

BREXIT AND ISLAMIC FINANCE

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Brexit/Islamic Finance Alert

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The future exit of the United Kingdom from the European Union is to be one of the most profound political, economic and legal events in the country's recent history. For those who seek to engage with Islamic Finance and attract Islamic compliant investment to the UK, there are opportunities in the upheaval.

WHAT'S CHANGED AND WHAT HASN'T

Some parameters have changed in the immediate aftermath of the vote to leave:

- The fall in the pound / US dollar exchange rate making the UK more attractive for those in US dollar pegged economies
- Potential UK tax cuts and incentives to draw investment
- A predicted short to mid-term decline in UK real estate values
- Potential higher costs of cross border business within Europe
- Uncertain impact on the remaining EU economies

However, most fundamentals have not changed:

- Islamic Finance has never been governed by EU law in the UK or elsewhere
- The UK has one of the most Islamic friendly legal environments with the most legislation of any of the EU countries to assist Islamic Finance from a political and tax perspective
- The English language, English law and the English courts remain attractions for overseas investors
- The need to attract investment is more important than ever

THE UK AS A GATEWAY OR A DESTINATION IN ITS OWN RIGHT?

It is interesting to speculate whether Muslim investors and institutions have used the UK as a gateway to enter the EU market. On the whole, we think not. The majority of our clients have looked at the UK (and, more accurately, London) on its own terms and for its investment opportunities. Currently, authorised financial services firms in the UK, including Islamic Finance providers, have the right to carry out business in any other EU (and European Free Trade Association) state, with or without a branch, provided the requirements of the single market regulations are

met. This allows UK-based banks, investment firms, asset managers, insurers, insurance intermediaries and payment services providers free access to EU markets.

Although many Middle Eastern owned banks have an exposure to the UK Islamic Finance industry through their UK subsidiaries, we do not get the impression that London is a "springboard" to major cross-border EU Islamic-compliant deals. That may have been part of the business plan on launching but has not proved to be the case in practice. Capital adequacy rules have also been relaxed in the UK. On 5 July 2016, the Financial Policy Committee (FPC) at the Bank of England reduced the UK Countercyclical Capital Buffer (CCyB) rate from 0.5% to 0% of banks' UK exposures with immediate effect. Absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK CCyB rate until at least June 2017. This may assist the UK Islamic banks to increase business.

BEING A EUROPEAN HUB

Talk about rivalry over the location of the Islamic Finance hub in Europe has been overstated. The UK, Luxembourg, Ireland, the Netherlands and other European locations are complementary to the Islamic Finance industry by offering different advantages. The distinctiveness of London has arguably been enhanced by Brexit and investment opportunities increased. Luxembourg is already the leading non-Muslim domicile for Islamic-compliant investment funds and third largest globally behind Saudi Arabia and Malaysia. It is also a popular location for listing *sukuk* on the primary market. However Luxembourg does not have the direct investment targets of real estate and corporate opportunities that the UK possesses. If we look to other popular EU real estate markets, France, Germany and Italy may have interesting opportunities however those jurisdictions suffer from tax and legislative hurdles to the use of Islamic Finance.

FOREIGN INVESTMENT IN THE UK WILL CONTINUE AND DIVERSIFY

The UK is currently the number one foreign investment destination in Europe with over US\$1 trillion in foreign direct investment (FDI) stock, net inflows of US\$72 billion and around US\$185 billion in foreign property investment alone.

Of the US\$4.5 billion allocated by Gulf Cooperation Council sovereign wealth funds to global real estate in the fourth quarter of 2014, over 80% was spent in Europe and over US\$3 billion (67%) in London alone, according to data from global real estate firm Jones Lang LaSalle. Property consultant Knight Frank confirms that between 2011 and 2013, non-UK nationals accounted for 69% of prime central new building purchases in London, while in 2015 around 63% of residential property purchases over £10 million were non-British. Last year, the number of Middle Eastern buyers rose from 11% to 16%.

Falls in UK real estate values and the low pound to US dollar exchange rate will give buying opportunities for those looking to invest in the mid to longer term and dissuade more cautious buyers. Cheaper assets for opportunistic overseas investors could result in a surge of activity. For Middle Eastern investors with a US dollar denominated currency, prices are looking a lot more reasonable.

The UK has a particular need for infrastructure improvements. With the potential loss of EU funds for infrastructure then Islamic Finance techniques are ideally suited to draw investment to this area of the economy.

HOW K&L GATES IS POSITIONED TO HELP IN THE POST-BREXIT ERA

The Doha, Dubai and London offices of K&L Gates lead our global Islamic Finance practice, and we work closely with colleagues in other offices, including Frankfurt, Berlin, Hong Kong, San Francisco and Singapore, as well as other practice areas including real estate and financial services. We advise principally on English, United Arab Emirates, Qatari, Dubai International Financial Centre (DIFC) and Qatar Financial Centre (QFC) law as they touch Islamic-compliant transactions and structures, and we work with other counsel to advise on local law issues in many countries, including Saudi Arabia, Malaysia, Egypt, Turkey, Bahrain and Kuwait.

Our integrated group of lawyers combine skills across the whole cycle of Islamic Finance transactions. We work hand-in-hand with our experienced corporate and finance lawyers and apply their significant regional, European, US and international experience to a broad range of corporate, commercial and regulatory activities, including mergers, acquisitions and disposals (both public and private), joint ventures, equity capital markets, corporate restructurings, private equity, funds and regulatory matters. Regulatory matters include advising on product development, prudential and supervisory guidance for Islamic Finance institutions, product marketing and distribution and advising in connection with regulatory approvals for new institutions. We can service structures that have regulatory requirements regardless of their location, from our offices in the Middle East, Europe, Asia, Australia or the United States.

We regularly provide a one-stop solution for clients who are looking for legal and *Shari'ah* advice on new products and documentation. We work with a number of *Shari'ah* scholars based in different jurisdictions who are able to provide *Shari'ah* law guidance, input and ultimately *fatawa* for clients across a number of schools of thought in Islamic jurisprudence.

CONCLUSION

The UK's prominent position in the Islamic Finance market will be maintained (and potentially enhanced) by Brexit. Many of the fundamentals to doing business have not changed. The UK government will need to expand its horizons to attract the investment it needs. Now is the time for Islamic Finance participants to encourage its use in a post-Brexit UK.

To learn more about our Islamic Finance practice, please [click here](#) and for more of our thoughts on the implications on Brexit, please [click here](#).

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