

# Structuring Sukuk in European Jurisdictions

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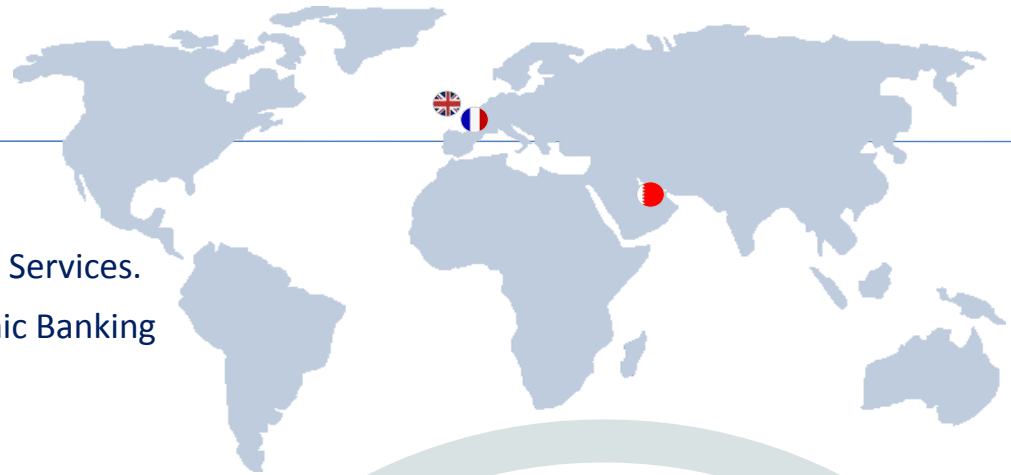
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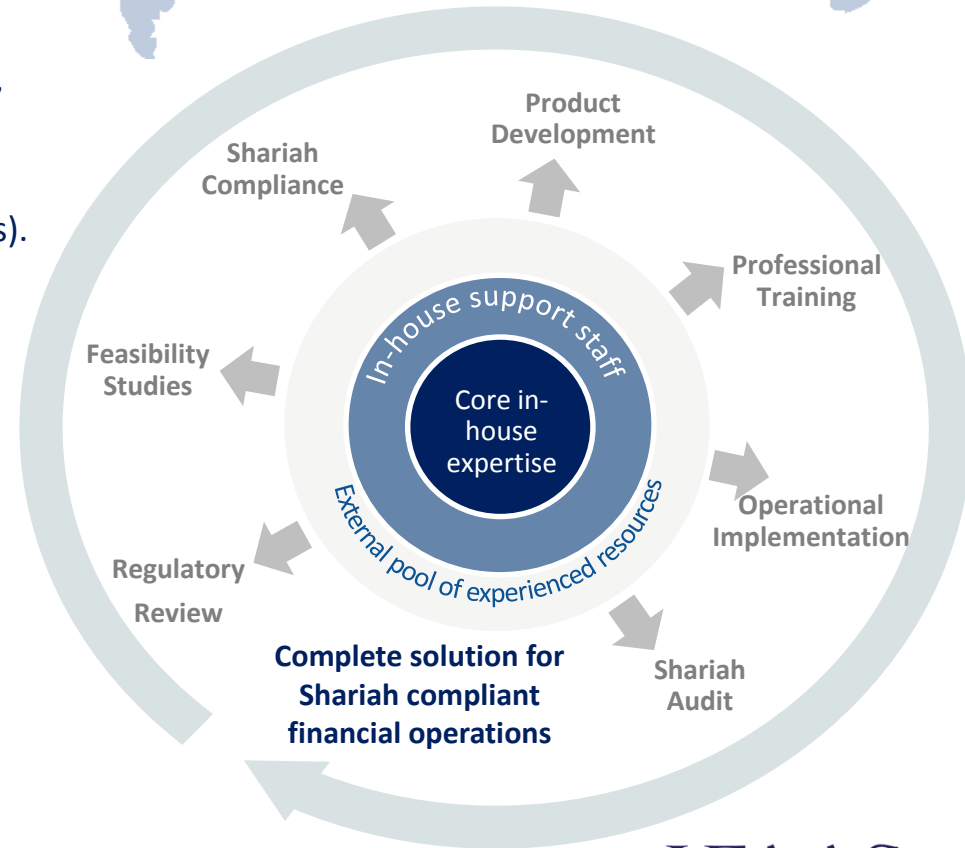
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# IFAAS AT A GLANCE



- IFAAS: Islamic Finance Advisory & Assurance Services.
- Professional consultancy specialised in Islamic Banking & Finance, incorporated in 2007.
- 3 Offices: UK, France, Bahrain.
- Over 50 institutional clients including governments, regulators, banks, funds, insurance companies, corporate organisations & NGOs.
- Projects in 22 Countries (completed and in-progress).
- Present client reach in 5 Continents.
- Largest market share in Europe and Africa.
- Over 100 Islamic financial products developed.
- Worked on regulatory frameworks in 10 countries.



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## **SUKUK – THE EUROPEAN EXPERIENCE**

# GERMANY

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- The first European country to issue a Sukuk in 2004
- The state government of the German federal state of Saxony-Anhalt issued a Quasi-Sovereign 5 years' Sukuk for €100M, rated as AA+ in accordance with the state's rating at the time of issuance and guaranteed by the federal government of Germany
- It was structured on the basis of 'Ijara' principle (sale and leaseback) using the State's real estate assets as the underlying assets for the Sukuk, generating rental income for the investors
- It was traded on Luxembourg Stock Exchange and was fully subscribed, mainly by the GCC investors
- The Sukuk was successfully redeemed in 2009
- No further Sukuk has been issued in Germany since 2004
- The German legal and taxation framework was not fully adequate at the time of issuance that was seen as 'rushed' by some critics
- The required infrastructure was not in place (understanding of Shariah requirements, legal and tax advisory, Shariah expertise etc)
- GCC investors prefer US\$ denomination over Euro
- The infrastructure has evolved now and the Islamic finance eco-system is emerging in Germany
- The German regulator BaFin has authorised the country's first full-fledged Islamic bank two weeks ago

# UNITED KINGDOM

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- The leading Islamic finance market in the non-Islamic world
- Government's strategy to promote Islamic finance in and outside the UK
- One of the strongest Islamic finance infrastructure in place (legal, regulatory and tax frameworks, professional expertise, research, academia and qualifications, political will, common vision and well-defined strategy)
- London is among the top 3 international hubs of Islamic finance with 5 full-fledged Islamic banks, over 20 Islamic windows of conventional banks including UK high-street brands, Takaful (Islamic insurance) structures, Islamic funds, Islamic indices and multi-billion dollar Sukuk listings, Islamic loans for students and start-up businesses etc.
- The first non-Islamic country to issue a Sovereign Sukuk that was 10 times oversubscribed, attracting a wide range of investors from the UK, Middle East and Asia
- Sterling denominated £200M 5 years' Ijara Sukuk with a AAA rating was issued by the British government in 2014 using government-owned real estate assets
- The debut Sovereign issuance is a benchmark for the British corporate sector that is now considering Sukuk as a viable alternative channel of fundraising via international capital markets
- The demand for Sterling denominated Sukuk was very high within the domestic Islamic finance market that is experiencing a strong growth hence the issuance was in Sterling
- International investors showed a major interest as well despite foreign exchange risk as investing in AAA rated Sukuk helps them with diversification of asset classes and meeting capital adequacy requirements in a market that is always short of supply
- The government's policy to maintain UK's leading position in the international Islamic finance market, providing equal opportunities to all communities within the country and attracting foreign investments into the UK fuelled the issuance

# **POLITICAL WILL** *(UK PRIME MINISTER'S SPEECH AT WIEF 2013 IN LONDON)*

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**Click here to watch the video**

# LUXEMBOURG

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- The small Duchy is a big player in the Islamic finance market with over 40 Islamic funds domiciled with multi-billion dollars of Assets Under Management
- Luxembourg Stock Exchange is a major platform for listing and trading of Sukuk issued around the world
- The local financial market has a reasonably developed infrastructure in Islamic finance that is evolving with time
- Luxembourg became the first Eurozone country to issue a Sovereign Sukuk in 2014 (second in Europe after the UK)
- The Euro denominated €200M AAA rated, 5 years' Ijara Sukuk was oversubscribed 2 times
- The investors are a mix from MENA region, EU and Asia with the largest holdings by the banks from these regions
- Highest rating of Sukuk helps the Islamic banks in meeting their capital adequacy requirements, however
- Low return offered by the Luxembourg government and the lack of appetite for Euro denomination among the investors dampened the demand for the first Sovereign Sukuk in Euro



# FRANCE

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- France started late in Islamic finance but built a good momentum in 2008/9 by establishing a Commission for Islamic finance at Paris Europlace (French financial marketplace)
- The finance minister announced the government strategy of making Paris ‘as welcoming as London’ for Islamic finance
- The infrastructure started developing with some tax reforms aimed at facilitating Islamic financial instruments but the political will faded away when the finance minister moved on in 2011
- Some small-sized corporate Sukuk have been issued to date however no major French corporate has issued a Sukuk in France yet (some have issued outside France using their subsidiaries)
- The ground is now ready in France for corporate issuances however the political climate has changed significantly meanwhile and the chances of any major issuance are not very strong at present
- The infrastructure has evolved though and Islamic finance eco-system is emerging with the advent of an Islamic window of a conventional bank, some Islamic funds, Islamic crowdfunding platforms and Takaful-based products in the market
- French experience of structuring Sukuk has some relevance to the Russian Federation as the French and Russian laws have similarities contrary to the UK Common law

# STRUCTURING SUKUK IN FRANCE – CHALLENGES

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Sukuk have been structured to date mainly under the English law

- Dilemma 1: Structure under French law or English law?
- Dilemma 2: Use French assets or off-shore assets?
- Dilemma 3: USD or Euro denomination?
- Absence of the equivalent of the “English Trust” in French law: How to externalise the assets (in accordance with AAOIFI\* Shariah Standards)?

*\*Accounting & Auditing Organisation for Islamic Financial Institutions (Standards setting body based in Bahrain)*

# FIDUCIE – THE FRENCH EQUIVALENT OF THE “ENGLISH TRUST”

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- The French Civil Code does not recognise the separation between the ‘legal ownership’ and the ‘beneficial ownership’ hence the underlying assets in a Sukuk structure technically cannot be ‘externalised’ as they are in the English Trust structure
- The concept of ‘Fiducie’ (special vehicle close to English trust in its form) was introduced a few years ago. The major difference in Fiducie and English Trust is that the ownership (legal and beneficial) is transferred to the ‘Fiduciary’ (Trustee)
- The Fiducie was accepted by the Shariah scholars as a solution for transferring the underlying assets in a Sukuk structure subject to the following conditions mentioned clearly in the contractual agreement:
  - The Fiduciary will hold the assets in his name “For” and “On behalf of” the beneficiaries of the Fiducie (Sukukholders)
  - The Fiduciary will have the “Right” and the “Duty” to dispose off the assets if required and pay the beneficiaries of the Fiducie (in case of a default by the originators/issuers of the Sukuk)
- The Fiduciary may also be replaced if required
- Being a relatively new concept in France, Fiducie is still being actively debated particularly by those who see it as a potential loophole for tax evasion



# CHALLENGES & SOLUTIONS FOR THE RUSSIAN FEDERATION

# CHALLENGES

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- Perceptions (negative associations with political, cultural and media interpretations of 'Islamic' or Shariah)
- International political environment (appetite on supply & demand sides)
- Awareness (lack of understanding by all stakeholders)
- A common vision and willingness to make Sukuk a reality in Russia
- Adequacy of regulatory, legal and tax frameworks
- Lack of expertise
- Interpretation of Shariah and its impact on the marketability of Sukuk
- Availability of appropriate assets for Sukuk structures
- Budget to cover the costs of R&D and capacity building
- Language barriers = communication issues, higher risk of Shariah non-compliance, longer timescales
- Relevance of experience: GCC, Malaysia or Western Europe?
- Currency devaluation and forex risks

# POTENTIAL SOLUTIONS

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- Categorize Islamic finance as an economic system with an extra set of rules (Shariah) like other financial propositions (e.g. SRI\*)
- Develop it as an alternative/complementary option with an open mind-set
- Develop a common vision that is shared by all stakeholders (e.g. like the UK)
- Have a plan with defined and realistic objectives, workable strategies and action plans
- Establish a Task Force including local players but also international experts to work on the adaptation of regulatory, legal and tax frameworks against set targets
- Develop Human Capital by way of professional training as the first stage, followed by academic courses and qualifications as the next stage
- Invest in R&D and capacity building by way of providing a budget but also capitalise on the goodwill that local expertise may offer (e.g. pro bono work)
- Have a communications strategy to raise awareness, facilitate the understanding and address any political qualms
- Encourage the development of Islamic finance ecosystem including Islamic banking, Takaful insurance, asset management, project and export financing etc for a more rounded proposition

# STEPPING STONES

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- Establishing contacts and relationships with international markets and players to have advice and assistance (avoid regional rivalry, identify the right partners with expertise, experience and willingness to help)
- Engaging with international players to have direct interaction and capacity building (e.g. representation of the Russian Federation in major industry events, developing joint academic and training courses in partnership with leading institutes, organising more events in the Russian Federation.....)
- Launching an awareness campaign to educate relevant stakeholders about the opportunities (e.g. possibility for corporates to raise funds through Sukuk)
- Organising an international roadshow once the national plan/strategy is ready
- Taking a cautious approach by testing the waters with a small scale issuance
- Giving preference to US dollar denomination and using the assets of large corporates instead of state-owned assets
- Considering using UK law as an interim solution (with its implications)
- Having advice from experts with hands-on experience in legal, taxation and Shariah compliance matters

**THANK YOU**

**Q & A**

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