own bilateral relationships) nor successful at persuading all others to follow suit. This points…to the striking variation in interests between the member states of the EU, and their policymaking elites' strikingly different foreign policy role conceptions in general and regarding the GCC in particular.[56]

A 2016 commentary noted that, given Brussels' preoccupation with Brexit negotiations, the long-running effort to conclude a GCC-EU Free Trade Agreement would be shelved, and relations would move from multilateral to bilateral with the GCC states likely to prefer dealing directly with member states including France, Germany, and Italy.[57] Indeed, Brexit may also be symptomatic of a wider decline in multilateral trade agreements between regions and/or blocs with increasing emphasis given to bilateral trade agreements.[58] Thus, given the relative strength of the UK's relations with GCC member states, Britain is in a potentially favourable position having an established history of strong ties, and post-Brexit the agential freedom of foreign policy action that the EU lacks. On the other hand, Britain's post-Brexit economic capacity for action on the world stage may, to some extent, be impaired.[59] Nevertheless, in an increasingly multipolar international arena the importance of more state-centred policymaking, be it economic or political, is an issue relevant not just to Britain post-Brexit but is a template already in place in much of the developing world. As a 2010 study noted, "State-sponsored capitalist models posit state intervention as a critical and primary engine for growth, and the approach has long been followed in the East Asian and Gulf states."[60]

One 2016 Gulf commentary envisaged future multiple bilateral relationships between smaller financial centres: "the growth of specialised centres around the world – ADGM (Abu Dhabi Global Market), Singapore, Kuala Lumpur, etc – linking with the Londons of this

55 Martina Fuchs and Shaheen Pasha "Economics, politics spur Islamic banking in Oman", *Reuters Africa*, 14 September 2011; James Worrall "Oman: The 'Forgotten' Corner of the Arab Spring", *Middle East Policy*, 2012, Vol.19, No.3, www.mepc.org; Leon Goldsmith "Immunizing Against Sectarian 'Sickness': The Case of Oman", 12 November 2015, *Middle East Asia Project*, Middle East Institute, Washington D.C.

56 Gerd Nonneman "EU-GCC Relations: Dynamics, Patterns & Perspectives", 2006, *Gulf Papers*, Gulf Research Centre, Dubai, p.22.

57 Christian Koch "The GCC and the EU's New Global Strategy", *GRC Analysis*, 13 July 2016, Gulf Research Centre, Jeddah, Geneva, Cambridge.

58 Andreas Nölke "Brexit: Towards a new phase of organized capitalism", *Competition & Change*, 2017, Vol.21, No.3, p.235.

59 Peter Harris "What does Brexit mean for the Arab Gulf States", July 2017, *IndraStra Global*, www.ssoar.info

60 Kristian Coates Ulrichsen "The GCC States and the Shifting Balance of Global Power", 2010, *Occasional Paper No.6*, Center for International and Regional Studies, Georgetown University School of Foreign Service in Qatar, Doha, p.19.

world to create a more effective system with specialised local knowledge concentrated in the right place. This system will have the added benefit of circumventing the systemic risk of institutions too big to fail."[61] According to Dubai Islamic Bank in 2017, despite claims by numerous non-Muslim governments to be regional or global centres of excellence for Islamic banking and finance, the UK is the only non-Muslim country to feature significantly in the major ranking of countries in terms of Islamic financial assets. "The USA and European countries other than the UK have yet to receive attention and confidence of Islamic investors."[62]

In the case of Malaysia, following independence from Britain in 1957, bilateral relations were variable particularly during the Mahathir era, although a 2017 commentary described fluctuations as being more akin to "spats between friends rather than adversaries." More recently, relations have expanded with Malaysia being the UK's second largest trading partner within the Association of South East Asian Nations bloc, or ASEAN. During a 2015 visit to Malaysia by then Prime Minister David Cameron, Malaysia's Prime Minster Dantuk Seri Najib Razak said bilateral relations had endured because both countries "believe in the power of moderation, the strength of civil liberties, as well as the need to increase prosperity by building open, outward-facing economies."[63]

The UK's involvement with Islamic finance in Malaysia also reflects stronger bilateral ties, and each country's historical engagement with and development of their domestic Islamic finance sectors share similarities via efforts to enhance socio-economic inclusion of their Muslim populations. Both countries are also important contributors to the development and expansion of education in Islamic finance. According to ratings agency Fitch in late 2016: "Malaysia continues to lead the global Islamic finance industry in terms of regulation, standardisation and sukuk issuance…"[64] The Bank of England's Associate Membership of the Islamic Financial Services Board in Kuala Lumpur provides scope for further linkages in the sector. Additionally, this linkage could help UK ties not only with Malaysia but also with other ASEAN members. IFSB members who represent ASEAN countries include: Brunei's Central Bank, Indonesia's Central Bank and Financial Services Authority, Malaysia's Central Bank and Securities Commission, Singapore's Monetary Authority, all of which are Full Members; and the Philippines Central Bank as a fellow Associate Member.[65] A 2017 commentary on Brexit's impact on the ASEAN region in general concluded the greatest negative consequence would come from a British economic slump that spread to the rest of the EU, with which ASEAN has far more economic interaction.[66] A significant factor in the extent to which Britain and potentially the EU would or would not suffer economically after Brexit would itself relate to the terms of a final Brexit deal with Brussels.

That Britain has good relations with the GCC states and Malaysia and that the latter countries are also expanding their ties including in areas

61 Sabah Al Binali "EU 2.0 and the evolution of the UAE's economy", *The National*, Abu Dhabi, 28 November 2016.

62 Katarzyna W. Sidlo "Islamic finance 2017: State of the art and outlook for the future", op.cit., p.12. Sidlo quotes the Dubai Islamic Bank "Global Islamic Finance Report: Overview of the Global Islamic Finance Industry" (2017), http://www.gifr.net/publications/gifr2017/intro.pdf

63 Mushtak Parker "UK-Malaysia Ties: Then, now and the future", *New Straits Times*, Kuala Lumpur, 28 August 2017.

64 "Fitch: Growth of Malaysian Islamic Finance to Continue", *Reuters UK*, 15 November 2016.

65 "IFSB Membership – List of Members", Islamic Financial Services Board, Kuala Lumpur.

66 Aédan Mordecai and Phidel Vineles "Brexit's Impending Impact: Assessing ASEAN's Exposure", 29 March 2017, *RSIS Commentary* No. 057, S. Rajaratnam School of International Studies, Nanyang Technological University, Singapore.

relating to Islamic finance, may also open further opportunities. One area of recent expansion in Bahrain's relations with Malaysia has been in this sector. "With the expansion of Islamic finance, both Bahrain and Malaysia are seeking a niche in an expanding array of possible services and products." Relations have also been boosted by the first visit in 2017 by a Bahraini ruler to Malaysia since the establishment of diplomatic relations in 1974.[67] Several Gulf Islamic banks now have branches in Malaysia including Kuwait Finance House and Asian Finance Bank, which is largely owned by Qatari investors,[68] whilst Al Rajhi Bank of Saudi Arabia has opened more than 20 branches since the 2006 visit of King Abdullah bin Abdul Aziz. According to a 2013 study, despite differing Malaysian and Saudi interpretations and practice of Islam, "at no point have these differences seriously disrupted the relationship,"[69] whilst, for Malaysia, relations with the Gulf states and the Islamic world form part of a wider strategy to balance Chinese influence in Southeast Asia.[70]

A 2015 study of GCC-ASEAN ties noted a lack of:

…universities or think tanks in the Gulf dedicated to studying and formulating policy with regard to ASEAN or…the states of the wider Asia-Pacific region…Arguably, this characterizes nearly all forms of GCC inter-regional diplomacy, but its interaction with the West, for instance, is alleviated somewhat by the considerable cultural and political familiarity the Gulf's elite posses with regard to the United States and Europe. None of this exists in relation to ASEAN, leading to superficial analysis, miscommunication, and an inability to construct operative strategies that serve GCC interests. There is thus a pressing need to professionalize and transform traditional Gulf approaches, and a key component toward achieving this is by building a knowledge producing infrastructure.[71]

British diplomatic expertise and relevant educational resources could provide an opportunity for trilateral interaction to assist in this situation. Nevertheless, given "Malaysia's common Islamic heritage with much of the Middle East and its proximity to the world's fastest-growing export economies in Southeast and East Asia, including China, Indonesia, and Vietnam, the country is well-positioned to become a key broker for flows of Islamic capital between these two regions."[72]

Conclusion

This report has explored the contemporary origins of Islamic finance, its development in Britain, the potential challenges Britain faces from continental European financial centres, and the scope for further developing relations between key international centres of Islamic finance. It has shown that there have been two principal drivers for its implementation – top-down state instigated policies designed to socio-economically enfranchise Muslim populations; and Gulf petrodollar surpluses. A third driver includes the role of 'grass roots' upwards public demand for the introduction or development of Islamic finance. It is also arguable that the three drivers have been variously interactive.

67 Giorgio Cafiero and Theodore Karasik "Bahrain-Malaysia Relations Set To Reach New Heights", 23 May 2017, *Middle East Asia Project*, Middle East Institute, Washington D.C.

68 Daromir Rudnyckyj "From Wall Street to 'Halal Street': Malaysia and the Globalization of Islamic Finance", op.cit., p.844.

69 Asmady Idris "Malaysia-Saudi Arabia Relations: Roots, Dimensions, and Prospects", op.cit.

70 Foley, Sean "Re-Orientalizing the Gulf: The GCC and Southeast Asia", *Middle East Policy*, 2012, Vol.19, No.4, Middle East Policy Council, Washington D.C., www.mepc.org

71 Mohammed Al Sudairi "GCC and ASEAN: Charting Out the Horizon", 9 October 2015, *GRC Analysis*, Gulf Research Centre, Jeddah, Cambridge, Geneva.

72 Daromir Rudnyckyj "From Wall Street to 'Halal Street': Malaysia and the Globalization of Islamic Finance", op.cit., p.845.

With the development of Islamic finance in Britain, the relevant state and regulatory bodies have acted more to facilitate the expansion of the sector rather than to direct it. In the European context, Islamic finance's rate of expansion has often been a reflection of the extent of the sector's development in Muslims' countries of origin. Thus, in the UK with many Muslims' countries of origin being in South Asia, and especially Pakistan which has a significant Islamic finance sector, there has been a consequent impact on Muslim inclinations towards this sector. Conversely in Germany, Muslims of Turkish origin have historically been more inclined to utilise conventional banking. However, expansion of Islamic finance in Turkey and a more accommodating regulatory and legal framework in Germany may change this situation.

Whilst states and key centres of international finance such as London have played important roles in the development of Islamic finance, many of the early developments in the UK sector took place outside the capital in places such as Bolton and Birmingham. This is not to downplay London's role but it does further reflect the interchangeable top-down and grass-roots upwards dynamics in the development of Islamic finance. This may also impact on the sector's future in terms of innovation and potential capitalisation. Although Yielders, the first UK Islamic financial technology company to receive regulatory approval, was a London-based firm launched in April 2017, innovation in the UK sector has not been restricted to London. In addition, in times of sector capital shortage such as has pertained since the collapse of international oil prices, crowdfunding to generate capitalisation for Islamic finance could be a growth area.

With its origins in the "alternative finance sector" of conventional finance, the US and the UK are the two western countries with the largest conventional crowdfunding sectors. Subject to relevant sharia-compliance requirements, such projects offer significant growth potential. In 2016 a survey of experts by Thomson Reuters identified "fintech [financial technology] and crowdfunding as major growth areas for the Islamic finance sector." Using financial technologies including mobile phone banking, crowdfunding platforms have been launched in the UAE and Qatar, but are still in their early stages of development. The issue of sharia-compliance in these new areas has been noted by the IFSB and it recommended regulatory bodies keep pace with such innovations:

It is important for regulatory authorities (in particular capital market regulators) to develop a sufficient capacity to fully understand the technical details and the legal and financial implications not only of crowdfunding but of a continuously widening range of increasingly complex FinTech operations. As regulations for platform (or other FinTech firms) that hold themselves out to be Islamic usually require an involvement of a Shari'ah expert, the need of capacity building regarding FinTech technicalities also applies to Shari'ah advisors and scholars.[73]

The importance of stimulating and facilitating further financial sector innovation has not been lost on the UK government and regulatory authorities, in part at least as a means to support the continuing global significance of the City of London. To this end, the UK's Financial Conduct Authority was the first to create:

73 "Islamic Financial Services Industry Stability Report 2017", May 2017, Islamic Financial Service Board, Kuala Lumpur, p.119, 120, 121 ; Katarzyna W. Sidlo "Islamic finance 2017: State of the art and outlook for the future", op.cit., p.17. Sidlo quotes from Thomson Reuters & Dinar Standard "State of the Global Islamic Economy Report 2016/17".

…'a regulatory sandbox that is a 'safe space' in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity in question.' The aim of the sandbox is the promotion of genuine innovation with a good prospect of identifiable consumer benefit. After the UK, Malaysia was the first Muslim-majority country where a regulatory sandbox was launched in October 2016, followed by Abu Dhabi in November and Indonesia in December 2016.[74]

Thus, not only is the UK a leader in financial sector innovation but its relations with other centres of Islamic finance have encouraged emulation. Britain has also gone further in facilitating financial sector innovation by providing the requisite 'space' to experiment - allowing ideas to succeed or fail whilst lessening the associated risk.

In regard to Brexit, Britain does face challenges to its conventional and Islamic financial sectors from continental European challengers, although two such rivals – Germany and France – are not yet well placed to accommodate domestic Islamic finance via their legal and regulatory frameworks. However, the 2017 granting of IFSB Associate Member status to Germany's financial regulator shows possible intent to address this issue. In the short-term, because of the history of involvement, combined with frameworks and policies already in place, Luxembourg probably rates as the most significant challenger to the UK in terms of Islamic finance. In the case of France, whilst potential exists for the Islamic finance sector via its mostly North African Muslim population, the most noteworthy recent development has been its pursuit of enhanced conventional financial sector status via the award of the European Banking Authority headquarters from London. Not only does this represent a boost for the French conventional finance sector, and Paris in particular, it also shows an early intent to challenge not just Britain and the City of London, but also Germany.

Thus, the Brexit process and its aftermath may herald an era of more general intra-EU contestation either between individual centres or countries, or between groups of countries – all of which will make Brussels-centred policymaking more difficult to accomplish. For non-European states wishing to develop and expand relations in Europe as a whole, an influential factor regarding whom they chose to do business with could well include the ease of diplomatic and economic access and engagement. In Britain's case, a long history of diplomatic expertise, strong relations with key countries involved in Islamic finance, a globally connected conventional financial sector, world class educational and professional services, a cross-party commitment to support the sector over the last two decades, and a domestic environment conducive to openness and innovation should ensure that, given continued national political support, Britain maintains a leading role in the future of Islamic finance.

74 "Islamic Financial Services Industry Stability Report 2017", op.cit., p.125.

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