In 2013, KPMG polled 800 Muslims living in Sweden about their attitudes towards Islamic banking. The income of the survey’s respondents was roughly in line with the average national monthly level of SEK23,000.

The results of the survey were telling. It found that there was a “clear demand from private customers for shariah-compliant mortgage loans, other types of loans and services.” Specifically, KPMG found that 95% of Muslims would switch to an Islamic bank if the option existed. Perhaps even more striking, in light of the economic downturn across Europe, was that 83% of respondents indicated that they would be prepared to pay more for shariah-compliant products and services than for conventional banking.

Given that the Muslim community in Sweden is projected to reach about 1 million, or just under 10% of the population, by 2030, this suggests that there is plenty of potential for a vibrant and profitable Islamic banking industry in Sweden. According to KPMG’s calculations, the total market for shariah-compliant financial services could be worth as much as SEK52 billion, with the mortgage market alone potentially valued at SEK26 billion.

In spite of this demonstrable potential, no local bank in Sweden yet offers products and services in accordance with Islamic principles, according to KPMG, which reports that banks have responded in a “fragmented way to the Muslim community requests for shariah-compliant banking services.”

The main reasons explaining why banks appear to be hesitant to offer shariah-compliant financial services in Sweden is “lack of clear international regulatory standards and exposure to reputational risk.” The KPMG analysis also found that the current tax regime is “disadvantageous” for Islamic banking.

The unfulfilled potential of Islamic banking in Sweden based on simple demographic extrapolations is mirrored throughout Europe. According to a study published in 2011 by the Pew Research Centre on Religion and Public Life, the global Muslim population will increase by about 35% over the next two decades, rising from 1.6 million in 2010 to 2.2 billion in 2030. Over the same period, Europe’s Muslim population is forecast to expand from 44.1 million to 58.2 million, an increase of 32%. More specifically, by 2030 Muslims are expected to account for 10.3% of the French population, for 10.2% of Belgium’s and 9.3% of Austria’s.

It does not, of course, follow that all Muslims will demand or even be aware of shariah-compliant financial services, let alone be prepared to pay a premium for them. Aside from KPMG’s Swedish analysis, research on this subject is dated, sketchy and inconclusive. A 2005 survey by Rabobank, for example, found that only 200,000 of the 1.2 million-strong Muslim population in the Netherlands expressed an interest in shariah-compliant mortgages. A more recent, and altogether more positive survey, undertaken in the UK in February 2014, found that 81% of Muslims living in Britain either currently use or would consider using Islamic financial services.

More broadly, however, it is frequently argued that one of the reasons why retail banks in Europe have maintained a lukewarm attitude towards Islamic finance is because the demographics of local Muslim populations make the economics of shariah-compliant banking questionable. A recent presentation on the potential of Islamic finance in Belgium, for example, which has an estimated Muslim population of 900,000, remarked on the “limited success of [shariah-compliant] investment products” arising from the “socio-economic status of the target group.”

Questionable viability for providers may explain why, even where the potential of Islamic finance has been recognised, and initiatives introduced to encourage its growth, it is notable that the emphasis has generally been on the development of opportunities in Islamic investment management and capital markets. Equally notable is that the development of these areas is aimed predominantly at building and diversifying financial centres in order to service the international market, rather than at satisfying the needs of local Muslim depositors, borrowers or entrepreneurs.

For a financial centre like Luxembourg, with its tiny domestic population, this is a wholly reasonable approach. As early as 1978, the Grand Duchy became the first country in Europe to host an Islamic financial institution. Since then, it has chalked up a series of other notable firsts for the Islamic financial services industry in Europe, with the Continent’s first shariah-compliant life insurance company opening in Luxembourg.
in 1982. Another landmark was passed in 2002, when the Luxembourg Stock Exchange became the first bourse in Europe to list a sukuk.

Luxembourg’s success in building its credentials as a hub for Islamic funds is immediately evident from the fact that the Grand Duchy is now the third largest domicile for shariah-compliant funds in the world, with 111 funds. Only Malaysia (263) and Saudi Arabia (163) have more. In the sukuk market, meanwhile, there are now 16 instruments listed on the Luxembourg Stock Exchange with a combined value of $7.3 billion.

Europe’s other leading centre for investment funds, Ireland, has also enjoyed considerable success in building its capacity as a centre for Islamic funds. Ireland has made no secret about its ambitions in the shariah-compliant market. In a speech in 2012, Deputy Prime Minister Eamon Gilmore explained that “developing Ireland’s involvement in Islamic finance has been identified as a priority government”. He added that “we have recognised the importance of the Islamic finance in the global financial system through adopting our tax system and financial regulatory system to ensure a level playing field between Islamic finance and conventional measures.”

The result of Ireland’s focus on the opportunities in Islamic finance was that by 2012 it was estimated that the country was already a location for 20% of Islamic funds domiciled outside the Middle East. Ireland’s success as a hub for Islamic investment funds, however, is in vivid contrast to what has been done to make basic shariah-compliant banking services accessible the country’s 55,000 Muslims. The failure of the domestic banking sector to explore the potential of retail Islamic banking has prompted the local Muslim community to “appeal to the Irish banks to contact any of the banks worldwide providing shariah-compliant products and learn from their experience.”

France is another striking example of a European economy that has focused more on building up the infrastructure for wholesale Islamic financial services than on extending shariah-compliant alternatives to Muslim savers and depositors. Paris Europlace set up its Islamic Financial Committee in 2008, and later the same year, France’s Finance Minister at the time, Christine Lagarde, put her weight behind the promotion of France as a centre for shariah-compliant banking.

In July 2008 she pledged that “we will adapt our legal environment so that the innovation and stability of our financial sector can benefit...Islamic finance and make its activities as welcome in Paris as they are in London and other places.” France has been true to its word, amending its tax regime to encourage the listing and trading of sukuk on Euronext in Paris and introducing a shariah-friendly legal and tax environment allowing for the efficient structuring of a range of funding instruments compliant with Islamic principles.

While retail banking services have been slow to take root in Continental Europe, an important landmark is due to be passed later this year with the establishment of the first fully-fledged Islamic bank headquartered in the eurozone. Backed by a consortium of private investors from the Gulf, the Luxembourg-based Eurisbank will have an initial capital of €60m and plans to offer a range of shariah-compliant retail, corporate and private banking services through a network of branches in key European centres such as Paris, Brussels and Frankfurt. A Deloitte feasibility survey has already indicated that Eurisbank, which is planning to begin operations in the last quarter of this year, will earn a high return on its investment.

While the Eurisbank initiative is an important step forward for Islamic banking in Europe, it is the UK, however, that has made the greatest strides in improving access to shariah-compliant alternatives for individual depositors and borrowers, corporates and investors alike. In 1982, Albaraka International Bank began offering Islamic mortgages in the UK, with the United Bank of Kuwait (UBK) following suit in 1996. It was not until the early 2000s, however, that shariah-compliant retail banking services were made more broadly available to the UK’s fast-growing Muslim population. In 2003, HSBC became the first high street bank to offer Islamic mortgages and other shariah-compliant products through its Amanah subsidiary.

The following year saw the opening of the Islamic Bank of Britain (IBB), the first retail bank targeted exclusively at Muslims in the UK. By late 2013, IBB was offering a comprehensive range of shariah-compliant financial services to more than 50,000 personal, business and premier customers throughout the UK.

This growth dovetailed with a range of government initiatives, which began in 2001 when the Bank of England established...
the Islamic Finance Working Group. Chaired by the then BoE Governor, Eddie George, this was aimed at investigating obstacles facing the industry and paving the way for the development of a flourishing Islamic banking industry in the UK.

One of the most notable of these obstacles was dismantled two years later with the passage of revisions to the Stamp Duty Land Tax (SDLT). This exempted individuals using alternative financing arrangements (including Islamic mortgages) from double charging on SDLT that might otherwise have applied when a financial institution buys a property for re-sale to an individual – which is one of the foundations upon which shariah-compliant home lending has developed. In 2005, the SDLT provisions were extended to equity-sharing arrangements, and a year later, companies were also made eligible for relief on the tax.

In February 2014, the government broadened the scope of Islamic mortgages when it announced that its Help to Buy scheme, designed to give prospective homebuyers access to taxpayer-backed funding, would be extended to HPPs.

The UK has also adopted a leadership position in supporting the development of the Islamic capital market. The UK Government announced in January 2014 that it had appointed HSBC and law firm Linklaters to advise on its planned debut issue of sukuk12, which may be the first shariah-compliant bond issue from a non-Muslim sovereign borrower, although it faces competition from Luxembourg and Hong Kong, both of which are readying debut sukuk transactions.

The experience of the UK, twinned with the confidence of the Eurisbank investors and the findings of the KPMG Swedish survey all suggest that there is still plenty of under-explored potential for the expansion of Islamic retail banking across much of Europe. This also applies to Turkey, where Islamic or so-called ‘participation’ banking still accounted for only just over 6% of lending in 2013, even though about 99% of the population is officially Muslim.

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