

The Islamic Debt Capital Markets – Challenges and Access to European Opportunities

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Islamic Finance *news*
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Introduction

- ❑ Why would a European Corporate choose to use Islamic Finance?
- ❑ The following are the key drivers:
 - Religious or ethical conviction
 - Lack of funding opportunities due to the “credit crunch”
 - Diversification of existing investor base
- ❑ The feasibility of Islamic finance as a significant funding solution in the Capital Markets depends on investor appetite
- ❑ This presentation focuses on that potential investor appetite

UK Overview – Total Shariah Compliant Assets

Rank	Country	Shariah-compliant assets (US\$ mn)	(%) Growth in value from 2007
1	Iran	235,335.2	27.5
2	Saudi Arabia	92,017.9	26.1
3	Malaysia	67,073.6	32.3
4	Kuwait	63,137.7	44.3
5	UAE	49,082.6	35.9
6	Bahrain	37,405.1	42.8
7	Qatar	21,022.0	77.5
8	United Kingdom	18,094.3	60.7
9	Turkey	15,782.7	65.5
10	Pakistan	6,314.8	39.0
11	Bangladesh	5,707.0	25.4
12	Egypt	5,660.6	14.5
13	Sudan	5,302.5	54.4
14	Indonesia	3,403.1	34.4
15	Jordan	3,237.2	8.6

Source: The Banker November 2008. "Top Islamic Financial Institutions Supplement"

UK Overview – Muslim Population

Country	Population (millions)	Muslim population (millions)	Percentage (%)
France	61.00	6.10	10.0
Netherlands	16.20	0.95	5.9
Sweden	9.30	0.40	4.3
Austria	8.50	0.34	4.0
Germany	83.60	3.25	3.9
Denmark	5.60	0.19	3.4
Greece	11.00	0.36	3.3
Switzerland	7.80	0.25	3.2
United Kingdom	60.00	1.80	3.0
Italy	56.00	1.39	2.5
Spain	42.10	0.60	1.4

Source: OECD World Fact Book 2005, EUMC Muslims in the EU 2006

UK Achievements

- ❑ The UK Government aim is to ensure that “nobody in the UK is denied access to competitively priced financial services due to their religious beliefs” (HM Treasury December 2008)
- ❑ The FSA has authorised five Islamic banks:
 - Islamic Bank of Britain plc (August 2004)
 - European Islamic Investment Bank plc (March 2006)
 - Bank of London and the Middle East plc (July 2007)
 - European Finance House plc (January 2008)
 - Gatehouse Bank plc (April 2008)
- ❑ Islamic investment companies have also been authorised, e.g. Barwa Capital, Dar Capital
- ❑ The Islamic insurance industry has also begun in the UK, with Principle Insurance Holdings Limited being authorized as the first dedicated Takaful insurance provider in the UK in 2008



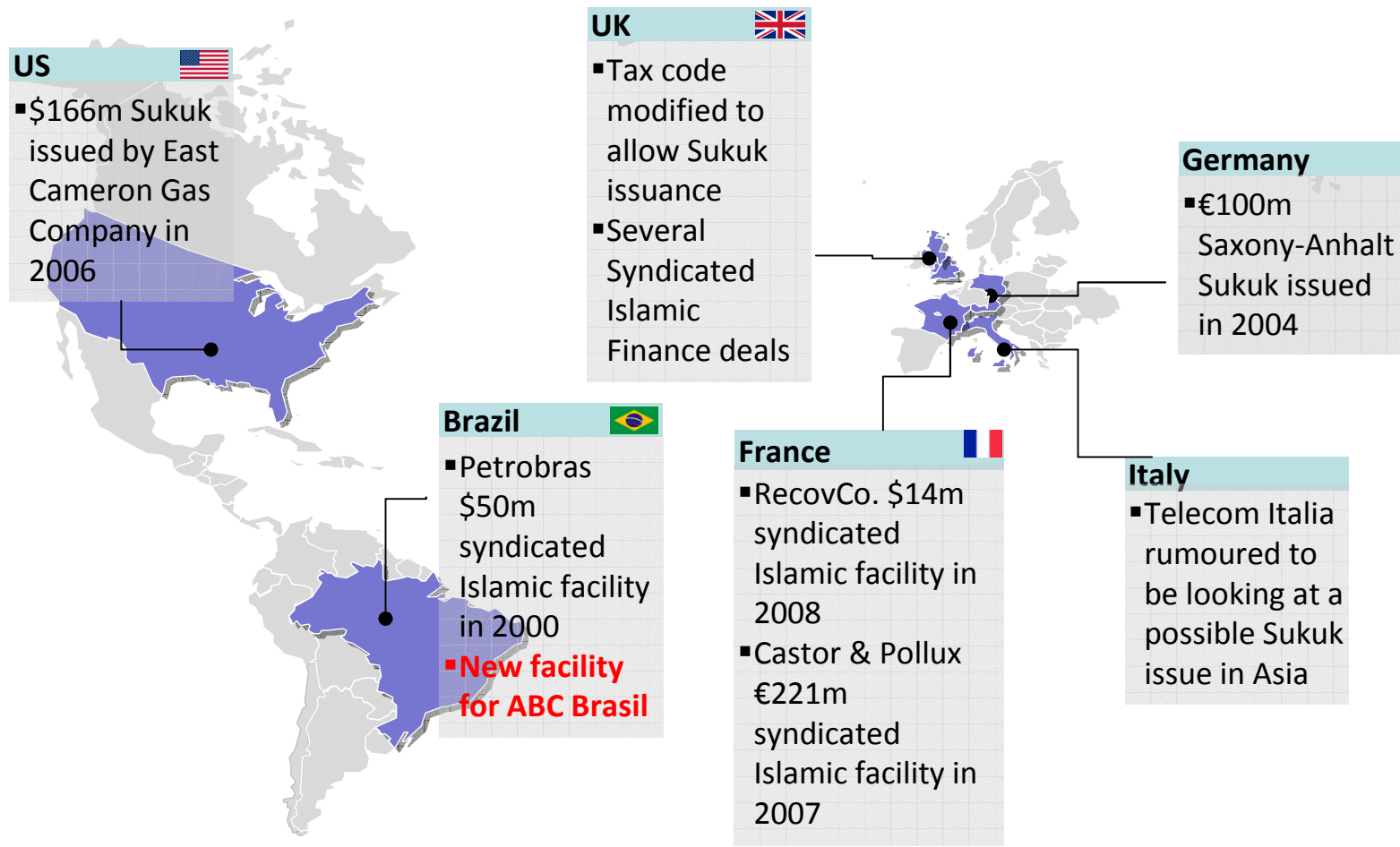
European Opportunities: France

- ❑ Largest Islamic community in the Western world, representing approximately 10% of the country's population
- ❑ In December 2008 significant tax and regulatory changes aimed at promoting Islamic finance in France were made:
 - the listing of Sukuk in France,
 - the tax neutrality of Murabaha transactions (in the form of an exemption from registration duty), and
 - tax deduction on the remuneration of Sukuk
- ❑ Further legislative changes for other products (notably ijara) will be required
- ❑ But there is little doubt that the French government wishes to establish Paris as a rival to the City of London as a European hub for Islamic finance in Western Europe
- ❑ Three GCC-based financial institutions are rumoured to be planning to open a presence in France

European Opportunities: Germany

- ❑ With over 3 million Muslims, Germany offers potential demand for banks providing retail Islamic financing
- ❑ The German legal and financial system, however, is not yet geared towards the development of Islamic finance
- ❑ Islamic investors have, however, moved into German real estate, with several Islamic funds in the German property market
- ❑ Germany also saw the first quasi-sovereign Sukuk issue, when the German state of Saxony-Anhalt issued a €100 million Sukuk al Ijara in August 2004
- ❑ Possible new financings in the pipeline

Islamic Finance is spreading outside its traditional Market – Europe and Americas

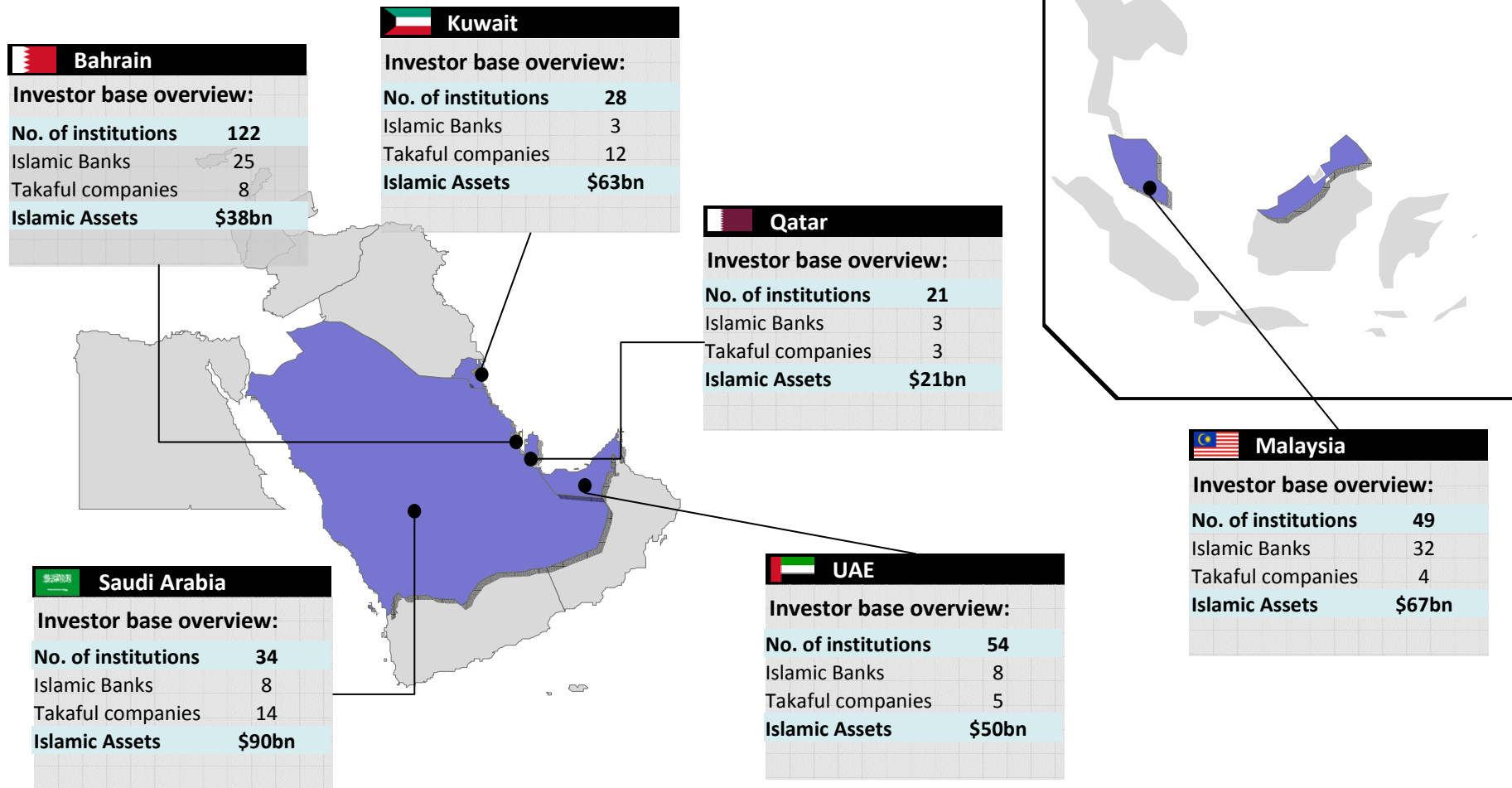


The Sukuk investor base is widening

Investor description	Type of Investor	Sukuk investors before 2005	Sukuk investors after 2005	Conventional bonds
Western	Retail	✗	✗	✓
	Banks	✗	✓	✓
	Pension funds	✗	✓	✓
	Mutual funds	✗	✓	✓
	Hedge funds	✗	✓	✓
	Investment Trusts	✗	✗	✓
Regional, indifferent to Shariah compliance	Retail	✗	✗	✗
	Banks	✓	✓	✓
	Pension funds	✓	✓	✓
	Mutual funds	✓	✓	✓
	Hedge funds	✓	✓	✓
	Investment Trusts	✓	✓	✓
Regional with preference for Shariah compliance	Retail	✗	✗	✗
	Banks	✓	✓	✗
	Pension funds	✗	✓	✗

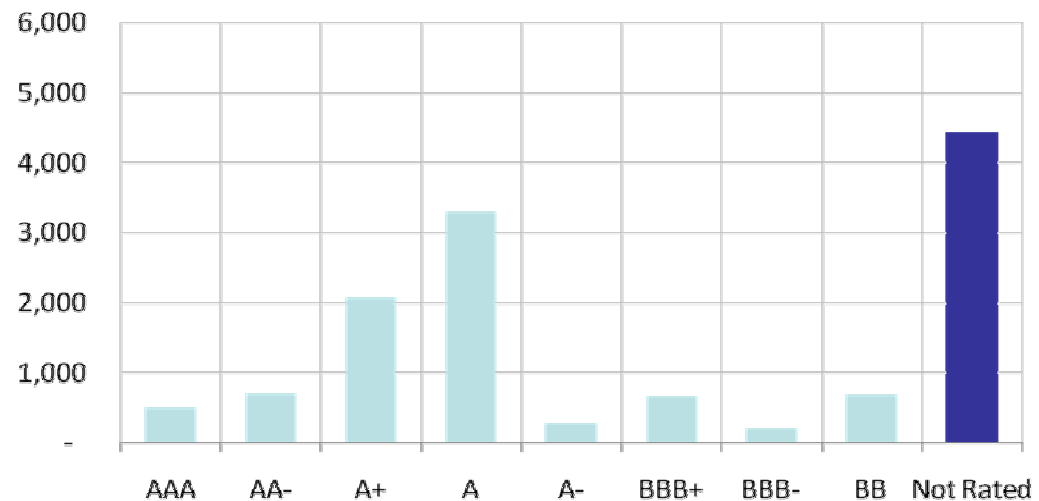
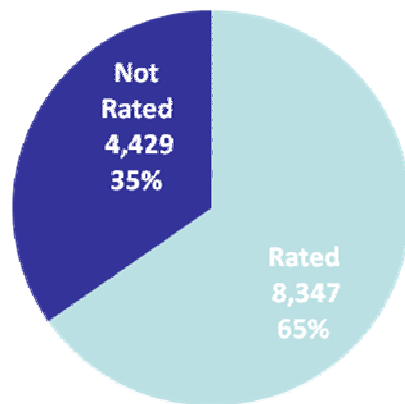
Source: 2008 World Islamic Competitiveness Report, McKinsey & Company

The Key Islamic investor base with potential interest in Sukuk



What are Islamic Investors Looking For? Asset Quality

Volumes of outstanding GCC Sukuks maturing in 2009-2014 by credit rating (*USD m millions*)



Source: Dealogic

What are Islamic Investors Looking For? Asset Quality

Diversification of asset quality:

- Islamic banking has not been immune to the 'credit crunch' and needs to provide a wider range of asset classes to meet demand
- BUT what about asset quality?
- Ratings agencies' credibility under strain
 - But this is for the methodology for structured product analysis
 - Corporate analysis and sector reports – reputation still strong
- Islamic investors should welcome assets with higher ratings, particularly AA or better
- BUT....
 - Pricing
 - Geographic/sector appetite

What are Islamic Investors Looking For? Pricing

Select recent EUR-denominated AA-rated (or equivalent) new issues

Issue Date	Issuer	Sector	Moody's / S&P	Amount (in €m)	Tenor	New issue spread
17/02/09	Total	Oil & Gas	Aa1 / AA	1,000	5-year	Mid-swap + 87bp
04/02/09	Shell	Oil & Gas	Aa1 / AA+	1,250	7-year	Mid-swap + 120bp

Select recent EUR-denominated A-rated (or equivalent) new issues

Issue Date	Issuer	Sector	Moody's / S&P	Amount (in €m)	Tenor	New issue spread
14/01/09	France Telecom	Telecom	A3 / A-	1,000	5-year	Mid-swap + 205bp
20/01/09	E.On	Utilities	A2 / A	1,750	5-year	Mid-swap + 195bp

Select recent EUR-denominated BBB-rated (or equivalent) new issues

Issue Date	Issuer	Sector	Moody's / S&P	Amount (in €m)	Tenor	New issue spread
15/01/09	Telecom Italia	Telecom	Baa2 / BBB	500	5-year	Mid-swap + 500bp
13/01/09	National Grid	Utilities	Baa1 / BBB+	500	5-year	Mid-swap + 365bp

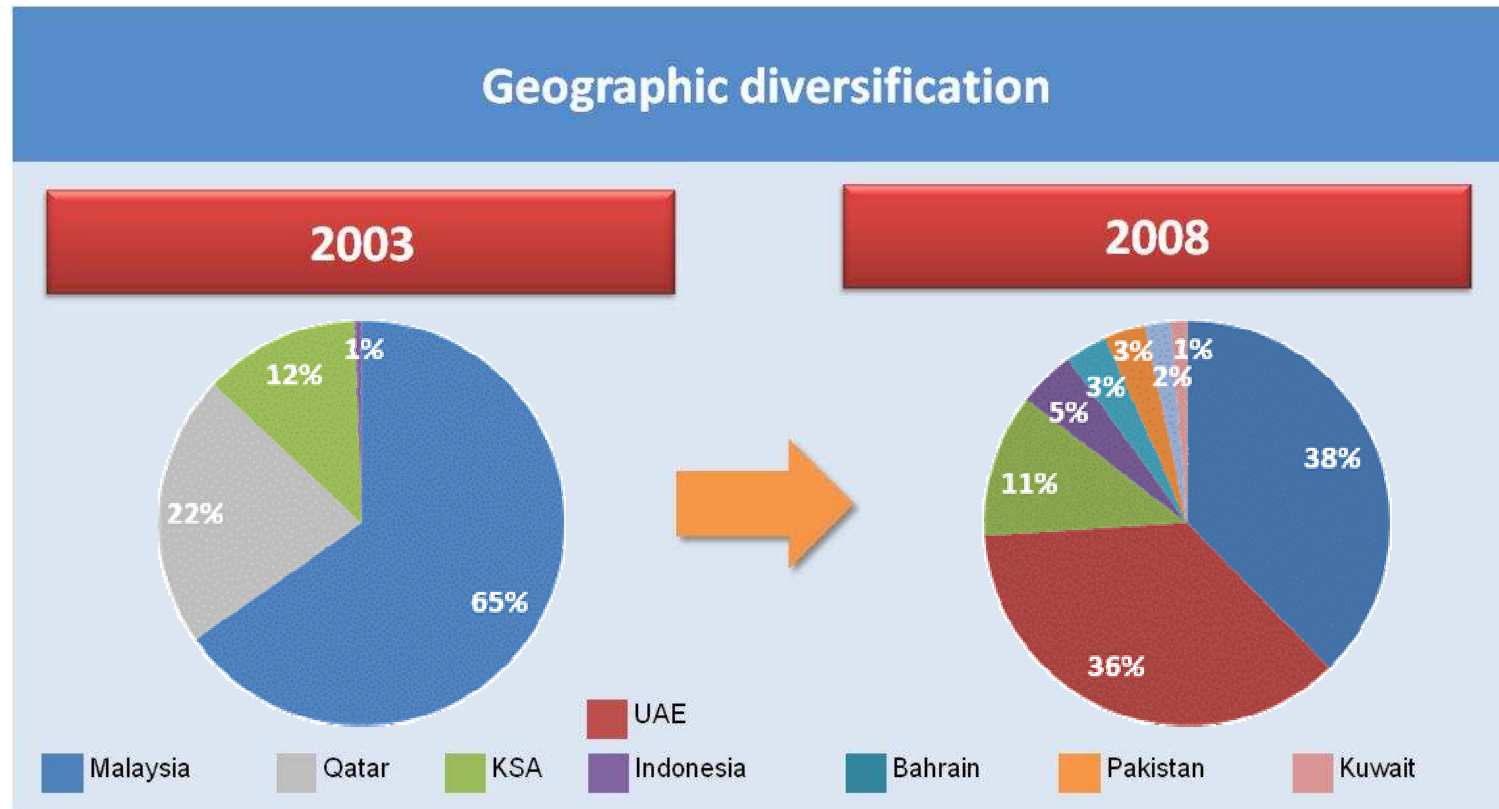
Source: Bloomberg, Dealogic, IFR

What are Islamic Investors Looking For? Pricing

Return:

- ❑ Conventional pricing benchmarks have been re-set so any previous perceived “Islamic premium” is no longer relevant
- ❑ Current European corporate benchmark levels are historically very high
 - Although GCC benchmarks have widened even more markedly
 - Withholding tax concerns from European issues
- ❑ Where is the balance in the risk/reward ratio?
 - The suspicion remains that Islamic investors still favour reward...
 - ...and in sectors they are already familiar with

What are Islamic Investors Looking For? Geographic Diversification



Source: Zawya, IFS, Bloomberg

What are Islamic Investors Looking For? Geographic Diversification

Geographic diversification:

- ❑ Only one European Sukuk issue to date (NB: Tesco out of Malaysia)
- ❑ Right now, GCC investors are focusing almost exclusively on GCC opportunities
 - Severe stress in Dubai
 - Self-inflicted wounds in Kuwait
 - Saudi Arabia in self-imposed isolation
- ❑ Strong interest in Islamic finance in Asia, but:
 - Focus is on how to raise finance for local corporates, not necessarily to buy European deals
 - A distressingly high number of potential conventional investors in the region seem to have exposure to Iceland, Lehman Brothers etc. – so why repeat the mistake?!

Limitations of the Islamic Finance Sector

- ❑ The Islamic finance sector globally is characterised by a large number of small banks, with only a handful of Islamic banks with balance sheets in excess of US\$20 billion
- ❑ For that reason, at least initially, Islamic finance will be providing funding solutions for European corporates in tens of millions of pounds, not billions
- ❑ In addition, there are sector restrictions which apply to Islamic finance: those corporates focusing on the production of alcohol, armaments or pork will need to look elsewhere
- ❑ Those companies that do not operate in these “Haram” (or forbidden) sectors will need:
 - to view the opportunity represented by the Islamic finance sector as a long-term option
 - to make assets available for use in the structures
 - to invest additional management time in closing their first Shariah transaction
 - (preferably) to be active already in the Middle East and Gulf countries

So – What Next?

- ❑ Cash flow deals
 - No more IRR-focused, development risk transactions
- ❑ Keep it simple
 - ***For example,*** establish market-standard Treasury products before sorting out an Islamic hedge fund
- ❑ Real estate still a strong card to play
 - BUT focus on good quality, let properties with strong covenants
- ❑ Sukuk issues NOT the only option
 - Islamic syndicated facilities have always had higher annual volumes than Sukuk issues

So – What Next?

- ❑ When will this change?
 - Earliest, optimistic best guess: post-Ramadan 2009, ie not before Q4
- ❑ There are reasons to see the glass half full:
 - Increasing diversification of Islamic investor base:
 - Sukuk funds – although current crop mainly opportunistic
 - Takaful/Re-Takaful companies constantly growing, albeit from a low base
 - Conventional investors – continued interest amongst European banks (NB: please ignore asset dumping by some investment banks in UAE...)
 - “Ethical investment” – the European cross-over point
- ❑ The potential role of regulators:
 - UK example: FSA requirement for all UK banks to hold stocks of highly rated liquid assets
 - To be followed elsewhere?, i.e. diversification out of necessity not curiosity

What's in the Pipeline?

- ❑ Like everyone else, Gatehouse Bank has a good pipeline of transactions
- ❑ Potential Capital Markets transactions include:
 - Sukuk and syndication opportunities in GCC
 - Several European financings:
 - ❑ Social housing
 - ❑ Clean technology in UK
- ❑ Health warning for next few slides: “**hostage to fortune**”

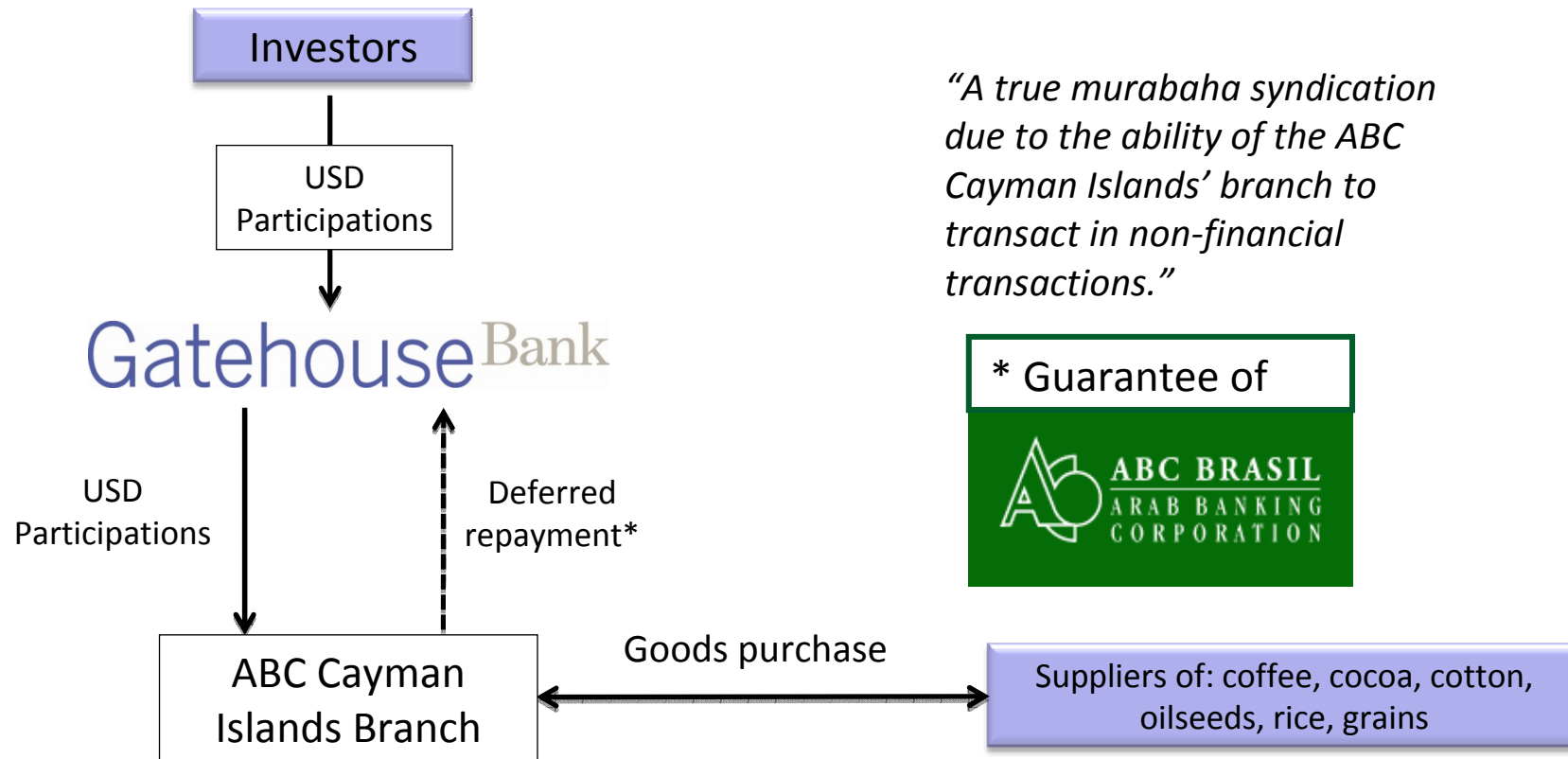


US\$50m 1-year Facility for ABC Brasil

ABC Brasil Outline Terms	
Purchaser:	Banco ABC Brasil S.A (Cayman Branch)
Guarantor:	Banco ABC Brasil S.A
Facility Amount:	US\$50,000,000
Tenor:	One year
Structure:	Goods Murabaha
Mandated Lead Arranger:	} Gatehouse Bank plc
Investment Agent:	
Bookrunner:	
Signing & Publicity Agent:	
Documentation Agent:	
Shariah Advisor:	

“A true murabaha syndication due to the ability of the ABC Cayman Islands’ branch to transact in non-financial transactions.”

US\$50m 1-year facility for ABC Brasil

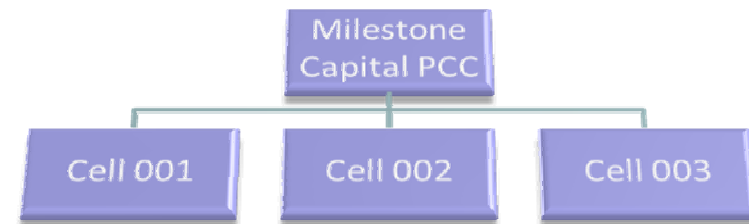


“A true murabaha syndication due to the ability of the ABC Cayman Islands’ branch to transact in non-financial transactions.”

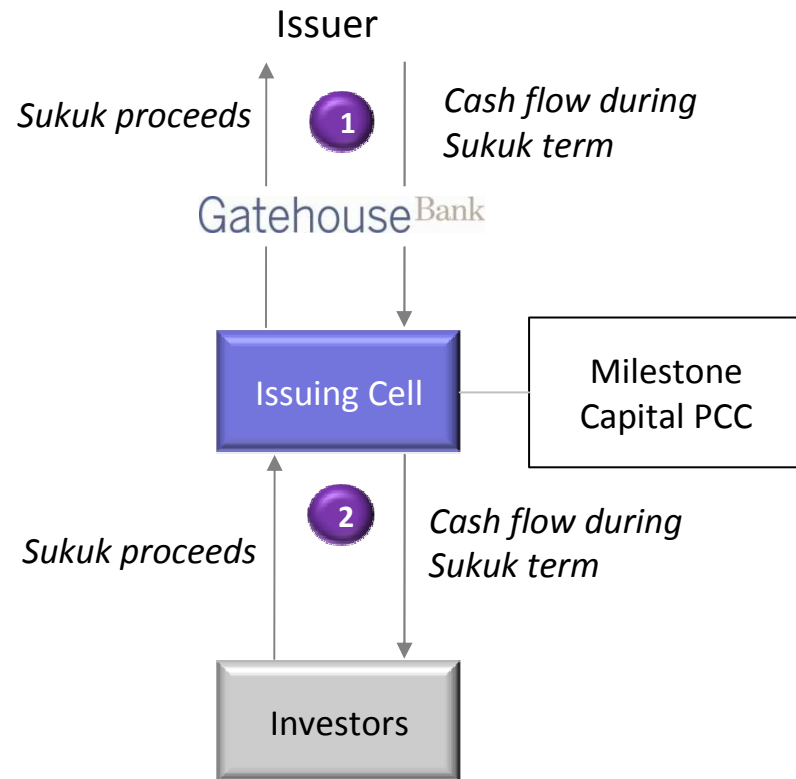


Overview of the Milestone Sukuk Certificate Programme

- ❑ The Milestone Sukuk Programme is an offshore Sukuk structure which provides issuers with funding through a Shariah-compliant capital markets structure, listed in Jersey and cleared through Euroclear and Clearstream
- ❑ Key features include:
 - All cells are ring fenced: only creditors of a particular cell can access the assets of that cell
 - A single regulatory consent has been issued to the PCC itself in respect of all the cells it creates
 - Cells can be established in a cost and time efficient manner
- ❑ Using Milestone will allow issuers to undertake a faster and cheaper execution compared to a standalone issue



Milestone – Transaction structure



1 Islamic trade (e.g. an Ijara) between Issuer and the Issuing Cell. Gatehouse acts as an arranger

OR The Islamic trade can also be between Issuer and Gatehouse – with a participation agreement between Gatehouse and the Issuing Cell

2 The Issuing Cell issues Sukuk to the Investor(s) reflecting in full the terms of the Islamic facility or participation agreement

Concluding Remarks

- ❑ Islamic finance in Europe is here to stay
- ❑ It is a specialist, niche sector at the moment but can grow from there
- ❑ 2009 will be a difficult year
 - unlikely to see a benchmark issue for a European corporate
- ❑ BUT many other opportunities
 - Syndications
 - Club deals/bilaterals
 - Funds/mezzanine/private equity



Thank You

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