

OFFSHORE FINANCIAL CENTRES ATTRACTIVE FOR ISLAMIC FINANCE

As the Islamic financial industry continues to experience exponential growth, offshore financial centers (OFCs) are keen to market their value for the development of Islamic financial products. OFCs are working towards establishing comprehensive eco-systems to gain competitive advantages over other jurisdictions for Islamic finance. Most OFCs promote the element of low taxes or low costs of doing business to attract international Islamic finance businesses.

MALAYSIA
WORLD'S ISLAMIC FINANCE
MARKETPLACE

The Growing Interest of Islamic Banking & Finance (IBF) in Key Offshore Financial Centres (OFCs)

The global Islamic financial industry has expanded rapidly in the past few years, with assets growing at a double-digit compound annual growth rate (CAGR) of 17% between 2009 and 2013.¹ As of 1H2014, the Islamic financial industry's assets were estimated at USD1.87tn². As Islamic finance industry continued to experience exponential growth, various possibilities are being sought after by investors and Islamic finance service providers for investments and structuring of Shariah-compliant products. One such possibility is the offshore financial centres (OFCs). On the other hand, OFCs are also keen to market their value to the development of the new wave of Islamic financial products.³

Commonly, OFCs are jurisdictions with small domestic economies - such as the British Virgin Islands (BVI), Cayman Islands, Bermuda, Luxembourg and Jersey, among others. They are established to attract foreign financial capital through numerous incentives, including low taxes, political stability, business-friendly laws and regulations, banking secrecy and anonymity.⁴ Accordingly, along with conventional transactions, many of these OFCs are now

introducing additional facilities to further lure the growing Islamic businesses.

To date, key Islamic finance jurisdictions which are heavily involved in the practice of 'onshore' Islamic financial services, such as Malaysia and the Gulf Cooperation Council (GCC) countries, have also established separate 'offshore' jurisdictions to offer various Islamic financial services to investors at more attractive prices.⁵ For example, to further extend its Islamic financial services, Malaysia has offered several Islamic financial products through Labuan International Business and Financial Centre (Labuan IBFC). Apart from Malaysia, a number of 'onshore' jurisdictions have also developed in selected GCC countries. These include Dubai International Financial Centre (DIFC)⁶, Qatar Financial Centre (QFC)⁷ and Bahrain Financial Harbour (BFH)⁸. These centres are instilled with features similar to offshore centres, in terms of regulations and taxes, so as to remain competitive compared to these offshore centres. An example is the enactment of a new regulation in 2008 for DIFC to enable the creation of Special Purpose Company (SPC) structures and vessel registration.⁹

¹ "Islamic Financial Services Industry Financial Stability Report 2015", Islamic Financial Stability Board (IFSB).

² "Islamic Financial Services Industry Financial Stability Report 2015", Islamic Financial Stability Board (IFSB).

³ "Growth in Islamic Finance to benefit the Offshore world", Cayman Financial Review (17th April 2009)

⁴ International Monetary Fund (IMF), 2000. Offshore Financial Centers. IMF Background Paper.

⁵ "Development of Islamic Capital Markets in Offshore Jurisdictions: A Cross Country Analysis" Sairally, B. S., Muhammad, M. and Hasan, S. (2012)

⁶ www.difc.ae

⁷ www.qfc.qa

⁸ www.bfharbour.com

⁹ Dubai International Financial Centre, 2008

OFCs and Islamic Financial Transactions and Activities

As the Islamic financial industry is growing and maturing, the advantages offered by OFCs, are consequently being sought after to facilitate and lower the transactions and regulatory costs incurred from the structuring of Islamic financial transactions such as sukuk, leasing (ijarah), incorporation of Shariah-compliant investment funds and etc. It is noteworthy to inform that some OFCs that have

succeeded in attracting key Islamic finance businesses include among others Cayman Islands, Luxembourg and Labuan IBFC.¹⁰ In addition, BFH and DIFC are also positioning themselves to attract offshore Islamic finance businesses.¹¹ Various Islamic financial transactions offered by several OFCs to further promote the growth and development of Islamic finance are as follows.

Various Types of Islamic Finance Services Offered by Various OFCs



Key OFCs Promoting the Provision of Islamic Financial Transactions and Activities

Accordingly, key OFCs highlighted above such as Cayman Islands, Luxembourg and Labuan IBFC has further enhanced its infrastructure so as to further promote the Islamic finance industry. The Cayman Islands, which is popularly known as an offshore centre for investment funds is a fourth leading offshore centre,

after Jersey, Guernsey and the Isle of Man.¹² With that, the OFC strong reputation as a listing vehicle on major exchanges has largely contributed to its development for Islamic finance structures, particularly on sukuk.¹³ Many sukuk that are marketed in the Middle East, such as Tamweel sukuk, Nakheel sukuk, Goldman Sachs sukuk and several others chose the Cayman Islands as the domicile for their offshore SPC.¹⁴

¹⁰ "Offshore centers: Accommodating Islamic finance transactions", Islamic Finance News (IFN) (6th June 2012).

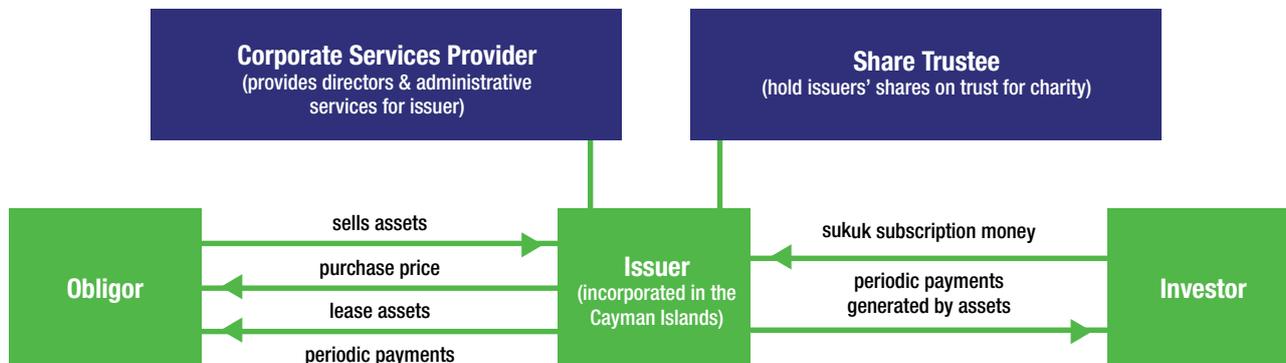
¹¹ "Development of Islamic Capital Markets in Offshore Jurisdictions: A Cross Country Analysis" Sairally, B. S., Muhammad, M. and Hasan, S. (2012)

¹² GFCI 12 (2012)

¹³ Cayman Financial Review, 2010.

¹⁴ "Development of Islamic Capital Markets in Offshore Jurisdictions: A Cross Country Analysis" Sairally, B. S., Muhammad, M. and Hasan, S. (2012)

Typical Structure of an Offshore Sukuk



Source: Cayman Financial Review, 2009

Apart from sukuk, the Cayman Islands also offers various other Islamic finance products and services such as Shariah-compliant investment funds. As at

2014, Cayman Stock Exchange (CSX) has more than 1,100 listings (including sukuk and Shariah-compliant funds) and listed market value of USD170bln.¹⁵

Developments of Islamic Finance in Cayman Islands



Source: ISRA

Elsewhere in Europe, Luxembourg has also attracted Islamic finance activity.¹⁶ It is also regarded to be among the top-10 centres likely to increase in significance as a global financial centre, competing with Casablanca, Shanghai, Singapore, Hong Kong, Dalian, Beijing, Gibraltar, Dubai and Abu Dhabi.¹⁷ The success of Luxembourg as a financial centre is mainly supported by its social and political stability, coupled with the availability of suitable 'low tax' or

'offshore' forms and structures alongside the onshore company.¹⁸ Nonetheless, the term 'offshore' is not part of Luxembourg's legislation; rather the use of the terms 'special holding company' is the most important criterion for gaining offshore tax treatment for most categories of business.¹⁹ Being the pioneer in Europe to venture into the area of Islamic finance with a combined value of USD3.4 mln (both ranked by the number of structures and by assets under management).²⁰

¹⁵ "British Virgin Islands: Islamic Finance: From the Cayman Islands to the Middle East and Beyond", Harneys (20th March 2014).

¹⁶ The Global Financial Centres Index 16, Year 2014, GFCI 16 (2014)

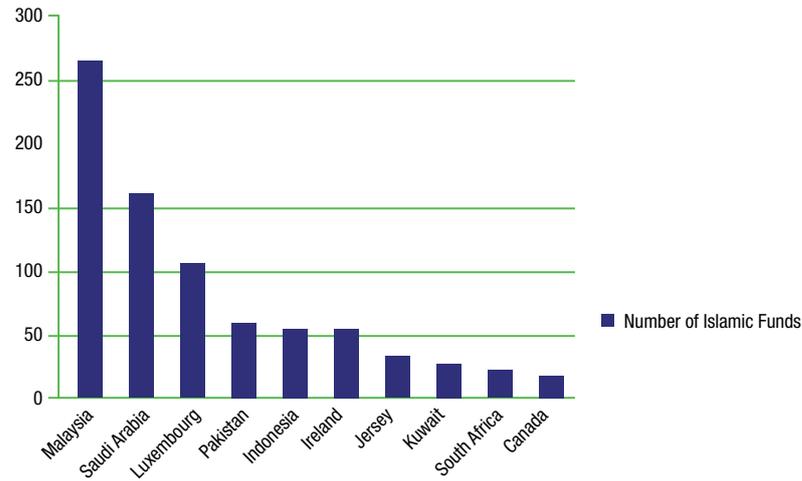
¹⁷ The Global Financial Centres Index 16, Year 2014, GFCI 16 (2014)

¹⁸ KPMG (2010). Luxembourg for Finance: Prospects and Challenges

¹⁹ "Development of Islamic Capital Markets in Offshore Jurisdictions: A Cross Country Analysis" Sairally, B. S., Muhammad, M. and Hasan, S. (2012)

²⁰ Thomson Reuters-Lipper Global Islamic Asset Management Report, 2014

Top 10 Islamic Funds Domiciles Number of Islamic Funds



Source: Thomson Reuters-Lipper Global Islamic Asset Management Report, 2014

Apart from Islamic investment fund, it also offers a wide array of Islamic financial products and services such as Islamic private equity, Islamic real estate investment trusts (I-REITS), Islamic venture capital, Islamic wealth

management services, sukuk and takaful. In 2014, four large sukuk were listed and traded on the Luxembourg Stock Exchange, with a combined value of USD2.3bn.²¹

Developments of Islamic Finance in Luxembourg



Source: ISRA

Elsewhere in key Islamic finance jurisdictions such as Malaysia, the Labuan Financial Services Authority launched the Labuan IBFC, offering a wide range of Islamic financial products and services. Throughout, it has witnessed remarkable growth in sukuk issuances and a double digit growth in the retakaful sectors. For example, several sukuk were issued in 2011, such as the USD2 bln trust certificates issued by Wakala Global

Sukuk Bhd, and China Remnimbi-denominated trust certificates of CNY0.5 bln by Danga Capital Bhd.²² The retakaful sector's gross contributions has also improved by 54.6% in 2011, from USD297.3 mln in 2010 to USD459.5 mln in 2011.²³ In total, Islamic banking assets in Labuan has increased from USD1.3 bln in 2010 to USD1.49 bln in 2011.²⁴

²¹ IFIS data, ISRA

²² "Development of Islamic Capital Markets in Offshore Jurisdictions: A Cross Country Analysis" Sairally, B. S., Muhammad, M. and Hasan, S. (2012)

²³ Labuan FSA, 2011.

²⁴ Labuan FSA, 2011.

Developments of Islamic Finance in Labuan



Comparisons of the Key OFCs

	The Cayman Islands	Luxembourg	Labuan IBFC
Regulatory Framework & Business Infrastructure	<p>Introduced usage of both Arabic and English names for the registration of companies and the opening of bank accounts</p> <p>Introduced Alternative Financial Instruments Regulations 2008 to allow an exemption from trustee licensing for trusts used in Islamic finance instruments such as sukuk</p>	<p>Under the Law 17 December 2010, structuring of Shariah-compliant investment funds can be set up without any specific legal requirements</p> <p>New Law introduced on 22 March 2004 on securitization to create a flexible and efficient tax regime for securitization vehicles, including sukuk</p>	<p>Legislate the Labuan Islamic Financial Service and Securities Act (LIFSSA) 2010 to streamline and consolidate all Islamic finance issues</p>
Sukuk Development	<p>Positioned 3rd among the top 5 sukuk domiciles as at May 2012, after Malaysia & Saudi Arabia</p>	<p>Luxembourg Stock Exchange (LX) was the first European stock exchange to enter the sukuk market, having listed sukuk since 2002</p>	<p>USD 2 bln trust certificates issued by Wakala Global Sukuk Berhad</p>
Islamic Financial Products & Services	<p>Offer various Islamic financial products and services such as Shariah-compliant investment funds</p>	<p>Offer various Islamic financial products and services such as Shariah-compliant investment funds, real estate investment trusts (REITs), Islamic private equity and venture capital, Islamic wealth management and takaful</p>	<p>Offer Islamic financial products such as Islamic banking, Islamic capital markets, takaful, retakaful, Islamic funds, waqf and Islamic trusts administration</p>
Taxation	<p>Tax neutrality for both individuals and corporates</p>	<p>Minimum flat income tax of EUR 1500 for companies whose financial assets, transferable securities, and cash at bank amount to more than 90% of their balance sheet</p>	<p>Companies established under its jurisdiction may instead elect to be taxed at the standard corporate rate under Malaysian Income Tax Act (ITA) 1967, thus gaining admission to benefits of double taxation agreements (DTAs) that Malaysia has signed with its 75 treaty partners.</p>

Source: ISRA

OFFSHORE FINANCIAL CENTRES ATTRACTIVE FOR ISLAMIC FINANCE

Overall, the expansion of Islamic finance, along with the attraction that OFCs have to offer, key OFCs highlighted above have successfully offered a wide range of Islamic finance activities. All the above-mentioned OFCs are working towards establishing a comprehensive eco-system including both soft and hard infrastructure to gain competitive advantages over other jurisdictions for Islamic finance. While most OFCs promote the element of low taxes or low costs of doing business to attract international Islamic finance businesses, soft infrastructure—such as a strong regulatory framework, fair, just and conducive business environment, political stability, security and investor protection, transparency, ability to adapt

existing structures to Islamic financial transactions and adherence to international standards like anti-money laundering—appear to be key to providing success to the OFCs for Islamic finance. It is notable to point out that the OFCs highlighted above have basically leveraged on their existing reputations in conventional finance to become major players in the Islamic finance industry. As such, potential OFC entrants in Islamic finance should take advantage of their competitive positions in their current niche expertise within the banking, insurance and capital market sectors to equally promote corresponding Islamic financial services.

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