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Islamic Finance – Taking Root

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Islamic Finance – Taking Root

With Shariah Compliant Islamic Finance's Growing Influence, How and Why is the UK Government Seeking to Harness its Positive Impact to Secure the City of London's Position as a Leading Global Centre of Financial Excellence and Innovation? In this article, the author purposefully removes himself from the crisis of identity currently being experienced across the Islamic world and seeks to simply offer an analysis by (a) explaining what Islamic Finance is; (b) evidence its impact upon the UK economy; (c) assess its implications upon the City of London; (d) explore how the UK Government is seeking to position the UK as the Western World's leading centre for Islamic Finance; and (e) explain what new business opportunities exist for the London insurance market.

In Analysis ...

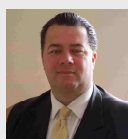
Adding Value by Cash Flow Hedging with Options Instead of Forwards

Using options may not be the traditional way that accountants and treasurers have thought about hedging forex cash flows and there are some operational and accounting complexities that need to be managed, but the potential benefits from enabling a firm to benefit from the upside on their forecast exposures while being protected from the downside are considerable and can lead your hedging/risk management unit to provide real value to your overall organization.

Analysis

Islamic Finance – Taking Root

Paul C Rowland



Paul C Rowland
Senior Partner
Invictus Risk Solutions

Biography

Paul C Rowland is a highly driven Broker and Client Advocate who holds a BA (Hons) degree in History and Law from Lancaster University. Paul is an accredited Lloyds of London broker and holds the ISO 9001 certification for excellent corporate compliance and governance. In addition, he has been awarded an MCIM from the Chartered Institute of Marketing after independent assessment of a decade of his work at an operational and senior management level.

After 20 years broking and underwriting on behalf of some of the industry's leading practitioners, Paul has created his own company, Invictus Risk Solutions LLP, with the goal of offering a single point of contact and a high level of bespoke, dynamic and intelligent service to clients across a range of areas of insurance and risk management expertise.

Offering a truly personal and pro-active service driven by his UK and International client's needs, Paul applies his in-depth knowledge of insurance products and underwriting markets to expand upon all existing and new relationships to create close ties between colleagues, customers and providers through a diverse range of transactions to manage their Commercial, Financial, Liability, Trade Credit, Political Risk, Surety and receivables management programmes.

*Paul is a regular contributor to **CREDIT CONTROL JOURNAL** and **ASSET & RISK REVIEW**, and has published articles in Business Money, Insurance Times and Post Weekly.*

*Contact Paul on (m): + 44 (0) 77666 86565 | (DDI): + 44 (0) 1473 836 930
(skype): pcrowland2012 or email at paul.rowland@invictusrisksolutions.co.uk*

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Abstract

With Shariah Compliant Islamic Finance's Growing Influence, How and Why is the UK Government Seeking to Harness its Positive Impact to Secure the City of London's Position as a Leading Global Centre of Financial Excellence and Innovation? In this bulletin, the author offers a personal reflection of his education at Highgate School and experience of Istanbul. The author purposefully removes himself from the crisis of identity currently being experienced across the Islamic world and seeks to simply offer an analysis by (a) explaining what Islamic Finance is (b) evidence its impact upon the UK economy (c) assess its implications upon the City of London (d) explore how the UK Government is seeking to position the UK as the Western World's leading centre for Islamic Finance and (e) explain what new business opportunities exist for the London insurance market.

Highgate School

The UK has always maintained very strong cultural and socio-economic links with the oil rich Gulf States of Bahrain, Qatar, Kuwait, Saudi Arabia and the UAE. The tabloid press makes much of the scions of the wealthiest Gulf families whose Sons

belong to the young “it” crowd of petrol heads who race their customized supercars up and down Knightsbridge, Park Lane and the Kings Road to the delight of the visiting shoppers and tourists, the chagrin of the local residents and horror of the liveried doormen of Harrods and The Ritz.

The real influence of the Gulf families is through the strengthening commercial relationships and new avenues of finance and opportunity that their access to Islamic Finance is creating. Such is the influence that Islamic Finance is beginning to play a very positive part in securing certainty in an otherwise volatile banking environment. Evidence of this influence and partnership is abundant as highlighted by London Excel hosting the World Islamic Economic Forum (WIEF) at the end of October 2013 during which the British Prime Minister, David Cameron, emphatically stated: “I want London to stand alongside Dubai as one of the great capitals of Islamic Finance in the World.”

Looking back through rose tinted glasses at the 11 years that I spent at Highgate School between 1978 – 1989, I was blessed to be taught by some very enlightened educators such as Mrs. Bickley, Mr. Szydlo, Mr. Coombs and Reverend “Rocker” Stone. More importantly, the School’s catchment area spread with ever increasing success from the leafy lanes of Highgate through the North London boroughs of Hampstead, Finchley, Golders Green, Totteridge and Whetstone. As the recruiting tendrils sprang back to School, they deposited the Sons of first and second generation Greek Orthodox, European Jew, Italian Catholic, Indian Hindu, Pakistani and Persian Muslim into Highgate School’s hallowed classrooms and corridors thus creating a social melting pot of cultures and religions at that time unprecedented in the English School system and remains without compare even now.

Some of my fellow pupils were called Akis, Nigel, Tony, Amir, Edward, Elliott, Mustapha and Zackariya! Not bad for a Church of England School founded in 1645 by Sir Roger with buildings named “Ingleholme,” “Cholmeley” and (somewhat unexcitingly) “Big School.”

Despite the School’s acceptance and tolerance of creeds and cultures, our history syllabus contained the myopic exhortations of the Victorian and Edwardian age vis-a-vis the good Christian and dastardly Musselman. Our well thumbed history books taught us that the Crusades were Papal sanctioned military campaigns through the Middle Ages creating an intermittent 200 year struggle between 1095 and 1291 for control of the Holy Land through seven major expeditions and numerous minor ones.

It was argued within the text that the Crusades were part of a defensive war against the aggressive expansion of Islam from the near east to defend the frontiers of Christian Europe; I always viewed them more sceptically as an opportunity born out of a confident and aggressive Papacy seeking to expand Christendom through its European and Byzantine territories against the Seljuk Turks and Arab Caliphs.

Our history books highlighted the positive impact of the Crusades as being profound; independent states were successfully established such as the Kingdom of Jerusalem; the Mediterranean became a highway of trade and travel; the wealth

of sea faring Italian states such as Genoa and Venice were enriched to such a degree that their patronage paved the way for a period of artistic and cultural enlightenment that burnt so fiercely it became known as the Renaissance. There is no doubt that the Crusades consolidated the authority and identity of the Papacy. However, it also led (perversely given the barbaric waste of lives and dispersal of wealth) to a surge in the appreciation of chivalry, heroism and piety that became the catalyst of Medieval art, philosophy and romantic literature.

The reality, as evidenced by modern historical and scientific research, is that not many among the Crusaders pursued the noble ideal of an armed pilgrimage leading to Apotheosis at Jerusalem. More often than not, the Christian combatants pillaged their way through the countries which they travelled, stole and retained property and territories while participating in the pre-meditated and indiscriminate massacre of Christian, Jewish and Muslim civilians.

There was no unified central command as the Aristocratic leaders were singularly motivated by personal glory, fame and wealth. Operating within their feudal system, this capricious social structure accelerated intense disloyalty with intra-faith and national factions jostling for political advantage and influence within the Crusaders' ever shifting alliances.

Such was the discord between the Christians that during the Fourth Crusade the Christian Byzantine Imperial capital of Constantinople was captured and sacked by the Western Roman Catholics in 1204. This event made impossible the hoped for reconciliation of the East – West Christian schism; this in turn critically weakened and undermined the Byzantine Empire across the subsequent generations that it eventually fell to the Islamic Ottomans in 1453.

Istanbul

Skip forward more than half a Millennia to the Autumn of 1998 and I am sitting on the glorious balcony of the Istanbul (Constantinople) Hilton Hotel overlooking the busy and shimmering Bosphorous, sipping a fine 25 year old Islay single malt Lagavulin Whisky while enjoying an aromatic and complex Romeo & Julietta Robusto. My travelling companion, and soon to be Wife, Sophia and I were visiting Istanbul together for the first time on holiday and to catch up with her Family's long standing Friends and business partners.

I had thought that no Girl who had lived in Istanbul could possibly have the slightest claim to respectability but I soon discovered that I had gone into bat for the right Girl and happily eschewed the opportunity of looking elsewhere. I chose wisely because 17 years later she does not even embezzle my money which is about the only fun that some Suffolk Ladies (whose private income are their husbands) can get out of life these days.

During our stay we experienced an Istanbul full of energy not seen since the days of Süleyman the Magnificent when it was first described as the "City of the World's Desire"; it is no surprise that in April 2014 TripAdvisor's poll of tourists from around the world confirmed Istanbul's status as the Number 1 top world destination because of its vibrant culture, historical sites, hotels and food.

We learnt of its delights ourselves as we took a guided tour of Istanbul with our family friends Hakan and Uğur which began with a walk through the historical neighbourhood of Sultanahmet to view some of the City's finest architectural legacies and landmarks while gorging on the sublime peaches sold to us from street side market stalls run by the wild looking women from the surrounding Anatolian hills.

We next turned our attention to one of the finest examples of classical Ottoman architecture, the eponymous Blue Mosque with its wonderful six minarets and thousands upon thousands of hand coloured Iznik tiles that create a cascade of sparking azure blue across the interior.

Next was a stroll into the Hagia Sophia Mosque with its UNESCO-listed museum showcasing Byzantine and Ottoman artifacts and then on to the Topkapi Palace that houses a collection of art and treasure that once belonged to the city's 15th Century Sultans and their lavishly appointed Harems.

We went from the light to the darkness as we descended 40 feet underground to view the labyrinthine water channels of the ancient Basilica Cistern.

Finally, we entered the Grand Bazaar which remains one of the world's most famous covered Souks comprising 60 streets and thousands of colourful shops into which the experienced and unwary alike are lured into purchasing hand bags, jewellery, leather, pottery, silver, gold, spices and so much more.

Given the admiring and rakish looks that my Sophia was receiving, I declined the invitation from Hakan to enter a raki-soaked meyhane (tavern) and even the more tranquil çay bahçesi (tea garden) held the fear of my non survival and Sophia spending her days in some latter day Harem! Instead, I embarked upon a far more masculine adventure, the pursuit of the perfect İskender Döner Kebab at arguably the best meat restaurant in all of Istanbul, the Bursa on Incirli street in the district of Bakirkoy.

For the uninitiated, an İskender Döner Kebab is a plate of deliciously smoky shavings of chargrilled lamb meat placed upon a bed of cubed flatbread, doused with spicy tomato sauce, hot green peppers, clarified butter and cooling yoghurt on the side.

As the waiter appeared and with great drama and theatre drizzled the rich melted butter across my plate, Hakan explained that this act is so gastronomically important to the Turkish that there is a special phrase for it, püf noktası meaning "the centre of the preparation." As I tucked into my feast with caveman abandon, Uğur explained that ever since the early 1800s the residents of this great Imperial City had prepared and roasted their lamb döner from a vertical spit that not even the rise of the Turkish republic in 1923 and the change of the City's name to Istanbul could change.

While immersing myself in all things Turkish, Hakan explained to me that the majority of men in Istanbul would not dream of shaving themselves each morning

but instead visited a professional barber every other day to have a straight edge shave. Hakan went on to explain that a trip to a barber shop is considered a social event, particularly at the street of barber shops under the Galata Bridge on the Eminonu side of Istanbul where men of all social classes gather, have a shave, perhaps a haircut, smoke, drink tea and have a chat.

Fast forward to July 2015 and on a bright Summer morning I strode into the Isar barbers on Leyden Street in the City of London for my monthly Turkish barber experience. I exchanged the generic Arabic greeting with its charming owner Ismail: “As-Salamu Alaykum” from me (“peace be upon you”) to which Ismail responded joyfully: “Wa’alaykumu S-Salam (“may peace be upon you”).

As I relaxed into the comfort of the deeply cushioned chair, Ismail applied hot towels and a moisturising tonic to soften the skin, lathered my face under a mountain of constantly re-applied soaps, gave me a straight edge shave with a glisteningly sharp cut throat razor, flamed my nose and ear hair, moisturised my face, gave me a back, neck, arm and shoulder massage ending up with a haircut styled and finished first with clippers then with scissors and shears of every dimension imaginable. The experience was not rushed and was finished to perfection as I was given time to relax and wind down with a sticky sweet espresso coffee before being sprinkled with aftershave and sent on my way; a 60 minute experience I thoroughly enjoyed without breaking any of my earnestly adhered to Marriage vows!

How does Islamic finance work?

Under Shariah Law, Islamic Finance eschews the standard banking demands for the creation of a debt obligation with an entitlement to receive interest; instead, the investor has their ownership interests in an asset formally recognized which in turn allows them to draw upon any revenues generated by the value of those assets; no revenue = no return; effective and simple.

Consequently, Islamic Finance has moved effortlessly through the recent global morass of collapsed banks and shredded sovereign wealth without apparent harm or blemish. The reason being is that it operates in a financial environment where individuals and institutions may only invest in products that are not speculative and are rooted in the real economy. In doing so, Islamic Finance has evolved into a product that offers balance, equitable risk share and fairness.

The City of London and the World Islamic Economic Forum (WIEF)

The City of London has continued its role since Roman times of being at the forefront of innovation and continues to underpin the success and wealth of the country’s economy. Through its ability to attract investment, London projects an image as a secure depository for wealth in times of crisis through its advantages of a business friendly time zone, scale and the “can do” attitude of its deal makers. When coupled with a robust commercial, legal and regulatory structure, London is held in very high regard as an economic powerhouse by the wider global business community that views the UK’s business culture as providing a highly tolerant environment in which to operate.

Last year the leading Accountancy firm PwC issued its “Cities of Opportunity Index” which is a study of the 30 most influential cities; London was named as the World Capital for business, finance and culture ahead of New York, Singapore and Beijing.

Notwithstanding the above, and despite all of these unique selling points, the City of London’s position as a leading center of financial excellence and innovation continues to come under repeatedly robust assault from countries such as Germany, France, Ireland, Luxembourg and further afield to Australasia.

By drawing upon its historical relationships with the Middle East, the City of London has sought to trump its competition and, as far back as 2002, the UK has been actively relaxing its regulatory and tax frameworks to attract and accommodate the growing importance of Islamic Finance.

The launch of the UK Trade & Investment Gulf team has really highlighted and polarised the Government’s sustained efforts to attract investment from the Gulf as evidenced by the UK holding the World Economic Islamic Forum (W E I F) in October 2013.

The WEIF has been referred to in the financial press as the “Islamic World’s Davos” with its importance evidenced by the fact that the UK Trade & Investment and the Foreign & Commonwealth Office both sponsored “meet and greet” pavilions. The goal of the participation and promotion was the UK’s existing trading relationships with the Islamic world and to demonstrate our nation’s position as a high caliber partner for future investment from Islamic investors with regard to Construction, Education, Healthcare, Infrastructure and Smart City Technologies.

The UK Government launches its first Islamic Gilt

There was a clarion announcement at the World Economic Islamic Forum on 29 October 2013 by the UK’s Prime Minister, the Right Honourable David Cameron, that the UK is the first country outside of the Islamic nations to issue and launch an Islamic Gilt (a Sovereign Sukuk) to create a store of capital liquidity.

The importance of this announcement was not the £200 Million store of capital liquidity it was hoped that this first Islamic Gilt would generate when it was subsequently launched; the but the breaking down of old boundaries and prejudices that may foster a new period of co-operation across financial and religious boundaries to attract further Islamic investment. Accordingly, by enhancing the knowledge of how Islamic Finance operates, this may stimulate the loosening of the strict banking covenants that continue to constrain and hamper the UK’s resurgent economy.

Emphatically, David Cameron stated: “I want London to stand alongside Dubai as one of the great capitals of Islamic Finance in the World.”

Subsequently, the UK Government raised £200 Million on 25 June 2014 with the issuance of a five year Islamic Gilt; this first offering attracted £2 Billion of orders generating ten times the threshold the UK Government was looking to receive.

The creation of this Islamic Gilt is the very first of its kind by the national Government of a G8 country; it is very rare in modern society that a Government can be heralded as an innovative pathfinder and a lightning rod for change, the UK now sits very firmly in this category.

The *City A.M.* reported the Chancellor George Osborne as having said: “Today’s issuance of Britain’s first sovereign Sukuk delivers on the Government’s commitment to become the western hub of Islamic Finance and is part of our plan to make Britain the undisputed centre of the global financial system.”

By pursuing this path, the UK Government has sought to ensure that the City of London cements its position as a centre of Islamic Finance excellence on behalf of the wider UK economy and our international partners; the goal of this pro-active plan is to keep the UK at the forefront of the global race to corner as large a slice as possible of this strategically important arena that continues to gain real momentum.

Demand outstrips supply

There appears to be a real disparity between the actual and future value of Islamic Finance; neither is there currently a broad enough appetite, capacity, licence or understanding from the London insurance markets to facilitate or service these opportunities.

Notwithstanding the above, the UK is currently the leading non-Muslim country and Europe’s premier centre with £11.4 Billion of assets that are managed in accordance with Islamic Financial parameters. However, this figure pales into insignificance when compared to the pace and volume of global Islamic investments that is making this product one of the fastest growing financial service markets in the world; accumulating value at 20% per annum which is 50% faster than conventional Banking.

The exponential growth pattern is supported by Gatehouse Bank’s Chairman, Fahed Faisal Boodai, who estimated in 2014 that the global property industry currently holds assets of US\$1.5 Trillion where return from the funding can only be related to a fixed profit stream (not interest) based upon a tangible underlying property asset.

Gatehouse Bank completed its first Shariah compliant real estate finance deal of £11.7 Million in 2014 to fund the purchase and conversion of a Fitzrovia office block into 8 residential flats. Also, Gatehouse Bank made three significant “hires” from Banco Popular, Credit Agricole and RBS to bolster its Real Estate financing unit that controls an estimated £500 Million deal pipeline.

Further evidence that activity in this sector has continued to rise in its importance to the UK economy is demonstrated by the influential value of funding that Islamic Finance has brought to the table through Sheikh Hamad Bin Khalifa Al Thani who controls the Emirate/Qatari Sovereign Wealth Fund; this has a conservative availability of £50 Billion of assets and capital liquidity that funded the £1.5 Billion purchase Harrods in 2010 plus significant cornerstone investments into Chelsea Barracks, One Hyde Park, the Olympic Village and one of the most recent

charismatic additions to the City of London's sky line, the Shard. At the same time, there is the Malaysian backed redevelopment of the iconic Battersea Power Station.

In addition, the London Stock Exchange's announcement that it is engaged in a feasibility study to erect an Islamic Market Index is further evidence of the importance of tapping into this strata of business. The sole aim of this new index is to act as a trading portal through which access will be given to overseas Islamic compliant companies to invest inward into new and existing UK domiciled opportunities.

Despite the overwhelming positivity of the above mentioned facts, only 10% of the 250 Foreign Banks that operate in London currently offer specific Islamic Financial services. Only a handful of professional London luminaries, Solicitor Norton Rose Fulbright, Banks such as Citi, Goldman Sachs, HSBC, Morgan Stanley, Standard Chartered and global information service platform Thomson Reuters have invested heavily in setting up specialist teams to assess and consult upon all aspects of Shariah Law through a framework of compliant procedures and protocols.

Within the UK there are only 30 higher education and professional institutions that offer specific Islamic Finance courses. The collective importance and future impact of these courses is far greater than their quantum may suggest. The reason being is that these courses will generate a new generation of entrepreneurial, forward thinking accountants, bankers, brand marketers, lawyers and property developers who will be able to structure deals that are compliant with Shariah Law requirements.

These same people will culturally and spiritually be able to engage with corporate brands who in turn are seeking market access and penetration to project their goods, products and services into an increasingly wealthy global Muslim consumer audience.

Farmida Bi, European head of Islamic finance at Norton Rose Fulbright, said: "Islamic finance is embedded in all areas of our practice. We see Islamic finance forming a larger share of the overall financial market in the coming years, with a particular dominance in the Muslim-majority countries."

What does the future hold?

Despite the huge pool of Islamic Finance in existence and the continued progress being made, there still remains a need for a central Bank with genuine global aspirations and reach that can offer Shariah compliant instruments to manage and support the liquidity available from Islamic financiers.

The Islamic insurance market (Takaful) is currently tiny but is expected to grow very significantly. Early signs of its development are already being seen in the UK with the establishment of Cobalt.

Given the stark mismatch of supply far outstripping demand, the solution may be held by the MOU counter signed in May 2013 by the Qatari Government and the Islamic Development Bank.

The proposal that has been tabled could stimulate the creation of a fully capitalized Shariah compliant Islamic Bank that could operate from the platform of an accepted and internationalized institution. As the coming surge in the uptake of Islamic Finance takes place, there will be a co-existent escalation in the demand for insurance and risk management to securitise the underlying proposition.

The London insurance market prides itself on being able to create and deliver innovative products to help drive the profitability and growth of financial services firms; the competitiveness of the financial services sector is such that every firm goes out of its way to differentiate themselves against their competitors and a fast evolving example of this is Islamic finance.

As no two sets of circumstances are the same, the insurance products are deliberately flexible and tailored in their application so that the end result is bespoke to the client's requirements. Accordingly, products such as investor protection and compensation solutions can make the financial services company more attractive to its existing and prospective clients.

With vast swathes of Shariah compliant capital and liquidity to be injected into investment programmes for housing, infrastructure and trade to stimulate and sustain growth across the business world, there is a great opportunity to source and engage underwriters able to offer their programmes through a Sharia compliant mechanism. If this opportunity can be harnessed, it may not be long before the London insurance market will be able to present to the business community a suite of solutions with regard to Property, Construction, Casualty, Marine Cargo, Trade Credit, Surety and Professional Risks (including Financial Institutions).