

UK Financial Services Authority Publishes a Paper on Islamic Finance in the UK

The Financial Services Authority (FSA) published a paper (the “Paper”) on 27 November setting out its role in the development of the UK as the major European financial centre for Islamic financial products and services.

Worldwide, Islamic finance has grown in recent years by a conservative estimate of 10–15% per annum and is worth about £250 billion globally.

The Paper outlines the social and economic reasons, and sets out how regulation has been an important factor, for the growth of Islamic financial products and services in the UK. It also identifies some of the challenges and opportunities specific to Islamic finance.

The FSA has encouraged the growth of Islamic finance by providing an open and flexible regulatory environment, which accommodates both Islamic and non-Islamic financial institutions. It was the first European regulator to authorise a wholly Islamic bank. Other Islamic financial institutions have since been authorised.

The FSA summarises the regulated activities that Islamic institutions may conduct in the UK and the authorisation process clarifying that the threshold conditions for authorisation are the same as for any other applicant, and that capital requirements for an Islamic bank are applied on the same basis as for a conventional bank.

The FSA identifies three main areas of potential difficulties that are common to Islamic applications for authorisation: 1) the regulatory definition of products; 2) the role of Sharia scholars; and 3) financial promotions. These difficulties include making sure that Islamic institutions apply for the correct permissions, defining the role of Sharia scholars and whether the role is executive or non-executive, identifying conflicts of interest where scholars sit on a number of Sharia supervisory boards, and ensuring that advertising for Islamic retail products is clear, fair and not misleading.

It should be noted that as a secular authority the FSA does not regulate or otherwise determine the compliance of Islamic financial products with Sharia principles.

The Paper notes that several hedge fund managers operate Sharia-compliant funds and that one stand-alone Islamic hedge fund manager has been authorised. As with any other fund, the regulatory focus on Islamic fund managers would be on systems and controls, valuations, disclosure, and conflicts of interest.

The Paper is not a formal consultation paper, but is designed to highlight important questions and contribute to the debate in this area.

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