



BANK OF ENGLAND

# Speech

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Speech given by

The Rt Hon Sir Edward George, Governor of the Bank of England

At the Islamic Home Finance Seminar, London

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Thank you, Andrew. It's a real pleasure to be here for this conference, and I am absolutely delighted that we – or I should say you – have reached the stage in what has been a long and arduous process, where there is a real possibility of developing a broader market in Islamic mortgages in this country, to the point that it is really useful to share the results of your work with a wider circle of home finance practitioners.

I don't pretend to any technical expertise in the area of Islamic finance – you have others on your program today who know far more about it than I do. But I became interested in it more than a decade ago when I met a very lovely, deeply religious, Muslim couple who were living in this country with their family, and who had recently bought a house on the back of a conventional mortgage. They told me of their delight in their home, but then they explained to me – not at all in an aggressive way, in fact in sorrow rather than in anger – their regret that they had had to go against their religious principles to finance it. That made a big impression on me. It was clearly troubling their conscience. And that seemed to me to be particularly sad because it struck me as totally unnecessary. Surely, I thought, our very inventive financial system could find ways of meeting the needs of the different sectors of our society in ways where this kind of problem need not arise.

When I looked into it a bit more, it seemed to me that in fact many of the financial products commonly used in this country – for example current accounts and savings products, such as investment funds or unit trusts, or borrowing through leasing or hire purchase products – already had some, at least, of the characteristics consistent with the teachings of the Qu'ran; if only we could come to a better and more precise understanding of the Islamic financial products that were being talked about at that time – if only we could encourage the Islamic community to develop a more consistent – and desirably more standardised – specification of the products they wished to introduce - then, with a little imagination, we could surely find ways of fitting them in to our legal and regulatory framework in this country, on a par with our more traditional financial instruments. I couldn't see how our essential legal framework needed to be disturbed or why our economic or social objectives needed to be adversely affected on this basis, and it seemed to me, in that case, that the principle of live and let live should apply in an open and tolerant society. Indeed it seemed to me also that, as a matter of general principle, a wider range of financial products would benefit the whole of our community and that Islamic products could prove to be attractive beyond the purely Muslim sector.

Against that background I didn't take much persuading when, following a meeting to launch the Heart of the City campaign some 2½ years ago, Dr Pasha, General Secretary of The Union of Muslim Organisations of the UK and Ireland – who I'm happy to see is with us here this morning – approached me on the specific subject of Islamic mortgages. And, having discussed it with the Chancellor, I invited Andrew Buxton, as Chairman of the Heart of the City campaign, and indeed who I knew also had an interest in Islamic finance, if he would convene a working group to investigate the obstacles to the wider use of Islamic mortgages in this country.

I cannot thank you, Andrew, enough for the way that you – and the very enthusiastic group that you managed to bring together – have carried the work forward.

The working party, which includes representatives of the Treasury and the FSA as well as the CML, a number of banks – including Ahli United Bank, HSBC and Barclays – lawyers

including Mr Paracha of Norton Rose – and representatives from the Muslim community, identified a number of obstacles to the wider use of Islamic “mortgages”. They include:

First, Treatment under Stamp Duty, where, because of the nature of the transaction, involving initial ownership by the financier, stamp duty may need to be paid twice (or even more often if the financier changes), or it may be payable at a higher rate than on a conventional mortgage.

Secondly, Higher regulatory capital charges where conventional mortgages – and indeed Murabaha mortgages – attract a capital risk weighting of 50% but some Islamic mortgages – Ijara mortgages – attract a higher rate of 100%.

Thirdly, disadvantages under the various public sector home ownership schemes – such as Right to Buy or Rent to Mortgage, where, because of the involvement of the financier as the owner of the property the purchaser may be unable to take advantage of the benefits offered under the schemes.

And Fourthly, disadvantages in terms of the housing cost element of Income Support or income-based Jobseekers Allowances compared with that which applies in the case of a conventional mortgage, with that cost element based upon interest rates on conventional mortgages.

There are also questions relating to legal costs where it has not been clear whether a single solicitor can advise both the financier and the purchaser in the case of an Islamic product – again because of the ownership role of the financier.

The Working Party I have to say has been doing a very commendable, thoroughly professional, job in identifying, and then explaining to and following up all of these issues with the many different authorities involved in them – the Treasury and Inland Revenue in the case of Stamp Duty, the FSA in the case of regulatory capital requirements, the Office of the Deputy Prime Minister on Right to Buy, the Ministry of Work and Pensions on the Social Security issues, and the Law Society on the conflict of interest point. What is – or ought to be – a relatively straight – forward issue in principle inevitably, in our complex society, becomes highly involved in practice. That’s not a veiled complaint against bureaucracy – though I’m sure we all yearn for less bureaucracy at times – it’s simply a fact that accommodating novel forms of anything within our legal and regulatory framework typically involves careful consideration of all the implications, to ensure that the changes don’t either open up unintended loopholes on the one hand, or lead to hugely cumbersome arrangements to prevent them, which themselves add unjustifiably to bureaucratic constraints, on the other. Making progress requires very careful and comprehensive analysis and presentation – it also requires a good deal of patience. And the approach that has been adopted by the Working Party has been exemplary in every respect. And this has paid off.

The good news is that, I think without exception, the reaction of all the different authorities involved has been generally very positive. They have been willing to listen, and to understand the positive purpose of what was being proposed, and they have been constructive in their approach to trying to find solutions.

The Treasury has certainly been actively looking into the question of Stamp Duty – which is perhaps the most immediate concern in relation to Islamic mortgages, and I am hopeful that a

way forward can be found at some point, though I dare not speculate on whether it will be covered by the Chancellor's Budget next month.

Howard Davies, the Chairman of the FSA, has, in a recent speech in Bahrain, made it clear that he, too, positively welcomes diversity and innovation in the world of finance, and he recognised that we in the UK have a clear economic interest in trying to ensure that the conditions for a flourishing Islamic financial market are in place in London. In relation to the regulatory capital weighting of Islamic mortgages in particular, Howard acknowledged, in his Bahrain speech, the disadvantageous treatment of Ijarah mortgages under the present Basel capital accord, but held out the prospect of more flexible treatment – which would probably remove much of the competitive disadvantage – under the new Accord, Basel 2, which we hope to finalise by the end of the year. Even then the new Accord would not become fully effective until 2006 – so again we need to be patient.

The other potential disadvantages of Islamic mortgages – while clearly important to those individuals who are potentially affected – are less general in their application. Nevertheless ways of addressing them are being considered. The Office of the Deputy Prime Minister, may not need to change the Right-to-Buy legislation itself – which might open up possibilities for abuse – but it could possibly issue revised guidelines to local authorities on its application. And, while I recognise the pressure of other priorities, I hope that the Ministry of Work and Pensions will find an opportunity within the legislative timetable at some point to introduce what I understand would be a relatively uncomplicated amendment to address the Social Security question.

As far as the question of Islamic mortgage transactions is concerned, I gather that this is largely a question of providing solicitors who are not necessarily familiar with the nature of Islamic mortgages with appropriate guidance, and I believe that the Law Society has taken the issue on board. But it may also involve changes to the documentation of transactions – for example the form of the Certificate of Title.

So all in all, Chairman, I think that you have made tremendous progress on the question of Islamic mortgages over the past year or two – and I congratulate you. Given the constructive response of the many authorities involved – and if, with the help of the CML, evidenced not least by today's conference, we can maintain the momentum which you have built up – then I believe that with a little patience, we will overcome the obstacles which you have identified.

That would be a wonderful thing for the peace of mind of concerned members of the growing Muslim community in the UK. It would represent both a useful business opportunity for those companies involved in the provision of housing finance and a welcome diversification of our financial system. And it would demonstrate in a small, but significant and very practical, way a commitment on the part of the authorities in this country, working together with the Private Sector, financial and professional community and with representatives of our ethnic minority population – in this case our Muslim population – to accommodate differences of religious principle or tradition insofar as we can without in any way undermining the values or traditions of our indigenous society.

And I'm bound to say, Chairman, that I hope that the work which you started will not end with mortgage finance.

The model that you developed of defining the products, identifying the obstacles, and entering into a properly informed dialogue with the relevant authorities to find ways in which those obstacles might be removed, can it seems to me, be usefully followed in relation to other Islamic financial products – and indeed much else besides. I can see no reason in principle why that should not lead to the establishment of fully-fledged Islamic financial institutions in this country, catering to our own Muslim and wider population but participating, too, in the rapid growth of Islamic finance internationally. Howard Davies, I know, shares this view, and I think you would find that the authorities more generally are willing to listen sympathetically.

But perhaps that's running ahead. Today I think we can derive satisfaction from the progress you have undoubtedly made on Islamic home finance and hope to see that through to its conclusion.