

Encore Calls for More Variety in Europe

By Arfa'eza A Aziz

At the recent Islamic Funds Asia meet (which ended on Wednesday) in Kuala Lumpur, **John A Sandwick** boldly told the audience why he'll be voting for Barack Obama, US Senator for Illinois who's gunning to become the first black leader of the Free World.

"We need to put some wisdom in the White House," quipped the managing director of Geneva-based Encore Management.



As frank as he is in expressing his political inclination, Sandwick adopts the same attitude when he gives talks on Islamic finance. Speaking to Islamic Finance news on the industry's development in Europe, **the well-known expert in Islamic assets management** did not mince his words. Sandwick said Swiss banks will suffer "swift and brutal" consequences if they don't establish a legitimate base for Islamic assets management in the country.

He also expressed concerns over the limited Islamic financial and investment products in the continent, adding that too much focus is being given on private equity, which is often just "venture capital in disguise". While private equity is good for any economy, but there are limits, he stressed.

In the interview, he also spoke on the challenges that Europe faces in building its Islamic funds and investment market. Below are his takes on the industry.

The UK is shaping up to be the Islamic finance capital for Europe. What are the main reasons for that? What does it have that other European countries don't?

Clearly, the most important element of successful Islamic financing of any kind is a legal and regulatory framework that accepts that not all distributions of cash are subject to withholding taxes. The UK has made substantial progress in recognizing that a lot of Islamic investing is not equity investing in the conventional western sense according to tax regulators, and permitted distributions without withholding tax. This alone is the biggest single step any European or in fact any government can make to support Islamic banking and finance.

The tax authorities in countries like France, Germany and Switzerland have been slow to acknowledge there are alternative treatments of cash distributions, capital structures and the like when it comes to Islamic investing. We believe this will ultimately change, especially as the stakes get higher. Remember, the oil exporting states of the GCC have about US\$38 trillion in total revenue during the next 20 years, of which Morgan Stanley estimates only 10% can be deployed into domestic economy investments. Where will the 90% go? They will go to international capital markets and direct investing.

As Islamic investing becomes increasingly common among sovereign wealth funds within the GCC, you will see an automatic adjustment by European — and indeed many non-European — governments to Islamic structures and tax treatment.

What do other countries need to do to catch up with the UK? How long will it take to see them on par?

Some governments will take a long time to adjust. France, in particular, has a very dedicated commitment to the secular treatment of all government affairs. They might ask: Why should tax treatment of Islamic investing be any different from conventional investing?

In fact, I think that each government in Europe has already looked into these issues, and is already considering how and when to implement policies to support and encourage Islamic investments and finance.

Why have other countries been slow to allow full-fledged Islamic banks and financial institutions as opposed to the UK, which now has allowed four full-fledged Islamic banks?

I wouldn't criticize their slow behavior, I would encourage their more rapid absorption of the new technologies and policies required to encourage Islamic banking. You know that governments everywhere take slow, measured steps on all banking regulatory matters, and Islamic banking is no exception to this rule.

London is leading the pack simply because it has: (a) a long tradition of financial market innovation; and (b) much deeper ties to the international communities that host most of today's Islamic banking professionals, meaning Dubai, Bahrain, Kuala Lumpur and other locals.

Switzerland holds potential in tapping the growing investors' base from the Middle East. Do you think it is doing enough to take Islamic finance to a higher level? What needs to be done there?

In general, there appears to be an overwhelming paralysis in Switzerland to the Islamic asset management industry. Not a single Swiss bank, or foreign bank in Switzerland, seems to be making any solid, concerted approach to Islamic wealth management. This is strange as there is (a) a gigantic pool of perhaps US\$200 billion in Muslim-owned funds in the Swiss banking system, and (b) nearly every Swiss bank has opened for business in Dubai, Manama and/or Doha. What is the cause of this paralysis?

It could be that after the demise of Bank Noriba (sponsored by UBS), there seems to be fear or reputation risk in the event of another failure. Further, I myself have actually heard senior Swiss bankers say they think Islamic banking is a fad, eventually to disappear after the industry's first major scandal.

I have heard other Swiss banking leaders say they don't understand or they fear the heterogeneous nature of fatwa (religious edict) and fear issuing a product with one fatwa that won't be accepted by the majority of their clients.

In my opinion, the Swiss must get moving now to establish a legitimate base of Islamic assets management before it is too late. Can you imagine what will happen if Singapore, Dubai or any other proposed center of Islamic assets management begins to eat into the Swiss market share in the Gulf states and Saudi Arabia? The consequences could be swift and brutal if the Swiss banks don't respond, and that could be very soon.

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Encore Calls for More Variety in Europe (continued...)

What are the other major challenges does Europe face in developing the Islamic finance market? How can these challenges be overcome?

Wholesale Islamic banking, meaning corporate finance, treasury, capital markets and similar services, are the easiest parts of the Islamic banking package to absorb because here, the regulatory involvement is relatively easy and limited.

Retail banking is the most difficult as it involves massive regulatory interference, just as retail banking requires everywhere. I think right now, most European governments are taking a 'wait-and-see' approach toward retail Islamic banking, observing the experience of the UK first before they make any formal entries into this area.

What has been Europe's best achievement in Islamic finance so far?

I applaud the establishment of so many Islamic investment houses in London. It will stimulate even further growth in the industry throughout Europe. Unfortunately, there are far too many Islamic private equity ventures in London; often, they are really only venture capital disguised as and with the more conservative name of private equity. And, while so many businesses were established, we still see very few actual products or announcements from the majority of them.

It is hard to say they have achieved much more other than physical presence, of course part of which is a more difficult regulatory environment outside of the UK. I'll hold my opinion for the time being on the word 'achievement' and wait for something more concrete before I bestow that honor.

East Asia and the US have expressed interest in setting up a global Islamic finance hub. What plus points does Europe have over the other non-Muslim majority jurisdictions?

You are interviewing me as I am here in Kuala Lumpur attending Islamic Funds Asia, where yesterday (the 10th March) I was teaching a master class on Islamic assets management to eager and very professional Malaysian and Singapore bankers.

Without a doubt, East Asia is very far ahead in the legitimization of the Islamic banking industry, and I mean that on a worldwide basis. The industry here is very professional and they are both serving client needs and making money. In fact, Europe and the US simply have to emulate the success of Islamic banking in countries like Malaysia to achieve the same results. Europe, of course, is home to many devout Muslims, not all of whom are skeptics or cynical about Islamic banking. Given meaningful alternatives that match conventional banking in all respects, this will cause the vast majority of European and American Muslims to choose this alternative.

There is a dearth of Islamic finance experts even in Malaysia and the Middle East, which are considered leaders of the industry. Do you think the shortage of such experts is one of the main reasons

Europe's Islamic finance development is slow? If so, how do you think the problem can be overcome?

Yes, I got a smile with that last question. I speak at Islamic banking conferences all over the world and am often surprised to hear the length of service an individual has in the industry. Many of them proudly proclaim they have been 'Islamic bankers' for six or 12 months! But, that's really not a barrier. Good banking is good banking, regardless of one's faith, and in fact, other than learning the basics of Islamic banking, any good banker can become an expert Islamic banker in short order. It is in fact only a matter of time before Islamic banking is fully legitimized worldwide. I don't see a single element of Islamic banking that would prevent this. Its adaptability to all commercial and regulatory environments is very high.

Do you think Islamic wealth management in Europe can ever catch up with its conventional partner?

Yes, of course, in the long term, it can and it will. Even in Germany, we are seeing some pension funds looking at offering their Muslim employees an Islamic retirement fund alternative. But the biggest complaint is the huge lack of products. As mentioned above, the Islamic banking units of so many Arab and European banking entities are falling all over themselves to create more private equity, which is often just venture capital in disguise.

Of course, private equity is good for any economy, but there are limits. Someone somewhere must create, manage and distribute world-class Islamic mutual funds of all kinds. The gigantic empty space in terms of Islamic products is what first needs to be filled. Only then can Islamic wealth management become a serious alternative to conventional asset management. We at Encore are working on that right now, with a soon-to-be established Bahrain-based fully dedicated Islamic mutual funds company.

How do you view Islamic finance in Europe in the next five years? What are the changes you want to see?

My predictive powers are poor, as are everyone else's. I can't tell you exactly where we will be in Europe, but I can tell you that we at Encore are trying to become a catalyst for change. Europe needs Islamic banking. Europe needs Islamic assets management. Of that, there is no doubt.

Translating that need into a reality is the difficult part. When will the French central bank, for example, permit what will perhaps be the most successful Islamic retail banking enterprise in all of Europe? It's hard to say. Eventually they will, as eventually all European banking and regulatory bodies will absorb and adapt their own versions of an Islamic banking environment.

Unlike the opinion of one Swiss banker, as I stated earlier, the Islamic banking industry is not going to disappear with the first scandal or meltdown. It is here to stay. ☺

Next Forum Question

In your view, what is hampering the growth of Islamic finance in the west?

If you would like to air your views on the next Islamic Finance Forum Question, please email your response of between 50 and 300 words to Christina Morgan, Forum Editor, at: Christina.Morgan@RedMoneyGroup.com before Wednesday, 19th March 2008.