LSE-Harvard Public Lecture on Islamic Finance
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Islamic Finance in the United Kingdom: Current Initiatives And Challenges: A short Report

The Islamic Finance Project of Islamic Legal Studies Program at Harvard Law School held its third annual public lecture on Islamic finance at the London School of Economics' Hong Kong Theatre in London on Thursday, 26 February 2009. As with previous years, the event was jointly hosted with the London School of Economics and immediately followed an intensive workshop earlier that day with a select group of Islamic finance's industry elite. In front of a packed lecture hall of well over 200 people, the UK Secretary to the Treasury, Ian Pearson, announced the UK government's intentions to postpone issuing its originally planned sovereign Sukuk.

Much to the dismay of many in the industry, the UK minister ended any immediate hopes that Britain would lead the way with a historical and long awaited first sovereign Sukuk issuance. Citing reasons of unprecedented economic times in a downturn unseen for generations and a failure to meet the UK Treasury's 'value for money test', MP Pearson recanted earlier aspirations for what would have been the United Kingdom's crowning moment as the undisputed leader of the Islamic finance industry in the western world.

The public lecture, entitled 'Islamic Finance in the United Kingdom: Current Initiatives and Challenges', was chaired by LSE Director Howard Davies. Sir Davies opened the lecture by briefly discussing the UK's lead in attracting and promoting Islamic finance. He reminded the audience of the current initiatives the UK has been taking in order to enter into retail and wholesale Islamic financial products. For instance, the country's financial regulatory body, the FSA, has issued several consultation papers in last two years on the subject. He then introduced the two guest speakers, first being the UK economic minister and the second Sheikh Esam Ishaq, an eminent scholar of Islamic finance from Bahrain.

To explain the current economic situation, the UK economic minister began his speech with a simple parable. He explained that as a society, "we have all gone through a period of too much money with very little fear to a period of too little money with arguably too much fear". He further added that this current economic crisis was all about "a global loss of confidence, affecting all institutions". Yet, he did acknowledge that Islamic banks had seen less of an impact due to their limited involvement in many of the controversial products that currently plague conventional players.

Islamic finance he explained was important to the UK because the government felt it was essential to have a diverse, fully functional capital markets system in London and that there was already a strong community of British Muslims with their global connections who all want to contribute to the UK's success. London he argued was a very diverse city with a strong international outlook and that feed into its success.

The minister went on to explain the UK's history and developments in Islamic finance. In 2004, the UK was the first EU country to authorise standalone Islamic banks and Islamic insurance companies. There are now five Islamic banks in the UK and one Islamic insurance provider. Over twenty conventional banks offer Islamic financial services as part of their product range. Eighteen Sukuk have been listed here in the UK, with an estimated total of US$18 billion between them. Last year, the first sovereign Sukuk, issued by the Kingdom of Bahrain, was listed on the London Stock Exchange. This means there are now more financial institutions offering Islamic financial services in the UK than all of Europe put together. Also, the UK has recently entered into a memorandum of understanding with Malaysia to establish financial links in Islamic finance. The minister emphasised that the UK government wants to continue this growth and the 'collaborative approach' with Islamic finance.

In terms of legislation and rules dealing with Islamic finance, since 2000, the UK Treasury and the Financial Services Authority (the "FSA") have been "active in trying to create the right conditions in the UK for Islamic finance to grow". They have made a series of tax and legislative reforms "to put Islamic finance on an equal footing to enable it to compete fairly with the rest of financial products". The effect of such measures he argued has led to Shari'a compliant mortgages and individual Islamic savings accounts being offered today. He cited there were more than 40,000 customers today in the UK and that the Islamic UK mortgage business is worth more than GBP 500 million (US$745 million). He said these statistics were considered by the government as positive signs, though he recognized that a lot more still needs to be done.

There is a working group of about 20 leading figures in the industry that advise the UK government and the UK Treasury on Islamic finance, which is chaired by Ian Pearson himself and which was originally set up by his predecessor, Ed Balls.

He also reminded the audience that a consultation paper was published jointly by the UK Treasury with the UK Trade and Industry at the end of 2008 detailing the UK's approach to Islamic finance and highlighting opportunities for the industry, the sector and for the government. One of the issues raised in this document, was a clarification of the possible issuance of a sovereign wholesale Sukuk by the UK government. In April 2007, a similar paper announced the feasibility of such a move.

A 'detailed study' of the possibility of a UK sovereign Sukuk was recently carried out by the UK Treasury and the UK's Debt Management Office. The focus of this study he said was "to ensure the issuance of such a Sukuk represented good value for money for the UK tax payer". These agencies apparently also consulted a number of bodies and industry advisers on the proposals. Having taken on all the responses, as well as the current economic situation and the potential costs and risks, the UK Treasury's view was that such a launch would not meet the government's own 'value for money test'.

Though this news did come as a blow to many who had hoped this would lead to a growing sovereign Sukuk market in the traditional Western financial markets, the minister did provide a glimmer of hope, in that 'the door was left open for future review of such a policy and such a launch'. He advised that he hoped to revisit this decision when "the economic situation would allow", though he did not clarify what he meant by that. He promised to continue to keep the issue under review and he stated he may reconsider issuing a Sukuk in the future "when considered appropriate" and that would "certainly be his ambition to do [so]". To soften the blow of his message, he quickly went on to say that there was still a lot that could be done in the interim.

He then shifted to the issue of standardisation and how the UK government viewed this issue with respects to Islamic finance. He referred to the current debate in the industry of the desire for many to have standardised rules and regulations governing Islamic products. Weighing into the debate, he took the position that the lack of standardisation in Islamic finance, in his view, was a key barrier to the industry's growth and development, similar to that of any other industry. He viewed the lack of standardisation caused increased costs, increased barriers to entry into the market, increased the time of such products into the market and reduced competitiveness in comparison to comparable products. He acknowledged that different jurisdictions took different approaches to the problems faced with the lack of standardisation.

He cited the example of Malaysia where he said it witnessed a rapid expansion of its domestic Islamic financial market and has therefore established a nationally appointed single Shari'a board that interprets and enforces Shari'a compliance. However, the UK minister quickly proclaimed that the UK government does not view this mechanism as the most appropriate method for the UK. As the UK financial authorities are all secular, there is a concern that such an approach to standardisation would "stifle innovation". It would prefer to look to industry itself to address the issue of standardisation, which he felt was "bound to happen naturally to some extent as the sector evolves and grows". Though, he did state that the UK government is still open to suggestions and different views on this issue.

To wrap up his speech, Ian Person reminded the audience that though it was tough times right now, this was "not a time to turn its back on innovative and growing sectors such as Islamic finance". He emphasised that the UK government will continue to play an active part in its development of Islamic financial services and to ensure that there will continue to be a level playing field for Islamic finance to grow. He felt there were still quite a few issues for the UK government to explore in Islamic finance.

In the Q&A session after Sheikh Esam Ishaq's talk, one question posed to the minister was whether there were any plans by the government, due to the current economic crisis, to return to the gold standard. But he confirmed that was no appetite on the current government to return to such a standard, but rather the emphasis will be more on cooperation and how to improve regulatory regimes in the areas of financial control. One other question was asked if the G20 summit would discuss Islamic finance as a viable alternative. He responded by saying this issue may be raised in the overall discussion, but not as a specific issue on the G20 agenda. The emphasis of the summit will rather be on "global coordination and cooperation on economic affairs". The minister pointed out that the great achievement of putting together this meeting was that the balance of economic power has now shifted from the G8 to include new members, now being the G20.

Sheikh Essam Ishaq then presented his speech by taking a more general approach to the topic of Islamic finance and how Islam law plays in current finance.

He began his talk by defining the basics of Shari'a, the sources of Shari'a law and their relation to finance and its remit. Shari'a, he defines, means a pot of water. This pot of water represents the full system of values and beliefs Muslims are expected to abide by. The sources of Shari'a include the Qur'an, the application of the Hadith (sayings, rulings and actions of the Prophet pbh), consensus of the community of scholars (Ijma'), and analogy of the Scholars

(Qiyas). The Shari'a he says is about morals and ethics.

In terms of finance, he stated that there are a number of general principles in Islam on finance, such as: 1) the prohibition against hoarding of wealth; 2) the prohibition of transactions leading to exploitation (i.e., where one party can only earn where the other party will lose, such as in speculation and gambling which is strictly forbidden; 3) the prohibition of interest and usury. Today, usury is defined separately as an excessive form of interest, but in the early centuries there was no distinction made between the two terms, usury and interest. Islam he says still takes this latter view. Interest, he points out, leads to the hoarding of wealth and no transfer of wealth from the 'haves' to the 'have-nots'. Interest is therefore forbidden on the basis of injustice.

Historically, the dissemination of wealth in Islam was initially by the transfer of wealth through the institution of Zakat. Also, the promotion of wealth dissemination is via its specific inheritance laws, as detailed in the Shari'a rules. These both lead to, he argues, "a fairer dissemination of wealth rather than a concentration of wealth".

Sheikh Esam then briefly discussed the historical views on finance. He reminded the audience that trade and finance in pre-Islamic Arabia was very advanced. Pre-Islamic Arabia had many of the same basic interest bearing tools found today. But when Islam came, it forbad certain transactions, such as short selling. The logic being that one could not sell what one did not own. Also, in Islamic law, one could not hinge a contract onto another contract. In other words, one financial contract could not be contingent on another contract taking effect, as this will lead to certain speculative and uncertainty prohibitions. These rules therefore affect how the Shari'a views specific forms of risk management, including basic types of risk management tools, such as assignment, collateral (rahn), etc.

Despite his emphasis on the various prohibitions regulating Islamic finance products and transactions, the Sheikh was quick to point out that, unless something is explicitly disallowed by the one of the four sources of Shari'a, then it is allowed and permitted to do in finance.

Finally, in the Q&A section, one participant asked the Sheikh about the permissibility of the use of foreign exchange in Islamic finance. Sheikh Esam reminded the audience that foreign exchange and money itself should not be looked as commodities in themselves. Therefore, the rules on commodities are much more restricted. Another participant asked about the permissibility of the use of stocks and the stock exchange in Islamic law. Sheikh Esam pointed out that there are two main views on this issue. He said that the Islamic Fiqh Academy does not allow investing in a stock if that stock contains any levels of debt. Whereas AAOIFI and a large portion of the Islamic finance industry have taken the view that stocks are permitted as long as they are within certain restricted ratio levels of total debt to the level of total assets.

Another question was also raised about Sheikh Taqi Usmani's own concerns on specific types of Sukuk. Sheikh Esam answered by pointing out that the Financial Times had interviewed Sheikh Taqi Usmani in June of 2008, whereby he clarified his views on this particular issue. Specifically, he had some concerns with reference to Mudarabah sukuk in which there was a requirement to give an undertaking by the issuer to redeem the Sukuk at the nominal price or at a given price. In other words, this undertaking took on a form similar to that of a guaranteed return, which is prohibited in Shari'a and therefore makes this particular type of Sukuk non-tradable.