



## Islamic Financial Policy in France

France has the advantage of having the largest Muslim population in Europe and represents a high level potential in Islamic finance area. According to the Pew Research Center, Muslims will represent 10% of the French population in 2030. With such demographic data, it is obvious that Islamic finance has a bright future ahead in this country. Despite this advantage, Islamic finance has been much slower to develop in France due in largely rigid regulatory standards and lack of legislative accommodations. Since the then France's economy minister, Christine Lagarde, announced in 2008 her intention of making France more open to Islamic finance her top priority, economic and financial policy has been changing to help Islamic finance find a foothold in the country. Notable developments in France legal framework have been made to better accommodate Islamic financial products and services whereby a series of tax and legislative changes have been implemented to boost the Islamic finance industry. Although French banks control only a negligible share of the Islamic banking sector, the French government believes the sector in France is worth up to €120 billion (US\$170 billion) and hopes Paris will take 10% of the global market by 2020.<sup>1</sup>

## Policy Changes to Accommodate Islamic Finance

France implemented the first changes in legislation and policy in order to enable Islamic finance transactions in 2008. The changes were related to the listing of sukuk in the French regulated market

and, to a lesser extent, reforms regarding fiducie (French trust). At the same time, the Autorité des Marchés Financiers or AMF, the French financial markets' regulatory authority, announced tax and regulatory changes to facilitate Islamic finance in France. This marks the clear intention of the French government to create in France a hub for Islamic finance. However, AMF involvement in developing Islamic finance was evident as early as 2007 when the French regulator published its recommendation on the regulatory conditions to be met by domestic mutual funds that are Shari'a-compliant. It is no surprise that the first legislative changes to accommodate Islamic finance in France focused on the asset management industry given that the country's market share of global assets under management (AuM) is 18%, making France a strong market for asset management in Europe. Institutional investors account for about 81% of these managed funds and mandates. At present, there are six Shari'a-compliant funds in France with total assets under management of US\$147.2 million, which are relatively evenly distributed between money market (47%) and equity (53%).

It should be noted that investment funds structures under the French law are compatible with mudaraba. However, AMF noted that it had to address specific features of Islamic investment funds especially with regards to the fund's management techniques. Among the requirements, the management company must preserve autonomy with its Shari'a Board. The latter can provide advice and opinion, but are not allowed to interfere in the management affairs of the fund with the ultimate decision rests on the fund manager. The AMF also authorized the purification of asset management funds (i.e. distribution of certain income to charities) provided that this was mentioned in the fund's prospectus. This is to ensure transparency as well

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1. Kern, 2011

as to protect investors' interests. The recommendation set forth also relates Islamic mutual funds to ethical funds where AMF noted that it shall treat Shari'a funds in the same manner as any other investment funds using extra-financial criteria to build their portfolio, such as social responsibility funds.<sup>2</sup>

In July 2008, the AMF published its position regarding the admission to listing of sukuk on a French regulated market. With this, AMF acknowledged sukuk issuance as either an asset-based or asset-backed structure. It also sets out the level of disclosure required in the sukuk prospectus for each type of sukuk. This was to ensure that sukuk prospectuses are prepared in accordance with European laws and regulations, in particular the Commission Regulation (EU) no. 809/2004 of 29 April 2004 and Directive 2003/71/EC (the Prospectus Regulation). The published statement also requires sukuk issuers to inform the AMF the type of sukuk being listed and the relevant annexes of the Prospectus Regulation with which they are complying when filing the draft prospectus. However, the AMF emphasised that the compliance of the sukuk with Shari'a law does not fall within its ambit. It is the responsibility of the issuers to document relevant information in the prospectus, including appropriate details of the Shari'a board involved in the transaction to enable investors to make informed decisions. With this development the the Bourse de Paris (Paris Stock Exchange) created a Sukuk segment and four tax regulations (relating to murabaha, sukuk, ijarah and istisna products) have been published that confirm a parity of tax treatment with conventional financial products.<sup>3</sup>

In 2009, the French Tax Administration issued guidelines relating to the tax treatment of murabaha and sukuk.<sup>4</sup> Under the French law, a murabaha contract is defined as a sale agreement from a legal standpoint and hence, profit derived from such sale is immediately taxable. This was the major impediment to the use of murabaha contract in the country. Under the new tax treatment on murabaha, taxation of the profit margin generated by the financier shall be taxable on a straight line basis over the life of the murabaha contract regardless of when the amounts are reimbursed on the condition that the contract was properly drafted and specific accounting requirements are met. It should be noted that this is limited to the portion of the profit pertaining to the consideration for the deferred payment and not to the portion of the profit relating to the reward of the financier.

In the case of profit margin paid by the French investor company to the financier located outside France, such payment is exempted from French withholding tax according to domestic tax rules (Article 131 quater of the French Tax Code). For French transfer tax purposes, since a murabaha arrangement qualifies as the acquisition and disposal of an asset, this would normally trigger the tax consequences of two consecutive disposals, i.e. 5.19% for each transfer of French real estate and 5% for each transfer of French real estate shares.<sup>5</sup> The tax guidelines provide a favourable tax regime applicable to real estate dealers which avoids any double taxation as regards to transfer fees relating to the two transfers of property (on acquisition and then on resale). Hence, a murabaha arrangement on French real estate shares would only trigger a 5% tax charge once. For the acquisition of a French real estate property, acquisitions made by the financing entity will bear the cadastral tax (0.715%), the registrar's fee (0.10%) and the notary fees. The guidelines also treat the margin relating to the deferred payment as interest and as such are VAT exempt.

2. Pasquier and Cekici, 2009

3. Mohammed, 2014.

4. The AMF is also planning to issue other guidelines dealing with other Islamic finance products such as musharaka and mudaraba.

5. Landwell & Associés, 2009.

Under the existing tax regime, remuneration paid to the sukuk holders could be considered as a distribution of profit and as such could not be deductible from the issuer's tax basis. This barrier to sukuk financing was dissuasive for Islamic investors. In the 2009 guidelines, the French Tax Administration confirms that remuneration paid under sukuk or similar debt instruments qualify as interest and hence, are deductible from the taxable basis of the SPV. However, the company interest has to be preserved and Sukuk have to comply with ordinary French tax rules regarding limitation of interest deduction provided by Articles 39, 1 3° and 212 of the French Tax Code. VAT exemption could be achieved on the transfer of goods, rights and warranties from the SPV to the fiduciary provided that the transaction is structured appropriately. Remuneration paid to non-French sukuk holders can benefit from the French domestic withholding tax exemption on interest.

In July 2010, the French government enacted an amendment removing Double Stamp Duty to facilitate sukuk issuances. This amendment effectively made sukuk a viable alternative to the conventional bond. With this amendment also, all expenses related to Islamic financial contracts could be exempted in France from the double tax. However, France does not have a trust law that approves dual ownership given that it is a civil law country. An amendment of Article 2011 of the French Civil Code passed by the French National Assembly rectified this issue and was seen as a positive step toward facilitating the origination of sukuk out of France.

In November 2011, Paris Europlace<sup>6</sup> launched the French Sukuk guide to support the issuance of sukuk in France. The guide explains how the French legal, regulatory, and tax frameworks works operate for sukuk issuance as well as documentation requirements put forth by AMF. In 2011, the first French sukuk with a value of US\$6 million was issued by French halal food specialist, Bibars, to finance the opening of its new restaurant in Paris. The first green sukuk was also issued out of France. The Orasis Sukuk, launched by Legendre Patrimoine, was for the financing of solar panels and takes the form of ownership rights that can be acquired by individual and institutional investors alike. In June 2011, the first Islamic deposit scheme was introduced and operated by Chaabi Bank (French subsidiary of the Moroccan bank) via its Islamic window. Following this successful launch, the bank launched an Islamic home finance product, a 10-year murabaha contract a year later. Currently, there are plans to launch a similar Shari'a-compliant deposit scheme aimed at small and medium-sized enterprises.

### **French Players in the Global Islamic Finance**

With favourable environment for Islamic finance to thrive and strong political will from the government to introduce Islamic finance in the country, several French players have emerged in recent years to capitalise on the industry's robust growth prospects. Societe Generale, French's third largest bank by assets, announced it has received approval from Bank Negara Malaysia and the Securities Commission to launch a sukuk program in June 2014. The proposed program would have a nominal value of US\$314.82 and a tenure of up to 15 years, with the first tranche to be launched in July. Although the planned issuance did not materialise, the bank affirmed that it will continue to strengthen its Islamic finance capabilities and presence.<sup>7</sup> Other French banks that are actively involved in the Islamic finance industry are BNP Paribas Najmah and Credi Agricole, but have remained active overseas rather than in the domestic market. These banks provide a range of Islamic financing solutions including Shari'a-compliant investments, wealth management and asset management.

6. Paris EUROPLACE is the professional body which supports the France-based financial services industry. As the coordinating organisation for the promotion of Paris as a financial centre, it maintains efforts to develop, reforms and improve the competitiveness of the financial sector as well as promote Paris internationally.

7. Islamic Finance News, 2016

## FUTURE PROSPECTS OF ISLAMIC FINANCE IN FRANCE

### 01

#### FAVOURABLE TRADE FLOWS WITH MUSLIM COUNTRIES

- France has favourable trade flows with many neighbouring Muslim countries such as Morocco, Algeria and Tunisia.
- About 7% of the French population originates from North Africa, thus driving domestic demand for Islamic finance.

### 02

#### FAVOURABLE DEMOGRAPHICS

- France has the largest Muslim population in Europe – 10% of the country's population of 65 million
- High percentage of young French Muslims with rising purchasing power - 64% of French Muslims are aged between 18 and 34 years old
- Most French Muslims are from the middle class with high purchasing power.
- France has one of the highest bank penetration rates in the world (99%)

### 03

#### DEMAND FOR ISLAMIC RETAIL PRODUCTS

- A survey by French pollsters IFOP in 201 reported that 55% of French Muslims are potentially interested in Shari'a-complaint financing, while 45% are interested in Shari'a-compliant saving products
- In terms of attitudes and religious practices, 45% of French Muslims, 41% said they are "believers & practitioners". This is a driver of growth for Islamic financial products

### 04

#### GROWTH IN REAL ESTATE

- Paris has one of the most lucrative property market and is a preferred destination of Middle East investors.
- According to the CBRE,
- Europe accounted for a majority of Middle East real estate outflows (80% average) over the past decade with Paris commanding a 15% share.
- CBRE expects Paris to register a five-fold growth in the next decade.

### 05

#### FAVOURABLE REGULATORY FRAMEWORK

- French law (the Roman Law) is much closer to the Islamic law than the Anglo-Saxon law.
- For example, both Islamic law prohibits riba whilst Roman Law prohibits usury.

### 06

#### STRONG CULTURE OF ETHICAL INVESTING

- There is already a good demand for Socially Responsible Investments in the region partially served by "conventional" institutions.
- France have a strong culture of ethical investing and has the highest SRI retail funds in Europe

Active in the Islamic finance industry since the early 1980s especially in the sukuk market, BNP Paribas was among the leading banks to recognise the importance of Islamic banking. In 2003, it established BNP Paribas Najmah, the group's global Islamic banking division, in Bahrain and later in Malaysia in 2011. In 2009, BNP Paribas Investment Partners, was granted license to set up an Islamic Asset Management company by Securities Commission Malaysia. With this, BNP Paribas Investment Najmah was established. Similar to BNP Paribas, Credit Agricole's offers a wide range of Shari'a-compliant financial products and services out of France. Headquartered in Dubai, Credit Agricole CIB provides expertise in syndicated financing, project and structured finance and sukuk issuance. Credit Agricole also has a stake in Banque Saudi Fransi, a Saudi Joint Stock Company. The Saudi-based bank offers a wide range

## CHALLENGES OF ISLAMIC FINANCE IN FRANCE

01

### LACK OF POLITICAL WILL

Since the efforts of Christine Lagarde in 2008, political support to further develop Islamic finance in the country has declined. France has not made any legislative changes to accommodate Islamic finance since 2010.

### SECULAR NATURE OF FRENCH SOCIETY

The country's strong secular stance remains a large obstacle to develop Islamic finance. Social factors have made development of Islamic finance on the local financial market a daunting task

The recent extremist assaults on the country in 2015 have made it more challenging for future growth.

02

03

### STRONG COMPETITION FROM LONDON

The UK has a more advanced Islamic financial market with very strong political will to make London the hub for Islamic finance in Europe

London is also a major global provider of the specialist legal expertise required for Islamic finance

of commercial banking services including Islamic banking. 13 of its 83 branches are dedicated Islamic branches. In 2009, the group set up its first Islamic fund, Crédit Agricole Asset Management (CAAM), which is domiciled in Luxembourg and Amundi Islamic was established in August 2010 following the merger of Société Générale Asset Management and CAAM.

The takaful sector in France is still in its nascent stage. There is no global takaful solution in France and currently takaful solutions exist only within three life insurance contracts: "Salam Epargne et Placement" by Swiss Life; "Amane Executive Life" by Vitis Life; and "Ethra'a Takaful Famille" by FWU AG. These family takaful contracts do not contain either death claim payment or life annuity and were validated by the Independent Committee of the Islamic Finance in Europe. Similar to the takaful sector, Islamic banking in France is served by foreign banks (e.g. from North-Africa or Middle East) that provide retail Islamic finance products via their European affiliates in France.

### Opportunities and Challenges for Islamic Finance in France

According to report published by the European Central Bank in 2013, there is huge potential for Islamic finance to flourish in France. Overtime, France could overtake the UK in developing Islamic finance as a viable alternative financial system. The French government's interest in Islamic finance is due to its keen interest to attract investors from Gulf countries to the Paris market. It is forecasted that France may attract US\$120 billion in Islamic assets through lend-

ing and investments in French businesses, property, and financial markets by 2020.<sup>8</sup> Some of the notable factors that make France a great contender to become the Islamic finance hub in Europe are explored below. However, it is highly likely that a French Islamic financial sector would be markedly different than Islamic financial hubs the likes of Dubai and Malaysia. A French Islamic financial hub would be based more on the notion of ethical finance.

Despite its favourable demographic advantage and somewhat conducive regulatory environment, the development of Islamic finance in France still lags behind in comparison to its other European peers. While Islamic finance could be an avenue for the country to tap petrodollars, the nation may have reservations toward taking that path considering its political, religious and social dynamics.

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