



Rise of the Eurosukuk market

An alternative financing and investment platform

A new debt capital market instrument has emerged, the so-called “corporate sukuk” which has seen steady growth in several parts of the world including the Middle East, Asia, Europe and the United States. The key differentiating factor of this asset class is a different risk and return profile investment that may also possibly have uncorrelated features to conventional financial market yields or risks. Just in time it seems, as David Sproul, UK Chief Executive of Deloitte, said “the low growth environment of the past five years, coupled with levels of consumer and government debt, mean the big business has to take a lead in driving a new era of wealth creation in the UK.”

Concurrently to this growth in the sukuk market, increased insights into the development and need for 'alternative financing' are gaining prominence and importance for both governments and the private sectors. The significant increase in global sukuk issuance through market growth in several jurisdictions supports the notion that the sukuk is an alternative, as well as ethical investment asset class: investing in the real economy, with emphasis on social and environmental sustainability. It also features investment through equity-based and asset-backed structures.

Sukuk, as per the Islamic Financial Services Board (IFSB), can be defined as certificates, each of which represents the holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such an asset.

The need for an industry-sponsored research to validate this proposition is well overdue. Industry think tanks and thought leaders are keen to dive deep into this emerging niche market that will arguably create other subsector opportunities in Europe and elsewhere in the world where there are mature and well-regulated debt capital markets.

A new industry research: the context and rationale

Responding to the need to understand this development in the Islamic capital market, a number of industry research collaborative initiatives have surfaced in recent years. However, critics believe that institutions offering Islamic financial services should generously fund industry research and align research planning with the organization's strategic business objectives.

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Current collaborative research is set to investigate the rise of the Eurosukuk in four European countries aimed at addressing the opportunities and challenges of the growth of a global corporate sukuk market and the potential demand for a Eurosukuk from blue-chip European corporates.

The broad objective of this industry study is to build practical knowledge and gain a better understanding of how the Eurosukuk serves as an alternative financing/investing asset class for blue-chip European corporates. In addition, it hopes to produce practical insights into how this new asset class can create interest from Middle Eastern investors—to invest in high quality (Sharia'-compliant) assets in medium-sized European corporates—who are arguably in need of risk capital to grow their markets. The research has set to highlight three objectives based on a three-way dialogue to address topical and timely regulatory practical issues for four European countries namely, France, Germany, the United Kingdom, and Turkey.

The three specific objectives of the study are:

- Develop and validate a conceptual framework for a Eurosukuk market addressing the key regulatory and tax implications for the growth of this asset class in Europe;
- Identify key determinants and growth drivers of a Eurosukuk market in manufacturing and industrial sectors—energy, technology, healthcare, agriculture and pharmaceuticals—that are evidently showing strong growth trends in corporate Europe;
- Produce a blueprint report proposing structures, sectors and industries, and markets that are most likely to see growth, supported by project-oriented cases and scenarios. The report will also seek to define what progressive roadmaps and actions are required from potential investors and how the Eurosukuk fits in within the context of the broader global Debt Capital Market (DCM).

Initially the four key European markets mentioned above have been identified for this research due to the strong economic base and contribution to their GDP of Small-Medium Enterprises (SMEs). In addition, preliminary

analysis indicated that generally, the regulatory and tax laws in these jurisdictions are favorably supporting Islamic finance to varying degrees. However, it was revealed from first phase of the research that two other countries have also developed an enabling environment for Islamic financial services, namely the Republic of Ireland and Luxembourg.

The research is wrapped around four key areas:

- The socioeconomic, regulatory, and tax environment;
- Assessment of the corporate bond and financing requirements;
- Analysis of industries and scale of transactional needs;
- Project-oriented cases and structures.

Sukuk issuance and listing in Europe

Following the success of the inaugural sovereign sukuk issued by two western market sovereigns in 2014, a number of sovereigns and corporates in Europe are also planning sukuk issuance, while regulators in many European countries are working to ease the path of Islamic Finance transactions, in particular the sukuk. The issuance in 2004 of the EUR100 million sukuk by the German state of Saxony Anhalt was a milestone in the progression to issuance by a major European sovereign, the first of these being Britain's GBP200 million sukuk in June 2014. The sukuk was heavily oversubscribed by investors in the UK, Middle East and Asia, attracting orders of GBP2.3 billion—over 10 times higher than the amount sold. Subsequently, Luxembourg followed with the issuance of its inaugural 5-year, EUR200 million sukuk in September 2014.

Needless to say, some European stock exchanges have come to the fore in this activity as key listing exchanges for the sukuk; the London Stock Exchange has the largest value and size of sukuk listed globally, with the Luxembourg and Irish stock markets also active.

Key research assumptions and prospects

One factor driving the trend towards greater investment in Sharia'-compliant instruments has been the impact of the global financial crisis. Trust—in particular among wealthy individuals and institutional investors—has been

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adversely affected. In addition, other key driving factors of growth of this asset class may invariably be summarized as below:

- Shortage of classic bank financing in most European countries due to Eurozone crisis amongst others.
- Strong growth of "ultra-high-net-worth" individuals—particularly the double digit growth in Asia—creating a demand for alternative investment opportunities and new asset classes. Credit Suisse estimates that globally there are close to 34,000 "ultra-high-net-worth" individuals with a net wealth of US\$100 million or more, and 3,000 family offices.
- Savvy professional investors from the Middle East and elsewhere in the world are Sharia' cautious and looking for investment opportunities in Europe and emerging markets which have high quality assets in arguably soundly regulated markets.
- Medium-sized and larger blue chip corporates are emerging from the global financial crisis looking for growth opportunities and risk capital to achieve expansion goals.

Nurturing this market

A practical approach to educate market participants on the benefits and uses of the Eurosukuk is the creation of a specialized industry group—an industry-supported initiative which can follow up on the market growth and development and help improve communications between the different stakeholders on the two blocks issuers on the one hand, and investors on the other hand.

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