

Corporate Sukuk in Europe Alternative financing for investment projects



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Content



Foreword	4
Executive summary	5
Tax, regulatory and policy environment	6
I. Cross-country experiences	6
II. Economic and regulatory review	8
Survey insights: Hallmarks of optimism	15
I. Tax and regulation	15
II. Financing requirements	16
III. Investment strategies	18
IV. Risk management	19
Project-oriented case scenarios	
Case scenario 1: Manufacturing industry–Turkey	23
Case scenario 2: Automotive industry–Germany	24
Case scenario 3: Renewable energy–Germany	25
Case scenario 4: Real estate–Turkey	26
Case scenario 5: Pharmaceutical industry–Germany	27
Case scenario 6: Infrastructure industry–UK	28
Case scenario 7: Agriculture industry–France	29
Industry thought leaders’ perspective	30
Looking forward: Harnessing the potential of Sukuk market	33

Foreword



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Dear colleagues,

We are pleased to present Deloitte's Islamic Finance thought leadership report, now in its 5th edition, our latest industry study of the Islamic capital market landscape. The study adopts an innovative, new approach to Islamic financial research which involved extensive outreach and dialogue with the industry leaders' community, academia and prominent Islamic finance thought leaders.

The dialogue included numerous interviews and interactive industry sessions to discuss the insights and opportunities for corporate Sukuk in European markets. Sincere thanks are extended to the industry experts and thought leaders who contributed their unique insights to this report. In particular, the members of the research team and industry experts who generously provided support and played an invaluable role in shaping a meaningful discussion about the case for corporate Sukuk in Europe markets and its potential integration to the world's debt capital market.

The global financial crisis was marked by market volatility, a lack of liquidity in many capital markets, and heightened the debate—among industry stakeholders—of the need for alternative financing asset classes which will have balanced risk and return characteristics that enhance regulatory capital and equity buffers in the financial industry.

Responding to several global forces, financial services institutions are now required to comply with fundamental regulatory capital changes. The Basel III requirement emphasized on capital quality and the need for improvement of common equity. Basel IV emerged to supplement these requirements and addresses the importance of capital instruments and debt exposures not only in the banking institutions but also in the corporate world. It further proposes the revision for credit risk, emphasizing on exposures to banks, asset quality and risk weighting methodology, and greater transparency among many other transactional practices.

While progress has been made on the regulatory front, the Islamic capital market introduced innovative equity and debt instruments which are seen to have strengthened the capitalization and liquidity positions of Institutions offering Islamic Financial Services (IFS). The development of High Quality Liquidity Asset (HQLA) Sukuk, Hybrid and Perpetual Sukuk is a case in point.

On the corporate debt front, different project financing structures were introduced and used by government and private sectors. Key markets that used these types of structures include the GCC, Malaysia, Turkey, Pakistan, Indonesia and Europe.

Deloitte's report provides a portrait of the development in Islamic capital market instruments and highlights potential growth markets for the Sukuk in European markets and sectors that could benefit from these arguably socially responsible investment asset classes. To this end, the report discusses these industry trends and proposes that the growth of the Sukuk market in Europe and elsewhere in the world could bridge the gap in infrastructure funding/financing, particularly with respect to real economy projects and public-private partnerships (PPPs).

We hope this report provides you with useful information on how Islamic capital market instruments such as the Sukuk could be used as an alternative financing tool to bridge the gap of European and global capital requirements to finance projects. It is indeed our profound hope that this report encourages a dialogue that can help grow Islamic capital market offerings.

Executive summary

Industry policy-makers and regulators continue to keep pace with global regulatory and financial markets developments providing the required support for the industry's sustainable growth. The Islamic capital market is uniquely advantaged in the current climate to create innovative Sharia'-compliant debt and equity instruments that will address the increased demand for funding infrastructure projects in both developing and maturing economies. Currently, developing countries spend about US\$1 trillion a year on infrastructure and an additional US\$1-1.5 trillion will be needed through 2020 in areas such as water, power and transportation projects, according to the World Bank.

This industry study assesses the demand and supply in European markets for an alternative financing instrument that will stimulate economic growth and cross-border investment. There is arguably a reciprocal need from European corporates to finance infrastructure and investment projects, caused by scarce debt finance for long-term infrastructure projects that generally require a high level of upfront capital. At the same time, there is a need from Middle Easterners and Asian investors for Sharia'-compliant assets in maturing economies that are often in time not economically correlated e.g. Europe.

The study provides empirical analysis of matching these two needs among historically interdependent trade and investment economies—the Middle East and Asia (MEA) and Europe.

Three trends emerging:

- Governments in several European jurisdictions are attempting to provide level playing fields for Islamic finance practice. Some have gone a long way such as the UK, Luxembourg, and Ireland. Others are striving to match the regulatory developments in these countries and have provided good breakthroughs in changing national regulatory frameworks to host the industry, in particular, Turkey, Germany, Italy and possibly Spain, and to some degree France.

91% of respondents have considered ethical investments in Sukuk

- Constrained professional and industry dialogue between corporate professionals and investment bankers, widening knowledge and awareness gaps of Islamic Finance amongst the market players.
- The observational analysis enforces good market sentiment amongst practitioners and market players. The general perception is optimism for great growth in this market in the next few years, depending on the improvement of global market conditions.

The survey's key findings reveal that:

- 91% of respondents have considered ethical investments in Sukuk.
- 73% of respondents would consider Sukuk and another 25% might consider the instrument depending on its merits if the transaction entailed any tax benefits.
- The majority of respondents prefer equity followed by Sukuk over all other proposed asset categories.
- Stakeholders are more likely to dedicate a smaller percentage bracket of their Capex to Sukuk.
- 81% of participants prefer to invest in USD-denominated Sukuk.
- 75% of respondents would still consider investing in Sukuk even with lower/similar yields than other bonds.
- 55% of respondents would definitely consider Sukuk as a tool to reduce risk and diversify their portfolio, with another 34% speculative.

Tax, regulatory and policy environment

Cross-country experiences: France, Germany, United Kingdom, and Turkey

The participation of each industry stakeholder plays a crucial role in developing an ecosystem required to build confidence in both potential Sukuk issuers and investors. This study found that the United Kingdom is leading in the implementation of initiatives to encourage the growth of Islamic Finance and the issuance of Sukuk in the country.

The study assesses various indicators, such as social dynamics, an economic and regulatory review, and a participating stakeholder’s review to gauge the current climate and potential in moving forward.

Social dynamics

The social fabric of different societies are gradually re-sewn with globalization and the migration of people seeking better job prospects in developed nations. While Muslims constitute a minority group in France, Germany, and the United Kingdom, there is growing demand for Sharia’-compliant goods and financial services.

Turkey

With the majority of the population being Muslim, it was expected that the development of Islamic Finance in Turkey would be largely driven by local demand. However, this was not the case given the sensitivities of developing the industry in the secular republic prior to 2012. The tide changed after 2012, when the Turkish government introduced Islamic Finance, through the issue of Turkey’s first sovereign Sukuk.

France, Germany, and the United Kingdom

There are approximately four to five million Muslims residing in each of the three countries. This creates a reasonable mass for Islamic Finance in areas of retail, corporate and the SME landscape, all of which could help grow corporate Sukuk issues in these countries.

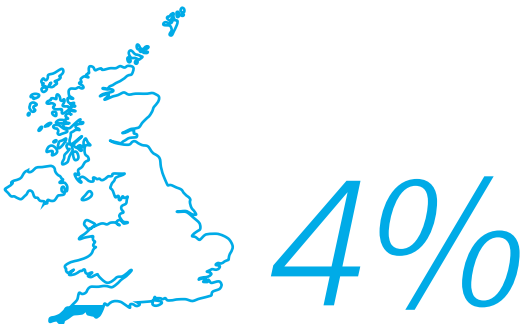
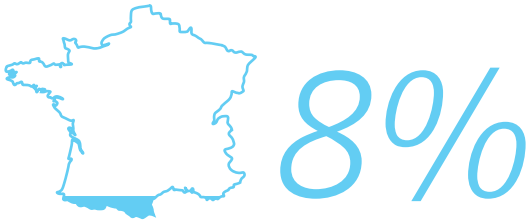
Summary of findings

	France	Turkey	Germany	UK
Social dynamics	Conductive	Very conducive	Conductive	Very conducive
Legal framework	Very conducive	Very conducive	Conductive	Very conducive
Tax neutrality	Very conducive	Very conducive	Improvement required	Very conducive
Indirect policies	Very conducive	Very conducive	Improvement required	Very conducive
Business support	Very conducive	Very conducive	Conductive	Very conducive
Participants	Conductive	Conductive	Very conducive	Very conducive

Conducive ecosystem rating

■ Very conducive
 ■ Conductive
 ■ Improvement required

Percentage of Muslims



The study assesses various indicators, such as social dynamics, an economic and regulatory review, and a participating stakeholder's review to gauge the current climate and potential in moving forward

Key findings:

While demography may determine the acceptance of Islamic Finance within the country, it will not be the core determinant of interest from foreign investors in these countries. Luxembourg and Ireland are examples of European countries with similar demographics to France, Germany, and the United Kingdom, and these two countries have made progressive developments in the industry with favorable banking regulations and government initiated policies.

Economic and regulatory review

Legal framework

Establishing a comprehensive and effective legal framework secures the enforceability of Islamic Finance contracts and ensures that there is an effective legal process for dispute resolution. Precedent Sukuk default cases have highlighted disputes across different jurisdictions on the rights given to investors of special purpose vehicles (SPVs), a structure heavily utilized in Islamic Finance contracts.

France



- Supervisory body: Autorité des marchés financiers - France (AMF).
- Legal framework was modified in 2009 to allow banks and private issuers to sell Sukuk.
- Clear guidelines for Sukuk issuance, drafting Sukuk prospectus, and obtaining approval for listing on French regulated market.
- Provision of advice to Sukuk issuers throughout the listing process to ensure compliance with EU Prospectus Directive.
- Established cooperation with Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) to develop amendments to French law to accommodate Islamic Finance.

Turkey



- Supervisory body: The Capital Markets Board of Turkey (CMB).
- Legal framework was modified in 2013 to permit the use of diversified Islamic financial instruments in Turkey, enabling Sukuk that are structured using

Istisna', Murabaha, Mudaraba, Musharaka, and Wakala.

- Issued clear guidelines, principles, and legal framework for lease certificates (Ijarah), special purpose vehicles, and Sukuk Ijarah.

Germany



- Supervisory body: The Federal Financial Supervisory Authority (BaFin).
- There are clear guidelines on bank license requirements for Islamic financial institutions under the German Banking Act.
- Issued a banking license to a foreign bank (Kuveyt Türk Beteiligungsbank) to conduct limited Islamic banking operations in Germany.
- Actively held conferences on Islamic Finance since 2009.

UK



- Supervisory body: The Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA), the Bank of England, and the government (i.e. HM Treasury).
- Legislative measures introduced to establish a level playing field for Islamic and conventional instruments and to enable UK companies to issue a range of Islamic financial products. Any inequality is swiftly remediated through revisions in the legislation and regulations.

Comparison with other European countries with established Sharia' practices

Ireland



Supervisory body–Central Bank

- Established a Sharia' Funds Specialist Unit to ensure regulatory applications involving Sharia' funds.
- Sharia' element is viewed as a "socially responsible" investment element.

Tax neutrality

Amendments to tax laws, in order to establish tax neutrality for Islamic Finance transactions and instruments, create a level playing field between conventional and Islamic financial products. Inequality of tax treatment arises in Islamic Finance transactions due to a sale or exchange of the underlying asset to the SPVs, triggering capital gains, stamp duty, and withholding income taxes depending on where the asset owner is located in a foreign jurisdiction. Providing tax incentives could reduce the hidden costs of issuing Sukuk and encourage more enterprises to issue or invest in them.

	Tax neutrality
Analyzed countries	
France	Yes
Turkey	Yes
Germany	No
UK	Yes
Comparison with other established financial markets	
Ireland	Yes
Luxembourg	Yes

Luxembourg



Supervisory body–Commission de Surveillance du Secteur Financier (CSSF)

- Regulation issued in 2011 to clarify the tax rules and listing requirements for Islamic financial instruments.
- There are no specific legal requirements concerning Sharia' investment funds set up under the Luxembourg law.

Key findings:

Having the first mover advantage into the European Sukuk market, the Saxony Anhalt (Germany) state's Sukuk issue in 2004 did not automatically translate into Germany becoming leaders in the European Sukuk market. With no tax neutrality or favorable government policies subsequent to the maiden Sukuk issue, corporate Sukuk issuance has been more concentrated on foreign companies that are keen on tapping into the deep liquidity in the German financial markets, rather than from local medium-size companies.

Developments appear more promising in France, the United Kingdom, and Turkey, where there are regulations and infrastructures in place to promote the issuance of Sukuk. However, guidance provided in Turkey is limited to Sukuk based on Ijarah (lease certificates). Despite the limitations, the Turkish government's open support to develop the country's Islamic Finance sector and sovereign Sukuk issuance serves as a promising factor.

Comparison with other European countries with established Sharia' practices



- Sharia'-compliant funds domiciled in Ireland
- Accommodated within the existing tax framework.
 - Entitled to the same favorable tax treatment offered to conventional funds (ie. zero tax on fund's income or gains, net assets, no stamp duty, and zero withholding tax on distributions to non-Irish residents).
 - Enjoy equal tax treatment for Islamic financial instruments and similar reporting obligations with conventional funds.



- Treatment of Sukuk and remuneration of Sukuk is similar to conventional debt and interest.
- Payments on Sukuk are not subject to withholding tax.
- The direct and indirect tax authorities have also issued clarifications on the major principles of Islamic Finance, direct tax treatment, and indirect tax treatment of Murabaha and Ijarah contracts.

Given the parallels that can be drawn between SRI and Sharia'-compliant products, France's emphasis on the SRI culture is strategic for potential growth of the Sukuk market in France

Other participating stakeholders review Indirect policies

Implementation of policies to encourage the development of identified industry sectors, growth of local companies, or socially responsible investments can be strategic for the development of Islamic Finance. The governments of France, the United Kingdom, and Turkey have implemented several schemes which have synergies with the development of corporate Sukuk. Socially Responsible Investment (SRI) Scheme:

- The French government's active support for initiatives that develop social and environmental transparency of business.
- Requirement for compulsory annual non-financial reporting on social, environmental and societal criteria for businesses whose shares are traded on a regulated market.

Exploring the potential of the French socially Responsible Investment Scheme:

Factors of Socially Responsible Investments (SRI):



Given the parallels that can be drawn between SRI and Sharia'-compliant products, France's emphasis on the SRI culture is strategic for potential growth of the Sukuk market in France.

Examples of socially responsible investments include green bonds, which are debt instruments issued to raise financing for projects that generate direct environmental benefits (renewable energy, social housing, education etc).

Green tax systems

- France, Germany and the United Kingdom have in place green tax systems to encourage green innovation and achieve energy efficiency. The incentives to develop green innovation come in various forms such as:
 - Tax incentives, subsidies on research, and low interest loan programs for energy-efficient construction and retrofitting in Germany.

- Discounts on the climate change levy and capital allowances on equipment to improve energy efficiency in the United Kingdom.
- Exemption from local property taxes for up to five years on green buildings in France. The development of green property is strategic for the development of Islamic Finance as the underlying investments are also Sharia'-compliant.

France, Germany and the United Kingdom have in place green tax systems to encourage green innovation and achieve energy efficiency

Comparison with other European countries with established Sharia' practices



Ireland is home to two industries that are Sharia'-compliant and have the potential to boost the Sukuk liquidity pool.

- Renewables and clean tech industry
 - Identified by the government as a key industry for development
 - Incentives for companies to realize inherent value from "carbon offset" qualifying assets
- Aircraft leasing industry
 - One of the oldest and longest established international financial services industries in Ireland



Luxembourg has marketed itself not just as a prime location for setting up and servicing conventional funds, but also Islamic funds.

The Association of the Luxembourg Fund Industry and Luxembourg for Finance has put together brochures to provide comprehensive information on the legal framework and tax treatment for a range of commonly used Islamic Finance structures, as well as best practice guidances for investors.

Key findings:

Country	1. Stock exchanges	2. Support from international and local organizations	3. Educational institutions	4. Sukuk issuers	5. Sukuk investors	Ecosystem
France	<p>NYSE Euronext Paris</p> <ul style="list-style-type: none"> Platform to issue Sukuk Does not have rating requirements 	<p>Paris Euro Place</p> <ul style="list-style-type: none"> Teamed up with AAOIFI Developed tax law guidebook to assist Sukuk issuers under different laws 	<ul style="list-style-type: none"> Several educational institutions offering specialized courses in Islamic Finance 	<ul style="list-style-type: none"> No sovereign Sukuk issue 2 corporate Sukuk issues in 2012 	<ul style="list-style-type: none"> Private Placement Funds Investors from the Middle East 	<p>In place</p> <p>More conducive for private placement</p>
Germany	<p>Frankfurt Stock Exchange</p> <ul style="list-style-type: none"> Sukuk and bond issues have the same listing requirements One of the two most popular stock exchanges in Europe for Sukuk listing 	<ul style="list-style-type: none"> Turkey, being one of Germany's most important trading partners Bank license granted to a Turkish bank to conduct limited Islamic banking operations 	<ul style="list-style-type: none"> Several educational institutions offering specialized courses in Islamic Finance 	<ul style="list-style-type: none"> First Sukuk issue in Europe (State of Saxony Anhalt) in 2004 13 foreign companies (Middle East & Malaysia) with overseas operations have listed corporate Sukuk on the Frankfurt Stock Exchange 1 corporate Sukuk issued via private placement in 2013 	<ul style="list-style-type: none"> International investors 	<p>In place</p> <p>More conducive for big corporations due to cost of issuance</p>
United Kingdom	<p>London Stock Exchange and Alternative Investment Market</p> <ul style="list-style-type: none"> No annual listing fees One of the two most popular stock exchanges in Europe for Sukuk listing 	<ul style="list-style-type: none"> The Middle East, being one of the United Kingdom's most important trading partners Strong government support through the establishment of the Islamic Finance task force 	<ul style="list-style-type: none"> Renowned educational institutions offering specialized courses in Islamic Finance 	<ul style="list-style-type: none"> First sovereign Sukuk issue in 2014 49 corporate Sukuk listed on LSE to date by foreign companies (Middle East & Malaysia) with overseas operations 	<ul style="list-style-type: none"> International investors 	<p>In place</p> <p>Conducive for local medium-size enterprises. However, credit ratings of Sukuk issued may deter popularity among investors</p>
Turkey	<p>Borsa Istanbul</p> <ul style="list-style-type: none"> No Sukuk listing All bonds listed are by Turkish companies denominated in Turkish Lira 	<p>World Bank</p> <ul style="list-style-type: none"> Established the World Bank Global Islamic Finance Development Center in Turkey Provided US\$250 million loan to improve Islamic financing to SMEs 	<ul style="list-style-type: none"> Several educational institutions offering specialized courses in Islamic Finance 	<ul style="list-style-type: none"> First sovereign Sukuk issue in 2014 1 potential corporate Sukuk issue received regulatory approval in 2014 	<ul style="list-style-type: none"> International investors 	<p>In place</p> <p>More publicity required to assure issuers on pricing</p>

Creating a corporate Sukuk market in Europe

France



- France has in place a conducive ecosystem to encourage medium-size enterprises to issue Sukuk. Given the number of Muslims residing in the country, there are a number of enterprises offering Sharia'-compliant products and services (ie. restaurants/ supermarkets selling halal food). The increasing difficulty in obtaining long-term corporate loans from conventional banks and the lack of Islamic banks to offer financing solutions makes Sukuk issuance a potentially attractive financing option for medium-size French enterprises. This is supported by the positive regulation and tax reforms in place for Islamic financing products which have been implemented since 2007.
- Furthermore, the French government's focus on promoting enterprises to include socially responsible investments (e.g. Green bonds and environmentally-friendly developments) as part of the enterprise's strategy creates a potential demand from French enterprises to invest in Sukuk, given the parallels that can be drawn between the two types of instruments.
- The key challenge that remains is the current political climate which has discouraged both medium-size enterprises and even large corporations from public issuance of Sukuk, despite having the platforms and resources to generate a demand and supply for corporate Sukuk.

Turkey



- Turkey, being the only emerging market analyzed, has received a high level of support from the World Bank Group to develop its Islamic Finance sector. The government has also been taking proactive steps towards developing the national bond and Sukuk markets for more effective channeling of capital into economic development.

- Given that non-bank financial institutions (NBFIs) have been playing a limited role in Turkish financial markets in the past, the market is not saturated and there is plenty of room for development moving forward. These factors give a clear indication that there are opportunities being created to develop the Sukuk market.
- The key challenge, however, is the macroeconomic instability in the country which has threatened to reverse the growth in Turkey's economy. Improving regulations to allow for more effective and efficient issues of the additional Sukuk before redemption of the first Sukuk in circulation, or creating an effective mechanism to handle creditors' rights and bankruptcy proceedings could encourage NBFIs to turn to the Sukuk markets to raise capital or invest in Sukuk. The most encouraging initiative is for the government to implement incentives to reduce the cost and make Islamic financial instruments more attractive than conventional instruments. This was successfully implemented in Malaysia, however the political climate might be challenging for this initiative to be implemented.

Germany



- Germany has the third largest trading exchange and liquid market in the world and this reputation has attracted international companies from the Middle East and also Malaysia to list Sukuk on the exchange. The number of Muslims residing in the country and strong trade relations with Turkey are indicators that the demand for Sharia'-compliant goods and services is expected to increase. The providers of these goods and services are likely to be keen to seek Sharia'-compliant financing to expand their operations.
- Given that there is currently a Turkish participation bank in Germany offering limited Sharia'-compliant financing options, Sukuk issuance will have to prove that it is more cost effective and attractive compared to the Sharia' financing options offered by the Turkish participation bank.



- The key challenge that remains for Germany is largely due to taxes. While there are no withholding taxes on interest or payments under a loan, there is a 26% withholding tax slapped on bonds/Sukuk resulting in high costs involved for Sukuk issuance. Furthermore, creating tax neutrality for Sharia'-compliant financing structures could be implemented to encourage medium-size enterprises to consider Sukuk issuance.

UK



- The United Kingdom houses the London Stock Exchange (LSE), which is one of the largest trading exchanges and liquid markets in the world. The LSE's stellar reputation and low cost of listing has attracted not just international companies to list Sukuk on the exchange, but also medium-size enterprises to list on the Alternative Investment Market (AIM), which is part of the LSE but caters for smaller growing companies. The British government has maintained extremely cordial relationships with the Middle East and has been extremely proactive, voicing support for the development of Islamic finance in the country.
- Furthermore, London is known to be one of the best cities for foreign property investment opportunities and this has attracted investors from Asia, the Middle East, and Europe. Specifically investors from the Middle East have been increasing their demand for Sharia'-compliant investments originating from London. This serves as a motivating factor for medium-size enterprises to consider bond issuance.
- The key challenge for the United Kingdom is to introduce measures to make Sukuk issuances more attractive than the other conventional and Islamic financing options currently available on the market. The United Kingdom boasts the highest number of Islamic banks in Europe which provide medium-size enterprises with sufficient supply of Sharia'-compliant financing options for enterprises. These options offer more confidentiality than a public issue of Sukuk on an exchange.

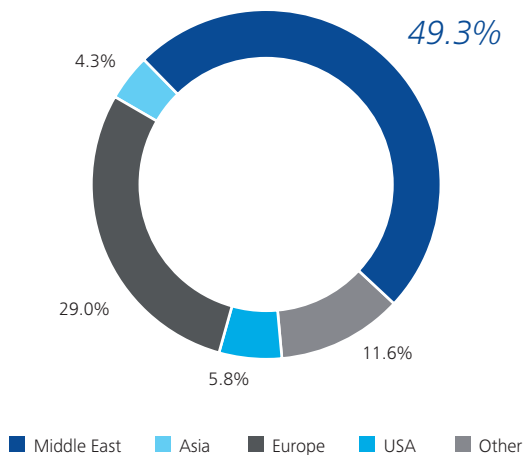
The practitioners' perspective

Hallmarks of optimism

This section quantifies the results gathered through the 'online survey questionnaire' in order to increase our understanding of the key determinants of an efficient Sukuk market in Europe.

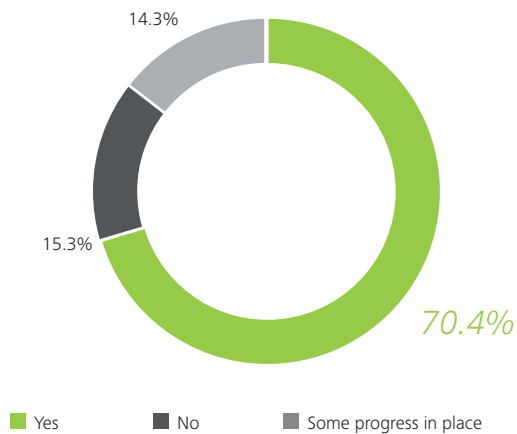
Global responses were received, with approximately half being from the Middle East and a third from Europe. As expected, this reflected the study's main objective of bringing together highly liquid Middle Eastern and Asian (MEA) investors with scarce European corporate debt markets.

Participants by region

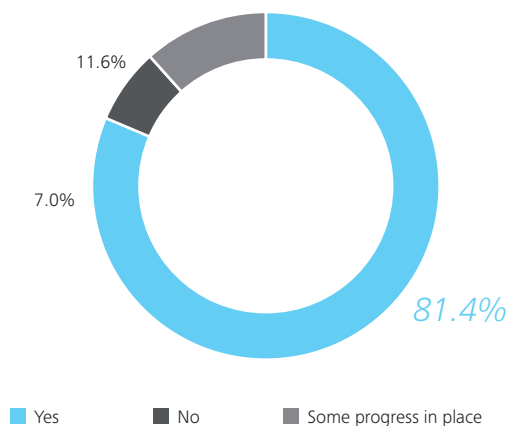


- 56.8% of respondents would consider Islamic finance transactions if financial reporting is aligned with conventional counterparts.

Does the regulatory system in which your company resides facilitate Islamic Finance transactions? (e.g. Investing/Issuing Sukuk)



Do other professional services providers (such as lawyers, consultants and rating agencies in the country in which your... facilitate Islamic finance transactions? (e.g. Investing/Issuing Sukuk)

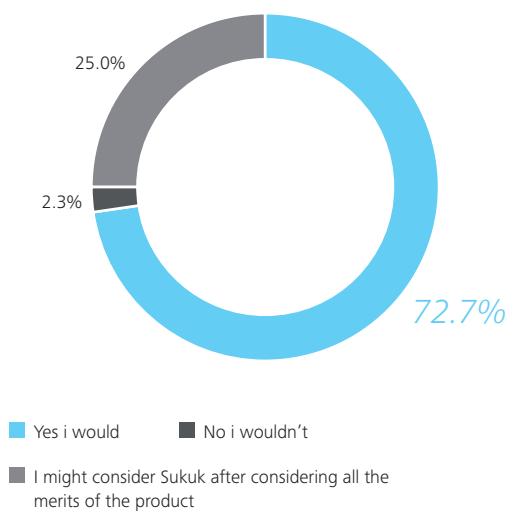


Regulatory and Tax

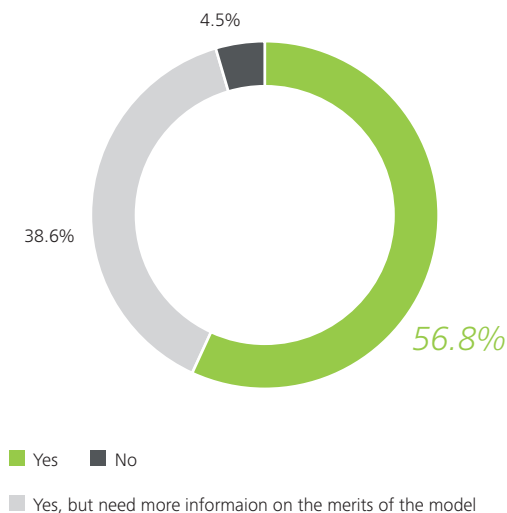
Key messages:

- The UK pioneered regulatory development by removing the double charge through the Stamp Duty Land Tax in 2003, in support of the Ijarah Sukuk.
- Many other markets have reacted similarly, resulting in better regulation across Europe.
- 70.4% of respondents confirm that the market they operate in facilitates Islamic finance transactions.
- 81.4% of respondents are aware of readily available support from professional service providers.
- 73% of respondents would consider Sukuk and another 25% might consider it if a tax benefit is perceived.

Compared to conventional counterparts (bonds), would you consider Sukuk (Islamic bonds) if there were any tax benefit(s) (tax neutrality, incentives, deductions, and exemptions) associated with the development and use of Sukuk in your country? Frequency



Would you consider an Islamic Finance transaction if financial reporting is aligned with the treatment of conventional counterparts? (i.e. IFRS/GAAP)

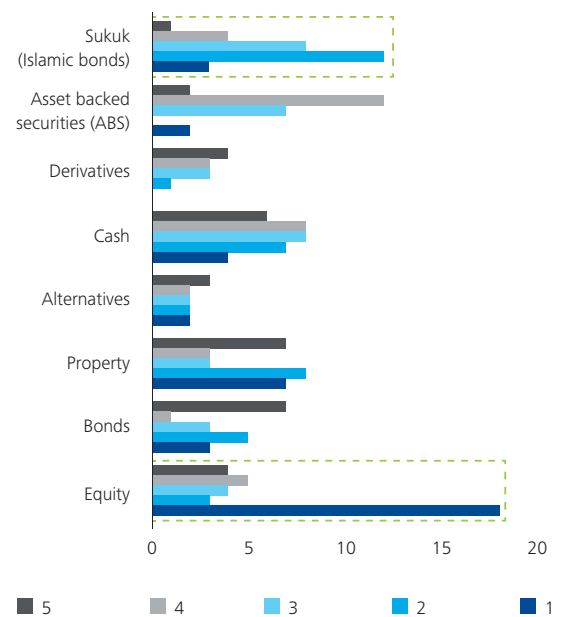


Financing requirements

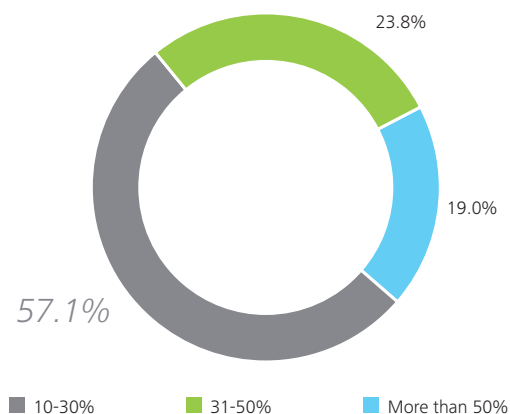
Key messages:

- Sukuk ranked second highest asset class followed by equity
- Majority of participants are likely to allocate 10%-30% of their Capex allocation.
- 38% of the participants would consider Sukuk as a fund raising mechanism whilst 33% are not sure.

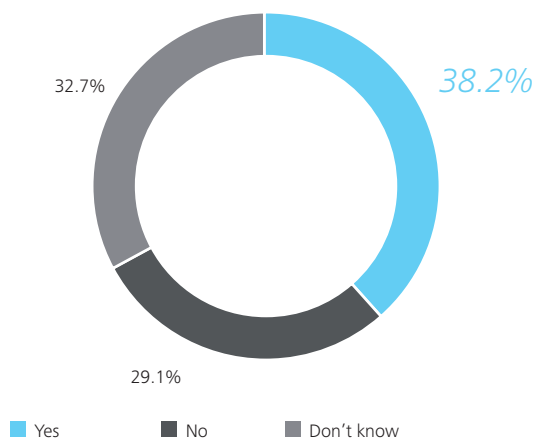
Rank asset classes as per your asset allocation strategy for the next 3-5 years. (Rank 1 - High; Rank 5 - Low)



What percentage of your total Capex will be allocated to Sukuk? Frequency



Is your company likely to consider issuing Sukuk (Sharia'-compliant bonds) for raising funds? Frequency



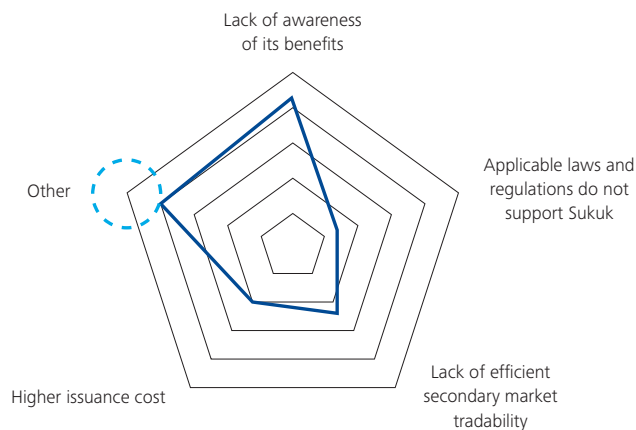
38% of the participants would consider Sukuk as a fund raising mechanism whilst 33% are not sure

Behavioral finance

Key messages:

- Evenly distributed responses were given in relation to using Sukuk as a method of raising funds.
- A lack of awareness around the Sukuk instruments' may have attributed to limited use within European corporates.
- The UK has set up an Islamic Finance Secretariat (UKIFS), aiming to educate and promote Islamic finance instruments.

Please state the reasons: (select all that apply) Frequency

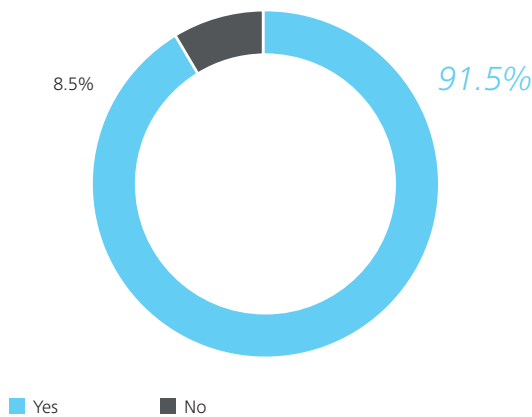


Investment strategies

Key messages:

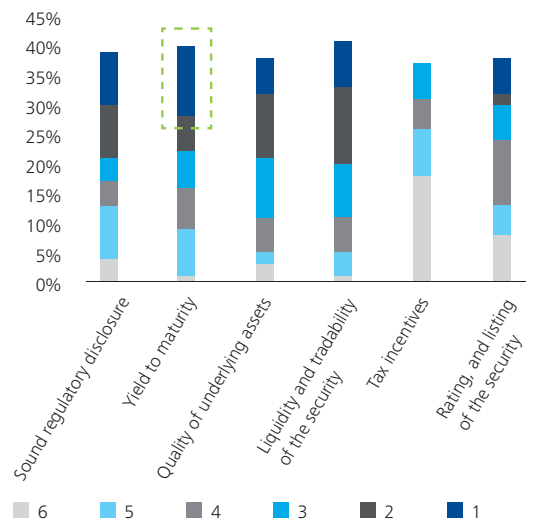
- Most respondents agree about the similarity between ethical investments and Sharia'-compliant investments.
- 91% of respondents have considered ethical investments and Islamic finance instruments.
- Yield to maturity was ranked as the highest concern in investing in Sukuk.
- 75% of respondents would still consider investing in Sukuk even with lower/similar yields than other bonds.

Have you considered ethical investments / Islamic Finance products like Sukuk? Frequency

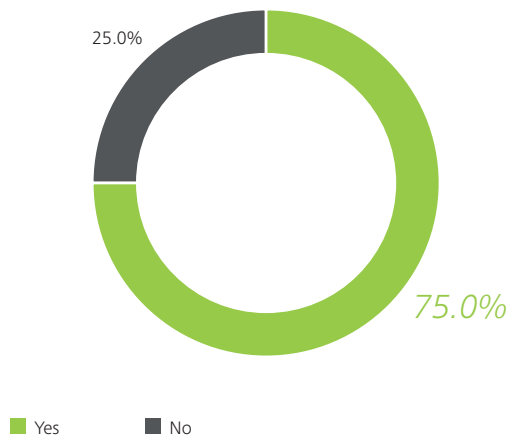


A lack of awareness around the Sukuk instruments' may have attributed to limited use within European corporates

Please give the relative rank of the following factors/ concerns that matter most in investing in Sukuk. (1 being the most important and 6 being the least)



Will you still consider investing in Sukuk if it provides the same/lower yield than bonds with the same characteristics? Frequency

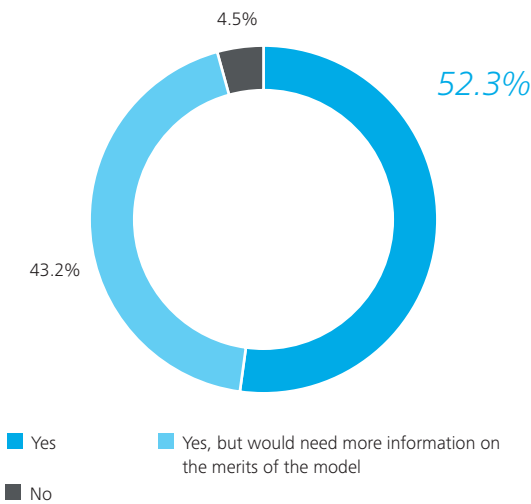


Risk management

Key messages:

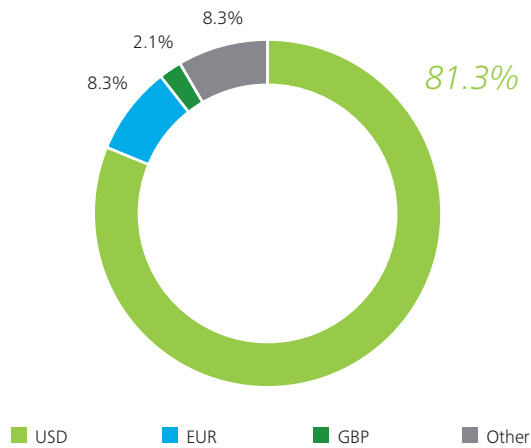
- 52% of respondents would definitely consider Sukuk as participatory equity-based financing, with another 43% speculative.
- The US dollar is the preferred currency with 81% of participants preferring to invest in US\$ denominated Sukuk.
- 55% of respondents would definitely consider Sukuk as a tool to reduce risk and diversify their portfolio, with another 34% speculative.
- More than half of respondents would use alternative financing to diversify and manage the risk of their portfolios.

Would you consider alternative financing e.g. (Islamic finance), which offers a participatory equity-based financing where both parties share the profit and loss in the business?

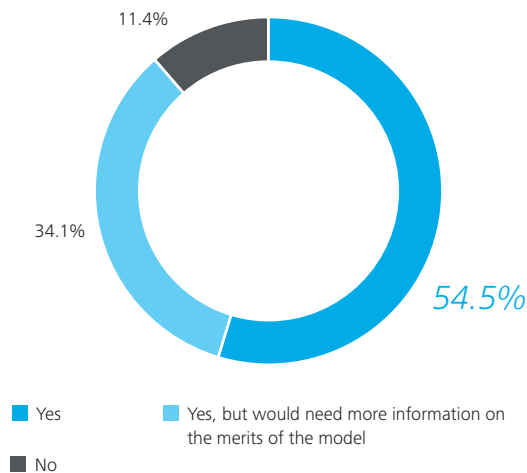


The US dollar is the preferred currency with 81% of participants preferring to invest in US\$ denominated Sukuk

What is the most preferred currency of Sukuk to invest in?



Would you consider alternative financing e.g. (Islamic Finance), in an attempt to diversify your investment portfolio and reduce risk?



Project-oriented Sukuk financing structures

Public issuance of sukuk

France



Stock Exchange: NYSE Euronext

1) Issuers can opt for issuing different products

- Retail bonds
- European private placement
- Green bonds

2) Key requirements

- Prospectus, appointment of a listing agent responsible for filing the admission application (European financing institution)
- Admission request filed with Euronext
- Choice of market segment

A listing timetable jointly agreed with Euronext Paris.

Turkey



Stock Exchange: Borsa Istanbul

- 1) Listing on Borsa Istanbul (Istanbul Stock Exchange). However, bonds must be denominated in Turkish lira (Regulatory approval required)
- 2) Listing on stock exchanges in France/Germany/UK allows for the flexibility of issuing Sukuk denominated in euros.

Germany



Stock Exchange: Frankfurt Stock Exchange

Key admission conditions:

- Securities prospectus
- Brief company profile and information on the corporate bonds
- A calendar of company events
- Audited annual financial statement and a group management report
- Up-to-date issuer or bond rating by one of Deutsche Börse's accredited credit rating agencies
- Defined company key figures on debt service coverage, debts and capital structure

UK



Stock Exchange: London Stock Exchange

1) Eligibility requirements for the main market & Professional Securities Market

- Minimum value of issue of £200,000
- Free transferability of debt securities
- All securities of same class to be listed

2) Issuers can contact the UK Listing Authority to discuss proposed transaction timetables or technical matters.

3) Listing agent is not required

Civil, common law and Sharia' law

The conflict between common law and Sharia' leads to some gray areas. As in any particular jurisdiction, clashes may occur due to dual system governance of financial transactions. For example, in cases where the verdict decided upon was based on sale contract law, while the substance of the contract was actually a conventional debt contract. Therefore, confusion emerges as to the legal basis of the verdict.

- **True sale execution**

The execution of a true sale is an important element in a Sukuk transaction, as it constitutes a real transfer of ownership from the originator to the Sukuk holders via the SPV. Subject to jurists' interpretations, in order for a transaction to be deemed a "true sale," it must meet the four key criteria articulated through the Sharia' perspective. Re-characterization of the transfer by court or other bodies may not be permitted, the transferred asset themselves must be bankruptcy remote from the originator, the transfer must then be perfectible at the election of the issuer, and finally all overriding liens must be cleared off of the sale (IFSB, 2009, p.9).

Nevertheless, some Sukuk issuances do not execute a true sale, as with asset-based Sukuk issuance, due to the absence of property and bankruptcy acts under civil law origin.

- **Bankruptcy**

Bankruptcy law is crucial for facilitating true sale transactions in which investors are protected and will receive payment on asset-backed Sukuk, even in cases of the originator's bankruptcy.

Bankruptcy law is crucial for facilitating true sale transactions in which investors are protected and will receive payment on asset-backed Sukuk, even in cases of the originator's bankruptcy

- **Special Purpose Vehicle**

An SPV is a remote firm, which is independent from the obligor. The SPV is established based on trust law in which the Sukuk's originator transfers the assets to the Sukuk holders via the SPV as a trustee with good faith. Therefore, trust law plays an important role in governing the SPV's establishment. Trust law has been well incorporated into both common and civil law jurisdictions. This trust law recognizes the equity for remedies and rights in which beneficiaries are provided with equitable treatment remedies against unfaithful acts. Within common law treatment, the legal rights of the trustee are bound by the legal rights of beneficiaries.

In contrast, under civil law treatment, the beneficiaries have no rights or control towards the assets managed by the trustee. Hence, civil law treatment entails a problem for Sukuk issuance that originates from civil law jurisdiction countries. In those cases, in the event of default, the Sukuk holders do not have recourse to the asset due to civil law restrictions, and therefore those Sukuk are characterized as asset-based Sukuk. However, for Mudarabah and Musharakah Sukuk, the trust elements are embedded in those underlying contracts.

Key Sukuk financing structures and sectors

Renewable Energy/Pharmaceutical/ Manufacturing	Murabaha	Cost plus financing arrangement: Financing the purchase of commodities used in the production of renewable energy, pharmaceutical medical drugs and textiles.	Expansion of operations in international markets Expansion of operations in local markets Investing in new business streams
	Salam	Sale where goods are purchased in advance for delivery on an agreed future date: Financing the purchase of commodities used in the production of renewable energy, pharmaceutical medical drugs and textiles.	
	Istisna'	Construction project to be delivered on a future date for a fixed, agreed-upon price and with specific product specifications: Financing the construction of production plants/facilities in overseas territories and locally.	
	Ijarah	Leasing arrangement: Finance or Operating lease of equipment used in the production of renewable energy, pharmaceutical medical drugs and textiles.	
Real Estate	Murabaha	Construction project to be delivered on a future date for a fixed, agreed-upon price and with specific product specifications: Financing the development of real estate properties.	Using Sukuk to diversify capital sources
	Istisna'	Construction project to be delivered on a future date for a fixed, agreed-upon price and with specific product specifications: Financing the construction of production plants/facilities in overseas territories and locally.	
	Ijarah	Leasing arrangement: Finance or Operating lease of equipment used in the production of renewable energy, pharmaceutical medical drugs and textiles.	

Case scenario 1: Manufacturing industry (Turkey)

The opportunity: Manufacturing industry in Turkey

- The manufacturing industry is one of the main drivers of the Turkish economy, accounting for 24.2% of total GDP.
- Turkey's 2023 goals include reaching certain benchmarks for exports in various sub-sectors.

The proposed issuer: ABC manufacturing company (Turkey).

- One of the largest companies in Turkey with three manufacturing facilities in Turkey.
- Exports largely to Europe and the United States of America.
- Listed on the Istanbul stock exchange.
- Debt securities used in the industry:
 - Turkish currency commercial paper
 - Turkish currency of bonds qualified investors with maturity of 5 years.
 - Turkish currency of bonds used via public offering with maturity of 5 years.

The challenge:

The ABC manufacturing industry in Turkey typically obtains financing through bank loans and in some cases corporate bonds.

Business issues:

- The export-oriented nature of the Turkish ABC manufacturing business puts the industry in a vulnerable position when there is a slowdown in the global economy.
- Domestic political uncertainty could make the country unstable affecting the operations of companies (i.e. foreign investors selling off their stake in Turkish assets amid the political uncertainty).
- Resources required for constant innovation, in order to achieve operational and cost efficiency as well as create new innovative products.

Financing issues:

- Inability for special purpose vehicles (SPVs) in Turkey to issue second Sukuk before the redemption of the Sukuk in circulation.
- Small- and medium-size enterprises tend to experience problems in obtaining sufficient working capital for

their day-to-day operations after the banks increased interest rates and lowered the amount of loans available to the private sector.

- Attractiveness of bonds issued by Turkish company to international investors, given that there is no government backing and higher country risk in view of the political uncertainty in the country.

The case for Sukuk issue:

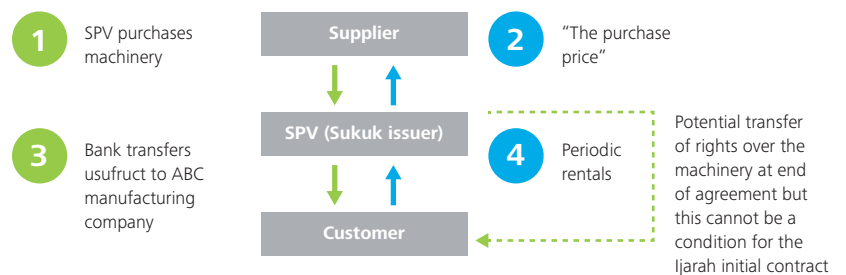
The key possible transactional features and considerations which set a Sukuk issuance apart are the requirements for Sharia'-compliant assets and utilization of proceeds.

Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	2-year tenure
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	US Dollar
Underlying asset	New machinery acquired to produce new ranges of textile products
Governing law	English law
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Ijarah

Sale-based contract: Ijarah



Case scenario 2: Automotive industry (Germany)

The opportunity: Automotive industry in Germany

Boasting the largest concentration of Original Equipment Manufacturer (OEM) plants in Europe, with 21 of the world's 100 top automotive suppliers being German companies, Germany is Europe's number one automotive market in production and sales.

The proposed issuer: ABC automotive company (Germany)

- A leading German automotive manufacturing company, top 5 automotive supplier in the world and industrial partner to key industries
- Listed on the Frankfurt Stock Exchange
- Debt Securities used:
 - Euro Corporate bonds with maturity of 5 years
 - Euro Corporate bonds with maturity of 7 years

The challenge:

Given the capital-intensive nature of the automotive manufacturing industry, it is no surprise that the bond market in Frankfurt Germany has been dominated by issuance from large corporations.

Business issues:

- Effective product technology and constant innovation is required to survive in the current competitive market place.
- Sustainable long-term business strategies are required to address high labor costs which threaten Germany's automotive industry in view of stiff competition from Central Europe, China and Latin America.

Financing issues:

- Being a capital-intensive industry, it is crucial for automotive manufacturers to get the right financial leverage and the most cost-effective financing solutions for their operational and production innovation needs.

The case for Sukuk issue:

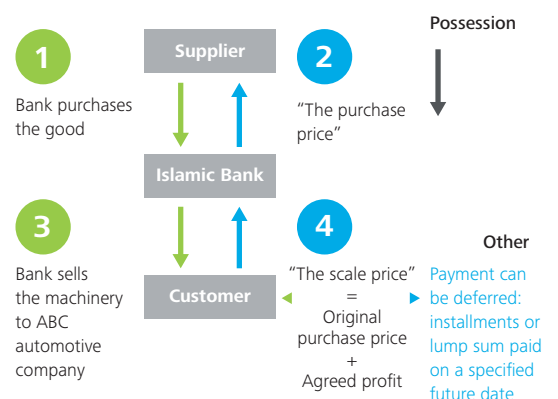
The key possible transactional features and considerations which set a Sukuk issuance apart are the requirements for Sharia'-compliant assets and utilization of proceeds.

Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	5-year tenure
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	US Dollar
Underlying asset	Machinery acquired to produce automotive parts
Governing law	German law
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Murabaha

Sale-based contract: Murabaha



Case scenario 3: Renewable energy (Germany)

The opportunity: Renewable energy industry in Germany

- The completion of new offshore windfarms in Northern Germany has increased wind energy production in the country.
- Renewable energy sources (solar, wind, hydropower, biomass) make up 34% of Germany's public net power supply in 2015, with the government targeting an 80% share in electricity generation by 2050.

The proposed issuer: ABC renewable energy company (Germany)

- A major player in the offshore wind industry.
- Installation of wind turbines largely in Germany and France and provision of offshore installation, service, and maintenance of wind turbines.
- No bonds have been issued by the company and it is not listed on any stock exchange.

The challenge:

Provision of renewable energy is capital intensive during the construction stage of the windmills.

Business issues:

- The European Union scaled down government subsidies for renewable energy sources (i.e. wind, solar) given the high costs of renewable energy affecting businesses forced to utilize renewable energy.
- Challenge to ensure that costs for renewable energies will be reduced through research and development, more prevalent usage to bring about economies of scale.
- New technology with high operating risks, smaller project sizes.
- Capital cost-intensive structure and high operating and maintenance costs.
- Renewable energy developers and sponsors have been classified as high risk.
- Long time horizons resulting in long exposure period to risk (long to extra-long maturities and interest rates at the low range).

Financing Issues:

- Difficulties in mobilizing financing given the high up-front costs and perceived commercial risks. High collateral is required in the renewable energy business.

The case for Sukuk issue:

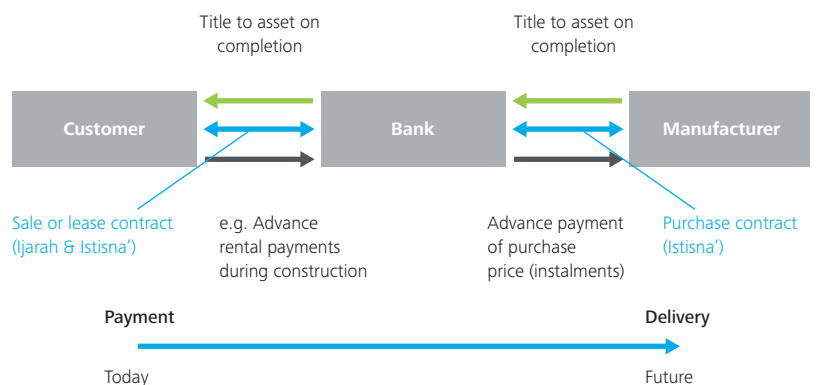
The key possible transactional features and considerations which set a Sukuk issuance apart are the requirements for Sharia'-compliant assets and utilization of proceeds.

Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	3 years tenure
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	US Dollar
Underlying asset	Windmill
Governing law	German law
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Istisna'

Sale-based contract: Istisna'



Case scenario 4: Real estate (Turkey)

The opportunity: Real estate (construction) industry in Turkey

Leveraging strong government support and good international relations, Turkish construction companies have ventured into more high risk regions such as Central Asia, the Russian Federation and the Middle East. Securing numerous projects over the past few decades, the construction industry now accounts for almost 5.9% of Turkey's gross domestic product and employs more than 1.8 million people. Based on a recent Engineering News Report survey, Turkey is now ranked second in the world for having top international contractors.

The proposed issuer: ABC Real Estate company (Turkey)

- A conglomerate specialized in construction, real estate, investment, energy production, health and education sectors.
- Portfolio of projects across 11 countries including Turkey, the Middle East, Central Asia and Russia.
- Issued bonds and listed on Istanbul Stock Exchange and under private placement for the purpose of financing construction projects in Turkey and in Russia.

The challenges:

Construction companies require significant financing throughout the project term to facilitate the completion of the construction. Securing long-term financing from financial institutions and understanding the new market may be challenging for companies entering new foreign markets. One strategy to facilitate the process is by partnering up with a local firm with a good credit history and reputation.

Business issues:

- Gaining a competitive advantage (i.e. through research & development) in view of strong local and international competition.
- Political uncertainty in both Turkey and countries where Turkish companies undertake international projects could affect the operations of companies (i.e. foreign investors selling off their stake in Turkish assets amid the political uncertainty).

Financing issues:

- Inability for special purpose vehicles (SPVs) in Turkey to issue second Sukuk before the redemption of the Sukuk in circulation.
- Difficulties in managing cash flows, in view of delayed progress payments by payee, cost overruns and design changes requested during the execution of the project. Should companies fail to secure adequate financing during the time span of the construction project, it can result in the construction being delayed indefinitely and bankruptcy.

The case for Sukuk issue:

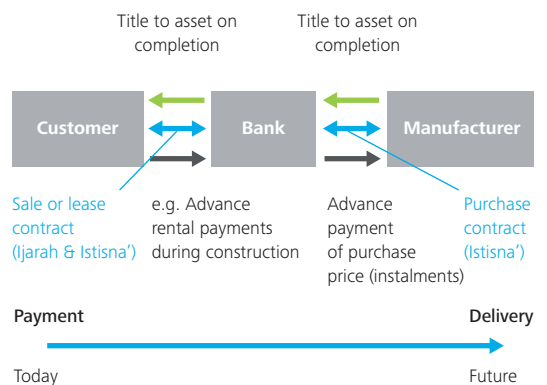
The key possible transactional features and considerations which set a Sukuk issuance apart are the requirements for Sharia'-compliant assets and utilization of proceeds.

Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	Dependent on the project duration
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	US Dollar
Underlying asset	Construction of buildings (project completion)
Governing law	English or French
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Istisna'

Sale-based contract: Istisna'



Case scenario 5: Pharmaceutical industry (Germany)

The opportunity: Pharmaceutical/chemical manufacturing industry in Germany

Being one of Europe's key assets and top performing high technology sector, pharmaceutical companies in Germany have adopted a consistent approach of investing in capital expenditure. As at 2013, the German pharmaceutical market stood as the fourth largest pharmaceutical market globally, and second largest pharmaceutical production market in Europe.

Target company: ABC pharmaceutical company (Germany)

- Independent, family-owned, international research-based pharmaceutical company headquartered in Germany.
- Production plants and affiliates in Latin America and Europe.
- Partnership with affiliates for the exclusive production rights of patented medical drugs.
- No debt securities issued. Loans taken from financial institutions or shareholders.

The challenge:

The pharmaceutical industry invests a percentage of its earnings in research and innovation, a key component for generating potential new patents and medication for the industry. However, unlike other industries (i.e. automotive and energy), where industry heavyweights have taken to the bond markets to raise financing, the traditional sources of financing for the pharmaceutical industry continue to be private and public equity. Debt financing is only feasible for large pharmaceutical companies with stable cash flows.

Business issues:

- A complex licensing and approval process, as well as price controls implemented by the government requiring drug manufacturers to prove the additional benefits of new medicines and then negotiate the reimbursement price with authorities, serves to impede innovation and discourage investment in research to develop more medical patents.
- Retail pharmacy is subject to entry and price regulations that impede competition in both retail and manufacturer level prices.
- Tax issues for German bond issuers entail withholding taxes of 26.35%.

- The pharmaceutical drug approval process can often take more than a decade, requiring long-term financing.
- Expansion and construction of production facilities in foreign markets require significant financing during the construction stage.

The case for Sukuk issue:

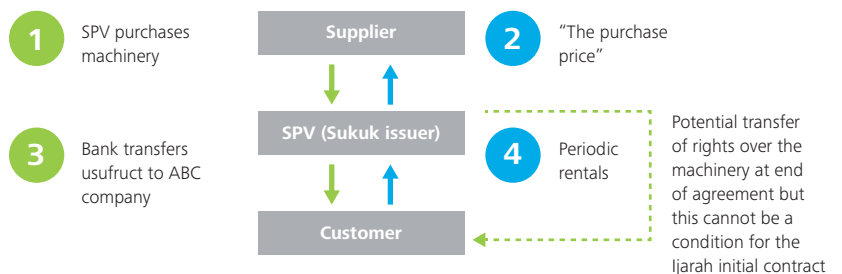
The key possible transactional features and considerations which set a Sukuk issuance apart are the requirements for Sharia'-compliant assets and utilization of proceeds.

Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	10 years tenure
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	US Dollar
Underlying asset	Machinery for the production of newly patented medical drugs in new markets
Governing law	German or English law
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Ijarah

Sale-based contract: Ijarah



Case scenario 6: Infrastructure industry (UK)

The opportunity: Infrastructure industry in United Kingdom

- In 2014, the performance of UK infrastructure was ranked 10th in terms of infrastructure quality as compared to France at 8th and Germany at 7th.
- According to the 2014 Infrastructure pipeline, 69% of planned infrastructure investment will be privately funded, 19% will be publicly funded, and 12% will be financed by a mixture of public and private investment.

The proposed issuer: ABC infrastructure group (UK)

- ABC group finance, develop, build, and maintain complex infrastructure such as transportation, power and utility systems, and social and commercial buildings.
- Debt Securities used:
 - Guaranteed Convertible Bonds
 - ABC group aims to improve its range of debt funding sources and liquidity through issue of convertible bonds

The challenges:

Private investment in infrastructure has always been an integral part of the UK's financial framework, accordingly private infrastructure investment has begun to flourish in the market to support the gap in public infrastructure investments.

As reported by Nesta in 2014, alternative finance in the UK is expected to grow to £1.74 billion. Alternative finance covers a variety of new financing models that have emerged outside of the traditional financial system.

Business issues:

- The Infrastructure sector in UK has suffered from under-investment in the public infrastructure investments.

Financing issues:

- The need of government support in financing infrastructure projects in the UK as the banks alone cannot meet the future financing requirements of the infrastructure sector. To combat this, new innovative financing structures and avenues of raising capital should arise.

- Annual infrastructure spending will be more than double by 2020. This will create an opportunity for alternative financing to bridge gaps in financing.

The case for Sukuk issue:

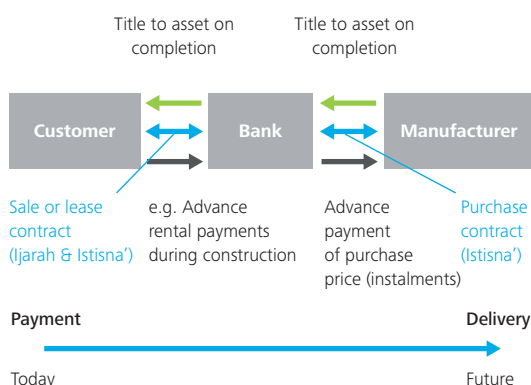
The key possible transactional features and considerations which set a Sukuk issuance apart are the requirements for Sharia'-compliant assets and utilization of proceeds.

Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	Dependent on the project duration
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	US Dollar
Underlying asset	Construction of buildings (project completion)
Governing law	English or French
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Istisna'

Sale-based contract: Istisna'



Case scenario 7: Agriculture industry (France)

The opportunity: Agriculture industry in France

With more than 950 thousand people working in the agriculture sector, the industry constitutes one of the most important industrial sectors in France. As one of the leading agricultural producers in Europe, the French government continues to support the industry through pledging aid to help companies invest in modernizing production over the next three years.

Target company: Agriculture Limited

- French group specializing in plant, animal and human nutrition (fertilizers).
- 77 production units, employing more than 7000 employees across 46 countries.
- Strong emphasis on research, development and innovation.
- No debt securities issued.

The challenge:

Despite the resilience of the French agricultural industry, the bankruptcy rate for the sector has increased since 2010. Firm productivity has thus become an important determinant of the survival of the company.

Business issues:

- High overheads, operational inefficiency, the end of European subsidies, as well as embargoes placed by Russia on European imports have made French companies vulnerable to price competition from their European neighbors. It is crucial for French companies to invest in technology to reduce operational costs and compete effectively.

Financing issues:

- In order to invest in technology to compete more effectively, French companies require adequate financing to acquire the technology, know-how and equipment. Given that bank loans account for the majority of financing for the agricultural industry, companies will need to fulfill the requirements of high collaterals necessary to obtain bank financing.

The case for Sukuk issue:

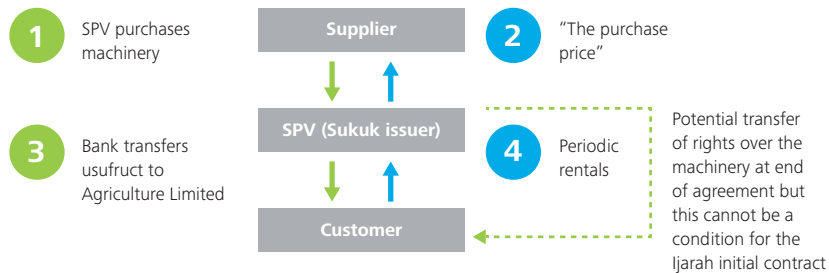
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Table 1: Transaction summary - issuance, terms and regulatory and legal aspects

Transactional features	
Issue price	US\$100 million
Tenure	5-year tenure
Coupon rate	6-month coupon rate
Payments	Settlement options
Currency	EUR
Underlying asset	Machinery for the production of fertilizers
Governing law	French law
Listing	As required
Regulatory approval	As required
Regulations	As required

The proposed structure type - Ijarah

Sale-based contract: Ijarah



Industry thought leaders' perspectives

The challenges facing the Sukuk market for European industry are likely just a precursor to common challenges many experts have anticipated in the following section. We set out to address three key strategic practice areas of regulation and tax, market structure and practices, and talent and skills development. The following are the points of views of industry thought leaders who generously contributed to this debate.

Regulatory and Tax

At the top of the agenda is the tax issue. "Tax treatment is one of the key challenges as there is a tax break on the interest payment for bonds while Sukuk profit payments might fall into the category of dividends which are taxed, and certain tax exemptions such as double taxation on sale of asset need to be addressed," said Ijlal Alvi, CEO, IIFM.

On the legal front, "some continental European jurisdictions do not recognize the legal concept of trust, and an alternative therefore needs to be found to the common Sukuk concept of an SPV held by trustees. Such alternatives do exist, but where this is an issue some thought may need to be given to the Sukuk structure, or it may need to be established under the law of a different jurisdiction," remarked Peter Casey, Advisor, Board Advisory Member, IFSB.

Generally, there is a lack of a European Union-wide regulatory regime despite the single market. However, "the favorable tax jurisdictions such as Dublin and Luxembourg may be best for Sukuk. Other factors include the currency issue which needs addressing. When should Sukuk be euro, sterling or dollar denominated?" commented Emeritus Professor Rodney Wilson.

"It is clear that existing and established international market regulations can encompass Sharia'-compliant as well as conventional financial practice. Similarly legal infrastructure can also accommodate (although perhaps more readily where English common law prevails) if there is a top down approach to determining whether it is appropriate to enable the requisite revision to such legislation where issues have become apparent," said Stella Cox, Managing Director, DDGI Limited.

"One of the key challenges is identification of assets on the corporate balance sheet. I also suggest that European corporate issuers may consider issuing Sukuk based on the covered bonds model. From the Basel Committee perspective it is important that European regulators should recognize Sukuk from a capital adequacy point of view," observed Ijlal Alvi. Equally important the need to create "Enabling regulatory and supervisory framework for asset-based and equity-financing. This includes securitized assets, participatory financing, and equity financing," said Dr. Zamir Iqbal, Director, World Bank Global Centre for Islamic Finance.

Creating an efficient Sukuk market

"Sukuk could be used to finance long-term infrastructure investments in the context of public-private partnerships. How attractive are such partnerships for investors concerned with Sharia' compliance? There are many choices in how Sukuk can be structured. Most European Sukuk have been based on Ijara contracts, but is there scope for Musharakah or Mudarabah Sukuk? Convertible Sukuk may also be attractive to some investors, especially if there is optimism about the longer term stock market outlook. Offering a variety of structures to serve different types of clients may be preferable than standardizing and promoting a single structure," explained Emeritus Professor Rodney Wilson.

"However, the ability to enable and, if needed, enforce 'true sale' of the assets, should in most circumstances limit the downside risk faced by an investor and as such effecting a real asset-backed transaction should have market appeal. Sukuk are suited to all sectors of the economy and a regulatory push could come into play through accurate risk charges for capital requirements, reflecting the limited potential for ultimate loss, which should result in a preferential risk weight allocation to a true sale transaction" emphasized Sabeen Saleem, CEO, the Islamic International Rating Agency (IIRA).

The world's capital markets are seeing their center of gravity shift toward new types of investment asset classes such as green bonds and Sukuk. Investors are evidently interested in these new assets looking for higher returns. "At present, Sukuk tend to have higher yields than comparable bonds (possibly because there is an illiquidity premium)," asserted Peter Casey.

“UK practitioners are very aware that British and other European corporates have been accessing forms of Islamic finance for many years, however the overwhelming majority have done so through private market arrangements which have included bi-lateral, club and syndicated facilities. In the UK there are numerous examples even now. It might be suggested that there is a degree of standardization and familiarity in those structural arrangements that provides comfort to the beneficiary in terms of comparability of offerings from other financial sectors (especially with regard to levels of dependable commitment, pricing, governing law and legal precedent, tax treatment etc),” stressed Stella Cox.

There are also a number of operating issues likely to have impact on the way the Sukuk market evolves in Europe. For instance, the “establishment of a secondary trading platform for Sukuk in an international European center, such as London, would boost the liquidity and tradability of Sukuk, thereby improving investment demand for Sukuk. In addition, such a secondary trading platform for Sukuk could provide a useful mechanism where issuers gain more understanding of the importance (particularly for investors) of consistent practices, allowing investors to evaluate Sukuk investments more easily,” argued Sohail Jaffer, Deputy CEO, FWU Group.

However, Islamic banks appear to be “much more active in cross-border syndications, driven by an opportunistic approach, particularly in emerging countries. This requires specific strategies for European corporates to tap into this niche market and benefit from the Sukuk’s attractive yield,” asserts Abdelilah Belatik, Secretary General, CIBAFI.

Moving towards the total standardization of practices would be difficult in the Sukuk market, “where each Sukuk issuance involves a unique set of underlying assets. However, a certain degree of consistent treatment of principles common to most Sukuk transactions would help facilitate a smooth, faster issuance process—that would ultimately lead to more corporates considering Sukuk as a viable means of raising funding for their business and assist investors during their evaluation of Sukuk investments,” said Sohail Jaffer.

In addition to the tax obstacle, “Sukuk need to be given equal treatment with conventional bonds including, in particular, avoiding property transfer taxes when assets are transferred into an SPV at the beginning of the period and out again at the end

In addition to the tax obstacle, “Sukuk need to be given equal treatment with conventional bonds including, in particular, avoiding property transfer taxes when assets are transferred into an SPV at the beginning of the period and out again at the end. From a regulatory point of view, thought needs to be given to the disclosures that are made in the offering document, in particular about the structure of the Sukuk, the Sharia’ opinions obtained, and the Sharia’ compliance of the underlying business. Subsequent disclosures, for example annual financial statements, need to be those of the ultimate obligor rather than merely the SPV (which technically will be the issuer). Ideally these disclosure issues would be addressed through Sukuk-specific regulation, but within Europe it is likely that capital market regulators will be able, where necessary, to use general provisions to require the necessary disclosures,” reiterated Peter Casey.

“So the challenge is potentially one for practitioners. How do we convince our corporate clients of the value proposition of Islamic finance? Conversely, how do we identify the domestic market opportunities for overseas investors that will support further broadening of their own investment perspectives and, perhaps, diversification into assets that may not be their usual preference, but that are better suited to support the origination of wholesale capital market issues from the UK or other European market platforms?” said Stella Cox.

Attracting skilled talent remains an exceptional challenge for the IIFS in all sectors and markets. This is especially the case for the Islamic capital market.

Managing brains

Attracting skilled talent remains an exceptional challenge for the IIFS in all sectors and markets. This is especially the case for the Islamic capital market. "This is the most important area that needs thought, engagement and action by all stakeholders. Industry, academia and students need to bond together to deliver an effective outcome. One of the best ways of doing this is through professional accreditation, similar to that employed by the accounting profession. In such a scenario, the relevant industry professional body sets the standards for competency and qualification, as well as ongoing professional development. Those standards are independently accredited by the likes of the FAA. Universities and educational establishments as well as their programs are then accredited against those standards. This will ensure a common benchmark for global use and the inter-operability of human capital across geographies," explained Daud Vicary Abdullah, President and CEO, The Global University of Islamic Finance (INCEIF).

"Leading investment banks and commercial law firms employ staff with experience of structuring and issuance. How can their knowledge be best disseminated? Are there proprietary issues to be addressed impeding the free flow of information?" said Rodney Wilson.

"Stress on complete education in terms of economics, finance and accounting, in addition to complete knowledge of Islamic Fiqh simultaneously, is required to lead the development of the industry from this point onwards. We need to turn increasingly to those who have comprehensive knowledge in multiple fields or towards multi-specialists," reflected Sabeen Saleem.

"The Islamic financial sector has evolved and grown from a banking footprint in the emerging markets. Our ethical investment counterparts have come, predominantly, from the international markets but do not have a similar form of dedicated banking infrastructure to support them," notes Stella Cox. "Work currently underway to research and explore potential for collaboration and co-operation between the two may provide further opportunities for both financial market subsets to expand. Although it has long been acknowledged that the socially responsible investment community may have interesting investment opportunities for our market, from personal experience, there is a great deal of potential for socially responsible investors to utilize and benefit from the Islamic capital markets infrastructure available in the UK and elsewhere in Europe (as well as the other core hubs of the industry) if the usual issues of knowledge, transparency and mutual understanding can start to be addressed," she added.

Bank of England data show debt issuance by UK businesses running at twice the levels seen before the crisis. "Many corporates have restructured their balance sheets, repaying bank borrowing and financing themselves with cheaper, long paid corporate debt. In this respect the UK corporate sector, which has long been largely dependent on banks for finance, is becoming more like its US counterpart, where corporate bonds play a bigger role," said Ian Stewart, Partner and Chief Economist, Deloitte UK.

The establishment of a Center of Excellence by various market participants and institutions will build capabilities and the skill sets required, according to Sohil Jaffer, with the following suggested three key benefits:

- Act as a catalyst for driving the European Sukuk market forward by championing consistent best practice.
- Provide a center that offers corporates/SMEs, investors and other interested professionals guidance and education on the nuances related to the Sukuk market.
- Encourage the development of skills relevant to the Sukuk market (structuring, issuance, evaluation, etc.) by providing a body of knowledge established by market participants.

Looking forward

Harnessing the potential of Sukuk market

Three main drivers familiar to capital market leaders have likely intensified the need for seeking alternative financing instruments: the growth imperative, scarce classic bank lending, and regulatory change. These three interrelated topical issues were reflected in much of the analysis in this report.

The results of this Deloitte study indicate that the prospects of a European Sukuk market are dependent on balancing the debate on two strategic fronts—the business and financial benefits of issuing Sukuk as opposed to issuing conventional corporate bonds on the one hand, and on the other, the dialogue with regulatory and policy-makers aimed at supporting the industry to devise enabling regulatory and tax legislations that help create interest from medium and large European corporates.

Overall, the study results reveal that several market and business environment policies—in many European jurisdictions—are changing for the good of industry growth. We expect continued development of Sukuk structuring and origination in light of the current global ‘scarce debt’, which was further exacerbated by the fall in prices of oil and commodities. Given these dynamic changes, the Islamic capital market’s business model should be reengineered to leverage this emerging need for fundraising in Europe and elsewhere in the world. Arguably, in the Middle East and Asia (MEA), investors aspire to diversify their investment portfolio with quality assets in Europe which conform to the Sharia’ principles. In Europe, blue-chip firms and quasi-sovereign enterprises are keen to diversify their debt financing methods and evidently search for cost effective financing. These two markets can possibly make the Sukuk a viable asset class in Europe.

Ian Stewart, Chief Economist, Deloitte UK asserts that “as banks have retrenched, alternative lenders, including private equity firms and asset managers, have moved in as providers of debt finance to medium and larger businesses. Mid-cap private businesses, which do not have access to equity funding, are increasingly turning to alternative lenders to diversify their sources of finance. Deloitte’s Alternative Finance Deal Tracker shows a 67% rise in the number of deals involving alternative lenders in the UK and Europe over the last twelve months.” This supports our view that the Sukuk makes a potentially attractive asset class for large and mid-cap enterprises to finance investment projects, infrastructural development and PPPs.

Perhaps the challenge remains now in the “demonstration effect,” which is important for showcasing the benefits of Sukuk. Two or three anchor Sukuk issuances will help create the interest and forge deals from both markets mentioned above.

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