



**MEDIOBANCA**  
*Banca di Credito Finanziario S.p.A.*

## **Development opportunities for an Italian bank in Shariah-compliant products**

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October 2008**

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# History and mission of Mediobanca

## Overview of Mediobanca

## Section I



- Founded after World War II by Banca Commerciale Italiana, Credito Italiano and Banco di Roma, the three state-owned “banks of national interest”
- Mission: to **support the rebuilding of the Italian industry through supply of medium/long-term financing and advisory services to enterprises**

- **1956: listing on Milan stock market** (the first banking group listed after the war)
- **1950s: supporting growth of leading Italian groups outside Italy**
- **Trustee business** via Spafid (1951), followed by **consumer credit** with Compass (1960) and **leasing** with Selma (1970)

- **Key role in supporting Italian industry restructuring:** MB became “house bank” for major Italian industrials
- By mid-1970s MB’s equity investment portfolio included **Generali** (4.5%), **Fiat** (2.5%), **Montedison** (2.5%), **Olivetti** (5%), **Pirelli & C.** (3.3%) and **Fondiaria** (10%)

- Faced with increasing public presence in the Italian economy, **MB resolved to maintain its professional and operational independence and arranged its own privatization**
- **Core shareholder’s agreement between banks (25%) and private enterprises (25%) set up**

- 1990s-present day: **shift towards fee-based services and increase in size of equity investment portfolio** (Generali 14.1%)
- New valued-added segments entered: **private equity - private banking – retail banking** (CMB, Banca Esperia, CheBanca!)
- **New management team and refocused strategy since 2003**
- Increase in profitability and market capitalization (approx. €8bn)



# Financial Highlights

Overview of Mediobanca

Section I

## Consolidated Highlights

|   | 30/06/2007 | 30/06/2008 |
|---|------------|------------|
|   | (€ bn)     | (€ bn)     |
| Total assets                            | 43,5       | 53,8       |
| Loans and advances to customers         | 26,8       | 34,6       |
| AFS securities                          | 5,6        | 3,8        |
| <i>of which: fixed income</i>           | 1,6        | 1,7        |
| <i>equities</i>                         | 3,3        | 1,6        |
| Net equity                              | 6,9        | 5,8        |
| <i>of which minority interest</i>       | 0,1        | 0,1        |
| Regulatory capital                      | 8,1        | 6,5        |
| Regulatory capital/risk-weighted assets | 16,18%     | 11,87%     |
|   | (€ m)      | (€ m)      |
| Profit from ordinary activities         | 1.181,1    | 1.192,9    |
| Net profit                              | 953,2      | 1.014,8    |
| Average number of Group employees       | 1.783      | 3.046      |

*Draft financial statement as at 30 June 2008*



# Integrated business model

Overview of Mediobanca

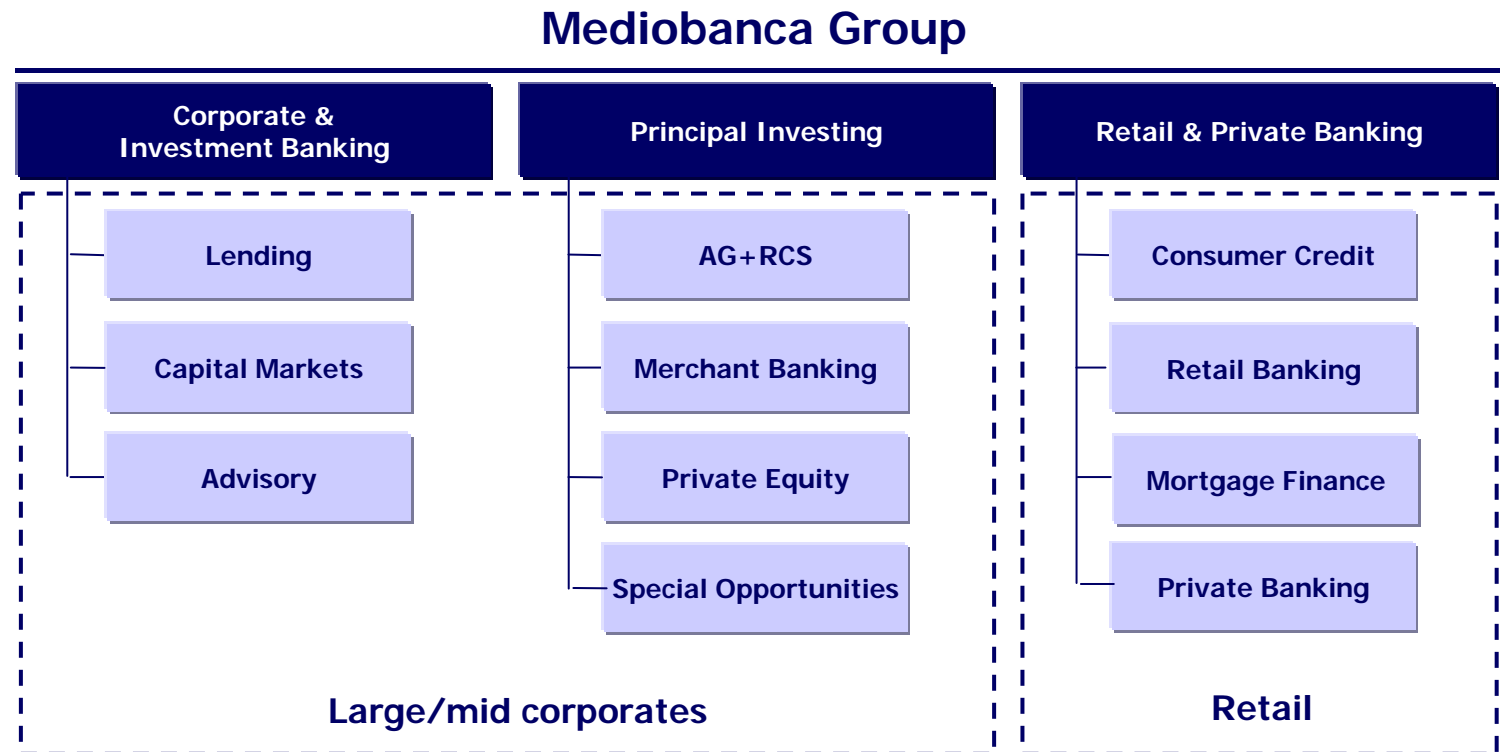
Section I

Mediobanca's activities have been reorganised into **three main business lines**: Corporate & Investment Banking (CIB), Principal Investing (PI), Retail & Private Banking (RPB)

**Integrated offering of lending, advisory and capital market services** in CIB division. The division also includes **leasing** business

**PI** includes **equity investment (AG and RCS)** and exploits **new asset classes (merchant banking, private equity, special opportunities)**

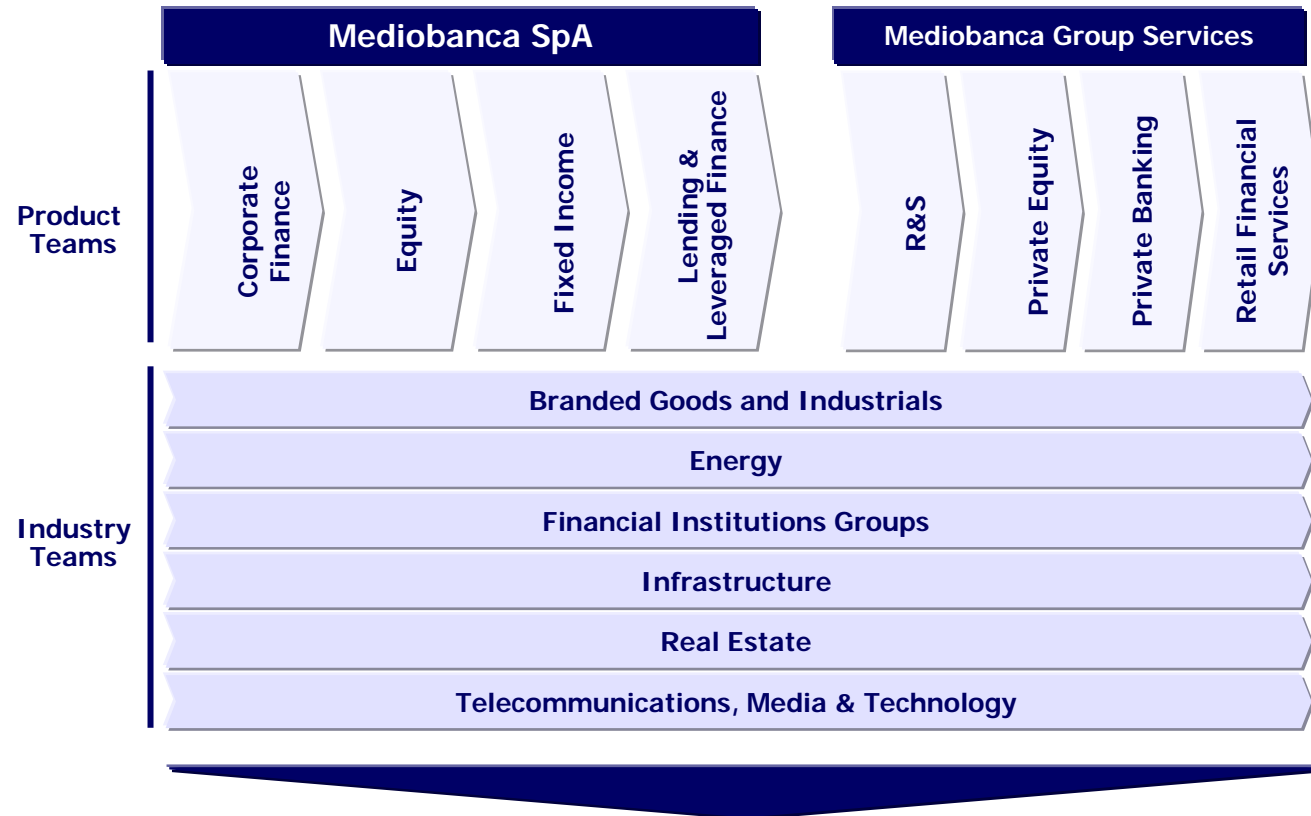
**RPB** is focused on **consumer lending, mortgages and retail banking**. The division also includes **private banking**



# An integrated approach to clients

Overview of Mediobanca

Section I



- /// Flexibility to combine industry and product expertise
- /// Client-driven approach: products and services are tailored to clients' needs



# Increasing international presence

Overview of Mediobanca

Section I

## Direct presence

|         |
|---------|
| France  |
| Germany |
| Spain   |
| U.S.A   |
| U.K.    |
| Monaco  |
| Russia  |
| Iran    |

- /// Branch in Paris set up in 2004
- /// Lending and investment banking activities

- /// Branch in Frankfurt set up in mid 2007
- /// Lending and investment banking activities

- /// Branch in Madrid set up in autumn 2007
- /// Lending and investment banking activities

- /// Brokerage activity set up in New York in 2007

- /// Capital market platform set up in London in spring 2008

- /// CMB: stake owned since 1989, fully owned since 2004
- /// Leading player in private banking

- /// Representative office

- /// Representative office (currently "dormant" due to international situation)



## Basic data

### MENA region and Islamic finance

### Section II

- **Extensive region with common language**
  - // MENA covers an extensive region, extending from Morocco to northwest Africa across West/South-west Asia covering 19 countries (Morocco, Tunisia, Algeria, Libya, Egypt Sudan, Jordan, Lebanon, Palestine, Syria, Saudi Arabia, Kuwait, Bahrain, UAE, Qatar, Oman, Yemen, Iraq, Iran)
- **Relevant population with high growth rate**
  - // Population of MENA is close to 330m, with a high historical growth rate of above 2%. World Muslim population close to 1,6 billion
  - // 50% of the MENA population is below 24 years of age
- **Significant GDP**
  - // MENA GDP in 2007 was in excess of US\$ 1.740 billion, GCC contributed for 46% approximately
- **Impressive growth rate of Shariah-compliant assets**
  - // From niche to mainstream Shariah-compliant assets are now estimated to be in excess of \$500 billion (detained by top 500 Islamic financial institutions), while still relatively small compared with \$74.232 billion conventional assets (detained by top 1000 world banks), Shariah-compliant asset growth rate is impressive (29,7% vs. 16,3%)
  - // Approximately 70% of the Shariah-compliant assets are held by institutions based in the MENA region
- **Significant trade relationship with Europe**
  - // In 2007, export from EU-5 (Italy, Germany, France, Spain) to MENA region : \$104,1 billion, GCC accounted for \$45,5 billion; import from MENA region to EU-5 : \$101,5 billion, GCC accounted for 18,3 billion

Source: Eurostat, IMF, The World Bank, The Banker

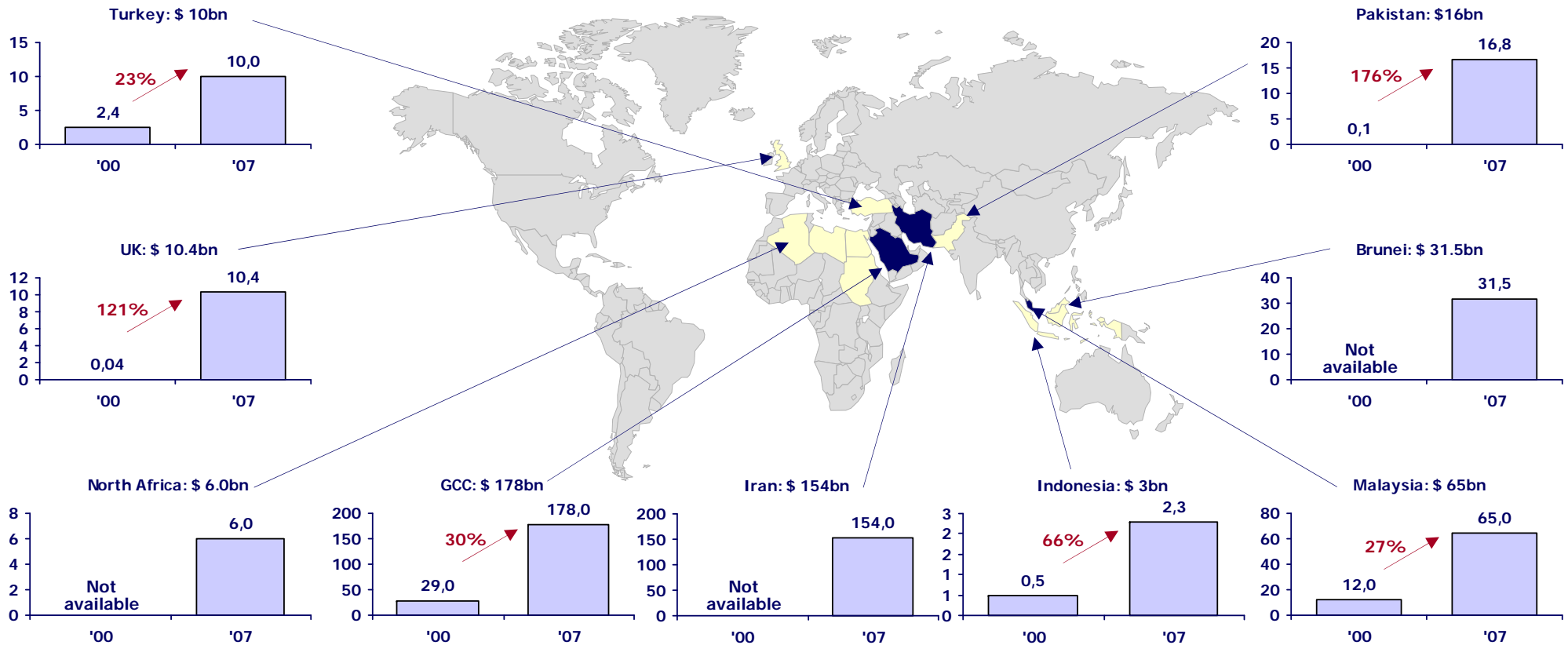


# Overview of selected key Shariah-compliant markets by asset size

MENA region and Islamic finance

Section II

Total worldwide market: ~ \$ 500bn<sup>1</sup>



1) Conservative estimate excluding assets held in Islamic funds – higher estimation up to \$ 700bn

Source: The Banker; Press search; Central Banks

2) Definition of Shariah-compliant asset may vary from country to country



# Main features of a Shariah-compliant instrument

MENA region and Islamic finance

Section II

## /// Main Features of a Shariah-compliant instrument

Based on Islamic principles and jurisprudence (*Shariah*) derived from a number of sources, including, primarily, the Qu'ran. Some of the key principles include the following:

- Maisir
  - (a) *No speculation (maisir)*
  
- Riba
  - (b) *No interest / no unearned – unjustified increase of capital (riba)*
  
- Gharrar
  - (c) *No Uncertainty (gharrar)*
  
- Haram industries:
  - /// Deals should not relate to industries which are *haram* (such as those related to pork products, gambling, pornography or alcoholic beverages)

# Mediobanca's interest in the MENA region

- **International reach in the MENA region**

- // Mediobanca is interested in extending its international reach further with regard to the Middle East and North Africa in particular, with a view to serving more effectively its European customer base and its growing international needs

- **Growing local customer need for Shariah-compliant solutions**

- // Mediobanca has identified Shariah-compliant products as being of possible interest to its current and prospective customer

- // A growing number of counterparties based in the MENA region with direct dealings with Italian/European corporates are: i) increasingly interested in financial solutions which are respectful of Shariah principles; ii) willing to diversify the financial institutions they deal with

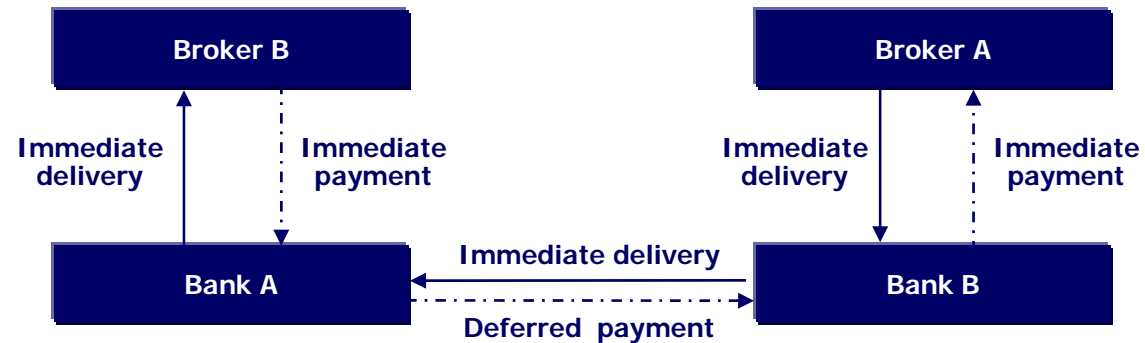
- **Two Shariah-compliant products of interest**

- // Within the many different Shariah-compliant products available, Mediobanca has currently focused on two classes: i) Shariah-compliant funding; ii) Shariah-compliant structured/project finance

- // Close co-operation has been developed with major Islamic financial institutions

# Shariah-compliant funding

- /// A typical structure which can be implemented in order to replicate the effects of a money market instrument is a *murabaha* which is depicted in the diagram below
- /// An underlying trade of commodities (which cannot refer to items which are *haram* – such as gold or silver) is necessary in order for the transaction to be properly executed



- /// Bank A is a “conventional bank” which wants to raise funds in the interbank market, and Bank B is an Islamic institution willing to place its liquidity
- /// Bank A informs Bank B of its willingness to proceed with the purchase of an allowed commodity; Bank B buys such commodity from Broker A at market value for spot delivery and spot payment and then immediately sells the same at an agreed mark-up price to Bank A on a spot delivery and deferred payment basis
- /// Bank A then immediately sells the commodity to Broker B at market value for spot delivery and spot payment
- /// The end result is that Bank A receives a cash amount and has a deferred payment obligation for the marked-up price to Bank B

# Shariah-compliant project finance – work in progress

- /// A structure which can be implemented when one or all of the sponsors envisage a future growth path for their company such as an IPO targeting Shariah-compliant investors, which means that the company 's debt has to be structured in a Shariah-compliant way
- /// A Shariah-compliant institution has to act as a fronting entity
- /// Possibility to involving regional financial institutions to provide:
  - /// local currency financing
  - /// better knowledge of the local “environment” (market, regulatory issues etc.)
- /// A deal of this kind may also qualify for western export credit agencies support, whereby by the recourse to export credit agencies may contribute the following:
  - /// enhancement of the credit quality of the project
  - /// improve the efficiency of the financial structure in terms of cost and tenor
  - /// enhance the “bankability” of the financing structure
- /// Almost all of the key features that characterize a risk assessment under a traditional project finance scheme may also be found under a Shariah-compliant one

# Key features of traditional project finance transaction vs Shariah-compliant structures

Mediobanca and Islamic finance

Section III

| Key features   | Traditional project finance | Islamic finance |
|--|-----------------------------|-----------------|
| The presence of reputable Sponsors with proven track record in similar projects and with an acceptable credit standing   | ✓                           | ✓               |
| A robust Project contract structure assuring sensible risk assignment to the various involved parties  | ✓                           | ✓               |
| Project construction risks (i.e. delays, cost overruns, non-performance) properly assigned to the contractor/supplier  | ✓                           | ✓               |
| Contractor/supplier to provide the Project Company with a performance bond (calculated by taking into account the contractor/supplier's potential penalties and overall liability) | ✓                           | ✓               |
| Achievement of the construction milestones must be strictly monitored by the independent technical advisor   | ✓                           | ✓               |
| A consistent financing plan, including   |                             |                 |
| (i) a sufficient amount of equity to ensure acceptable debt service coverage ratios and adequate risk sharing between the sponsors and the lenders                                 | ✓                           | ✓               |
| (ii) adequate level of contingencies to cover cost overruns and construction delays  | ✓                           | ✓               |
| Confirmation of the Project's economic and technical viability (in all phases of the project) as well as legal, tax and insurance due diligence powered by independent advisors    | ✓                           | ✓               |



# Key features of traditional project finance transaction vs Shariah-compliant structures (cont'd)

| Key features  | Traditional project finance | Islamic finance |
|---|-----------------------------|-----------------|
| A robust security package corresponding to international standards for limited recourse transactions of the same kind, including but not limited to   |                             |                 |
| (i) mortgage over all the Project Company's physical assets   | ✓                           |                 |
| (ii) pledge over the Project Company's assets, some of which to be held offshore  | ✓                           |                 |
| (iii) assignments of the Project Company's rights under the contracts entered into with third parties, including insurance policies   | ✓                           | ✓               |
| (iv) pledge over the Sponsors' shares in the Project Company  | ✓                           | ✓               |
| (v) control of the use of the Project Company's revenues through a cash waterfall mechanism   | ✓                           | ✓               |
| All authorizations, consents, permits, powers of attorney, etc. from all relevant authorities, necessary and according to applicable laws and regulations   | ✓                           | ✓               |
| Allocation of <i>force majeure</i> risk acceptable to both the lenders and the sponsors. <i>Force majeure</i> risk may be allocated to private insurance companies, to SACE and/or export credit agencies | ✓                           | ✓               |
| An environmental impact assessment acceptable to all parties involved   | ✓                           | ✓               |

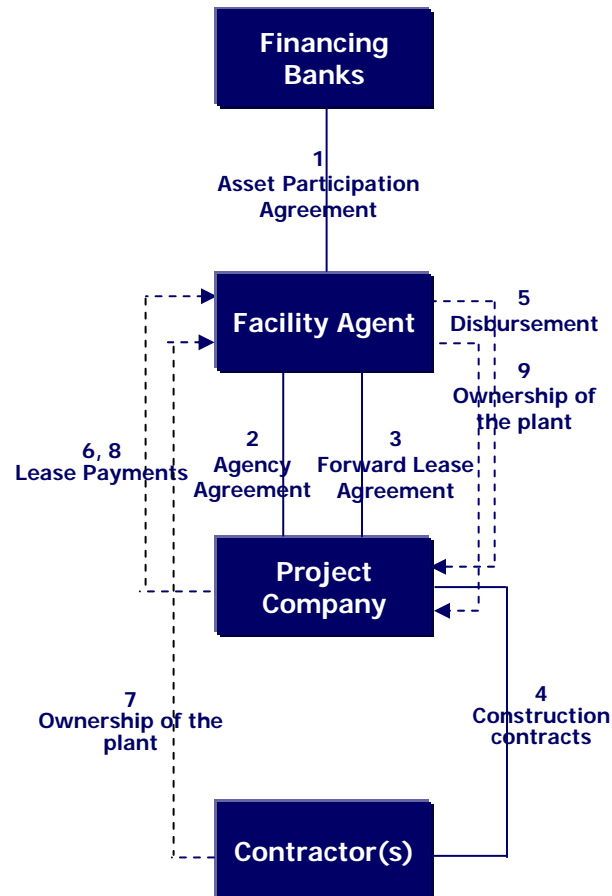
# Key features of traditional project finance transaction vs Shariah-compliant structures (cont'd)

- ⚡ Certain differences can be found in the security packages as, under Shariah-compliant project finance structures
  - ⚡ the lender is also the legal owner of the assets being financed throughout the duration of the financing
  - ⚡ Islamic lenders will not be able to take security over interest-bearing (non-Islamic) bank accounts, hence alternative security should be sought
  - ⚡ in the case of a Musharaka (Islamic Joint Venture), a pledge over the sponsors' shares in the Project Company may be seen as non-compliant to some Shariah Scholars
  - ⚡ Shariah-compliant hedging structures are still at an early stage of development

# Applicable Shariah-compliant structures

- ⚡ Various Islamic financing structures would lend themselves for a Shariah-compliant project finance including plain lease, forward lease (**Ijarah Fil Zimmah**), order to manufacture (**Istisna'a**), joint venture (**Musharaka**), and/or some combination of the above
  
- ⚡ A key feature of Islamic structuring is the financing of tangible assets. In most structures the bank owns the assets for the entire duration of the financing and title is transferred at maturity
  
- ⚡ Typical Shariah-compliant project finance structures resemble conventional lease structures via which the lender becomes legal owner of the assets being financed and leases them back to the operator in return for lease/rental payments
  
- ⚡ The structure which is currently under evaluation is Ijarah Fil Zimmah, a contract whereby the lessor transfers the usufruct (usage) of a particular asset to the lessee for a particular time period

# Ijarah Fil Zimmah indicative structure



- 1) The financing banks enter into an Asset Participation Agreement, by which they agree to jointly build and own certain assets (the "Plant") and lease them to the Project Company. A financing bank is appointed as Facility Agent
- 2) The financing banks (acting through the Facility Agent) and the Project Company enter into an agency (Wakalah) agreement authorizing the Project Company to appoint all necessary parties in order to build the Plant for the financing banks
- 3) The financing banks (acting through the Facility Agent) and the Project Company enter into a Forward Lease Contract with Transfer of Ownership ("Ijarah") regarding the future Plant
- 4) The Project Company enters into agreements with contractors on behalf of the financing banks
- 5) Under the Wakalah agreement, the financing banks disburse payments to the Project Company or directly to the contractors
- 6) During the construction of the Plant, the Project Company pays fixed advance lease payments
- 7) The financing banks receive ownership of the Plant
- 8) After completion of the Plant, the Project Company makes lease payments consisting of a variable profit element and pre-agreed principle installments
- 9) Upon payment of the last lease installment ownership of the Plant is transferred to the Project Company

- /// Shariah-compliant products allow the gap between Islamic and western financial markets to be bridged, providing technical solutions which may allow to exploit the best features of “both worlds”, promoting:
  - /// the export of industrial know how, goods and services from western countries
  - /// the investment of capital from the MENA region into the western industrial and financial sectors
  - /// efficient allocation of resources in this period of liquidity shortage and credit crisis
  
- /// Compliance with Shariah principles varies from country to country: need for “standardisation”
  
- /// Need for common accounting practices and regulatory approach on Islamic finance
  
- /// The current global crisis has also and mayl continue to affect the Islamic finance sector:
  - /// Possible lower future growth rates
  - /// Possible higher priority given to major domestic projects