

UK

London: Still a viable market

In Vol 6 Issue 34, *Islamic Finance news* reported on the state of Islamic banks in the UK quoting a senior practitioner, who spoke on condition of anonymity. He said the four investment banks, which focus mainly on asset management, should re-evaluate their core business model and also consider the tax advantages of operating offshore instead of in London as it is not a big market for Islamic financial services. He was also unconvinced of the UK Islamic banking and finance's prospects largely due to the UK not being a predominantly Muslim nation.

Islamic Finance news obtained the views of Islamic Finance Council executive board member Omar Shaikh on the matter. He said London does not seem to be a conducive environment for Islamic finance at the moment only due to the global economic crisis and because it has not had the time to develop.

"But is it so restrictive that we can never see it developing or the structure would not permit the growth? That, I think, would be going too far," he argued.

On regulatory support for Islamic finance, Omar said the reality is that there are a few things missing that hamper the Islamic banks, but these are issues not just peculiar to the UK but also globally. However, he added, the UK's regulatory environment is principles-based, which enables it to be adaptable and flexible.

"As a secular regulator, I think there are issues, particularly in the Shariah compliant arena, but do these prevent the existence of Islamic banks? We already know the answer because there are five of them in the UK. Do they prevent the banks from expanding and growing?"

"It does hamper managing the balance sheet, definitely. But it is not the 'be all and end all' of the problems; there are other issues and challenges but it does not mean that you cannot continue financing, and we know this because Bank of London and the Middle East (BLME) has done this. Its balance sheet is close to GBP1 billion (US\$1.6 billion) now and we have seen other banks starting on that journey," he said.

Omar continued that one of the strengths that the UK has or could leverage on is the fact that it is a global financial capital benefiting from the depth and vigor of its capital market.

"This is evident from the 12 Sukuk being listed on the London Stock Exchange, with none of them originating from the UK. That is the reason why there will always be an opportunity for London, and the UK by extension. And that is not the retail sector but more towards the capital market. We have strong established and matured corporations here," he said.

Traditionally, Omar explained, the UK and even Europe and the US had always benefitted and from the Middle East capital flow requiring quality mature assets which exist in those regions. Examples include real estate deals, the Aston Martin car maker and various other acquisitions, numerous deals and companies that were established.

"Naturally, anyone caught in this liquidity dilemma would want to look for mature or emerging markets for exposure. In that context, the

banks here facilitate that process further. It is basically the business plan rationale that they all had," he explained.

However, Omar said there is a perception that these banks may have been slow to capitalize on this. He said they had to focus more on the crisis in the Gulf and also building a UK wide or European wide strong lending book to provide financing for small- and medium-sized enterprises as well as businesses in a Shariah compliant manner.

"I think BLME has done that quite successfully; it has gone out there and been more proactive. It is not an easy thing to achieve but if ever, it is probably as easy as it gets because conventional banks have 'closed the taps'. Any source of liquidity, or liquidity that is perceived to be continuous, is beneficial but again, one has to look at the restricted size of the balance sheet of these banks as well," he said.

On the purported lack of business for the Islamic banks in the UK, Omar said the opposite is the case as there is a massive amount of deleveraging occurring within the banks as a result of their respective internal problems, exposure to subprime and the changing regulations.

He said because of this, good quality businesses are suffering as they are unable to obtain the credit required for working capital, growth or expansion.

"Of course, businesses during a recessionary time are going to go bust and hence the demand naturally reduces, but when the supply of credit is massively cut, then there is clearly an imbalance and a path of demand that is not being serviced.

"So you have got good quality organizations and businesses which are being forced to close down because they cannot obtain the credit which they have historically had access to. And it actually creates a window of opportunity for Islamic banks," he said.

Nevertheless, Omar felt that the Islamic banks in the UK have not done as good a job as possible to seize this opportunity over the last year as they have had to deal with their own issues due to their restricted balance sheets, besides grappling with regulatory and primarily tax issues, which have recently been overcome.

"I think their ability to obtain further funding from their parent companies or initial shareholders in the Gulf in the last nine months have been hampered because the Gulf has gone through its own crisis. These banks are recently established and had they been set up 10 to 15 years ago and then this crisis had come, they would have been in a stronger position to capitalize on this.

"Any new organization is still building its team, bolstering its balance sheet and understanding the market, among others. So even though the crisis has been good for Islamic finance as an alternative to the conventional market, Islamic finance is still too young to capture a bigger share of the pie which is on offer," he said.

By Raphael Wong