

CSFI

CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

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The Global Market for Islamic Finance: A round-table discussion with James Sproule (Accenture), Maghsoud Einollahi (Deloitte), Tarek el-Diwany (Zest Advisory), Humayon Dar (BMB Islamic), and Michael Ainley (FSA) held on Tuesday, April 22, 2008, at Watermen's Hall, 18 St-Mary-at-Hill, London, EC3R 8EF, from 12:30 – 2:15pm.

Islamic finance is a fast-growing industry within the Muslim world and in financial centres such as London. Five such banks operate in the City. But while forecasts point to continued growth, issues such as a failure to agree key definitions threaten to hamper the growth in the retail market and risk pitching City regulators into religious rows.

The first speaker laid out the upbeat picture. He said demand for savings products tended to kick in when GDP per capital hit \$7,000. Currently the market is dominated by what he called "Energy Islam" – states such as Saudi Arabia. However from 2012 he said emerging economies such as Turkey, Indonesia and Morocco had potential as mass markets. In the meantime, European Muslims, whose GDP/head is not much lower than the European average, were lucrative markets. Even assuming a cap of 25% of portfolios going to Islamic products, this would see the market grow from \$8-10bn now to \$36bn by 2020.

The second speaker said it was vital to focus on the challenges. Primary among these was excessive stress on the technical description of the product rather than any attempt to work out what the market wanted. The challenge is to create an infrastructure in the City that can declare something *Shariah* compliant today, tomorrow and for the life of the product. The danger is that a product could be declared compliant one day and non-compliant another. It hasn't happened but the risk creates uncertainty. As with Macs and PCs, users are not interested in who approved it, just that it will work. Islamic finance in the UK is a long way from that.

The current system is a mess and Islamic banks need to put their house in order. *Shariah* boards can declare a product *halal* or *Shariah* compliant but not whether it fits with the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in Bahrain or the Islamic Financial Services Board (IFSB) in Malaysia. The prize would be a sovereign bond issued in London that would boost the reputation of all parties.

For the third speaker most current Islamic finance was a sham. Banks had got round the clear prohibition on debt interest via semantics and legalism. The semantic device was to replace interest with a penalty for late payment applying after one day. The legalism was to allow interest-free loans with a gift payable at the end. Islamic finance is not creating an alternative – consumers are still in debt and banks are not taking risks. One member asked whose rule he should live by, while another said the speaker's definition made all current

products non-compliant. The speaker said some products might be compliant – the problem was banks shopping for the “right” opinion from scholars. The second speaker and others strongly disagreed. One person asked what the FSA was meant to do in the situation.

The fourth speaker said it was a minority of scholars who were not happy with the direction of Islamic finance. He wanted to stress the importance of *Shariah* advisory boards as contributing to the confusion. There were now 27 of these private bodies that would benefit from public oversight – although the authorities have held back from that. That was a mistake: regulators must come up with a code and deem *Shariah* advice as a regulated activity. The next question was to decide who were acceptable *Shariah* scholars.

The fifth speaker asked how the FSA was meant to distinguish between them. He said the regulator had to assess people as “fit and proper” according to their knowledge of finance and could not be expected to make a religious judgement as it did not have the expertise. It had to ensure that Islamic law did not manage the bank. Most importantly the FSA, which regulates 300 banks from 50 countries, could not be seen to create a separate regime for one class. At the end of the day it used a principles-based system with five key thresholds and a healthy dose of flexibility.

One member involved with a newly compliant City bank, said it was clear from outset there were two schools of thoughts however he found negotiating *Shariah* similar to fitting with other criteria for the wholesale market. The problem for the retail market was who was going to declare ex-ante that the product was, and would be compliant. Another member asked whether it was possible to have grades of Islamic finance, such as an Islamic-based and Islamic-compliant as existed with ethical finance.

What is the future? The third speaker maintained his hard-line stance that if Islamic finance offered the same products as interest-bearing banks it would suffer the same fate. It was a shame to throw away the chance of building an alternative in a “debt-submerged” world. The second speaker said the market would adapt and produce standards with the UK taking a major role in the market. The fourth speaker said retail banking would remain a problem area but that insurance and investment banking were the way forward. The first speaker said ethical funds were a good model for Islamic finance now that pricing was falling close to market levels.

While the discussion was not what many had expected, it was thought-provoking. The CSFI hopes to hold a programme of events on Islamic finance to get into these areas in more detail.