

ISLAMIC FINANCE IN EUROPE GAINING TRACTION AND POISED FOR GROWTH

Islamic finance is set to record new achievements in Europe this year, with sovereign sukuk issues planned in the United Kingdom and Luxembourg. The two issues are expected to raise over USD600mln in proceeds, and signal the respective ambitions of the two jurisdictions to become hubs in Islamic finance. Similar developments have taken place recently in France and Germany, while Ireland and Italy could also be entering the field of play, demonstrating the rise in interest for Islamic finance across Europe.

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Islamic Finance in Europe: Gaining Traction and Poised for Growth

Monumental developments are in the pipeline for the Islamic finance industry in Europe in 2014 including sovereign sukuk issuance plans by Luxembourg and the United Kingdom, which in total will raise over USD600mln¹ in proceeds. The Eurozone will also witness the launch of its first full-fledged Islamic bank, Eurisbank - headquartered in Luxembourg, which will have a start-up capital of EUR60mln² with branches in France, Germany, The Netherlands and Belgium.

The global Islamic finance industry continues its double digit growth rates averaging annually between 15% and 20% over the past decade. The alternative financial sector's assets are widely tipped to surpass the USD2tn mark in 2014³. The contribution of Europe towards the global Islamic financial assets, however, has remained marginal with an estimated USD50bln to USD60bln in assets in the region in 2013⁴. Yet, recent developments in key European financial markets, including the United Kingdom and Luxembourg's plans to issue sovereign sukuk in 2014, represent promising potentials for the Islamic financial sector to gain deeper traction in Europe. The economic and financial characteristics of the European region enable several key growth areas which provide Islamic financial institutions ample opportunities to expand on Islamic finance offerings across

the region. These key growth areas include, among others, (1) growing trade and financial linkages between the European Union (EU) and the Organisation of Islamic Cooperation (OIC) Countries; (2) increasing preferences for ethical financial solutions in the EU; (3) tremendous interest to develop the halal food business sector in Europe; (4) the need for tapping alternative pool of liquid funds in the aftermath of the economic difficulties in the conventional finance markets in recent years; and also (5) increasing governmental support to develop the Islamic financial sector in various European jurisdictions. Islamic finance has the potentials to satisfy these market needs in Europe and the current trends of Islamic finance initiatives and developments in Europe set an encouraging growth trajectory for this ethical sector in the region which will further spur the growth of this thriving global Islamic finance industry.

Trade between EU and the OIC - A Natural Growth Driver

The OIC economies have long been important trade partners with the EU. Despite the recent economic uncertainties in the Euro-zone, trade value of OIC with the EU reached EUR2.2tn as per latest statistics available⁵. The OIC-EU trade relationship is likely to remain steady in the coming future given signs of economic recovery in the Eurozone area. In the past few years, growth in trade between the OIC and the EU has remained positive ranging between 1% to 7% annually during 2003 to 2011, except for brief periods of contraction in 2006, 2009 and 2010.

¹ KFH Research Limited

⁴ ibid

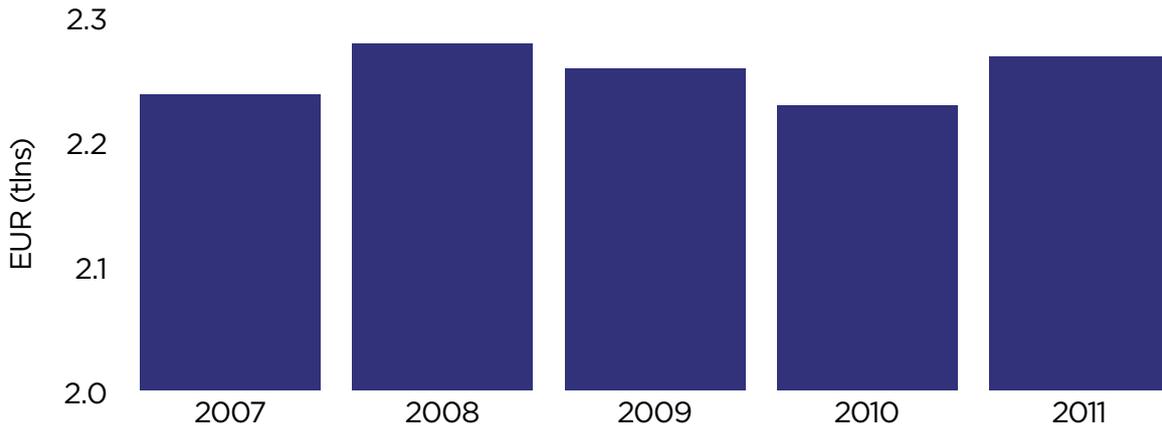
² Reuters

⁵ EuroStat

³ KFH Research Limited

OIC-EU Trade Value: Consistent and Steady Performance

Source: Eurostat, KFH Research Limited



EU's volume of trade with the key Islamic financial hubs of the Gulf Cooperation Council (GCC) and Southeast Asia has also been steadily gaining prominence over the years. The EU is currently GCC's largest trading partner with nearly 13.5% of GCC's global trade taking place with the EU as at end-2012. The bilateral trade between GCC-EU has increased by 45 per cent since 2010 to reach EUR145bln annually⁶.

Similarly, EU is the Association of South East Asian Nations (ASEAN's) second largest trading

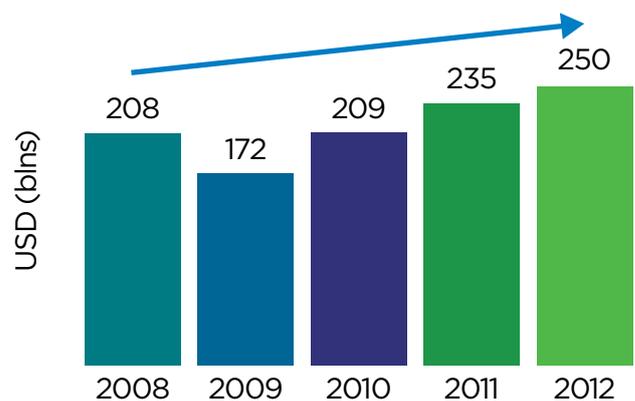
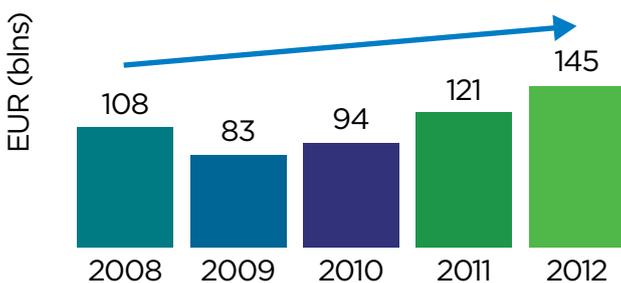
partner while ASEAN itself represents the EU's third largest trading partner outside Europe. The volume of annual trade between these two markets reached the USD250bln mark in 2012⁷. Key trade markets in EU-ASEAN trade relations include Malaysia, Singapore, Indonesia and Thailand which all have Islamic finance presence. **The growing trade relationship necessitates the need for trade financing support and hence, in retrospect provides Islamic banks opportunities to innovate and churn new Islamic trade financing products.**

EU-GCC Trade Value

Source: Eurostat, KFH Research Limited

EU-ASEAN Trade Value

Source: ASEAN, European Commission, KFH Research Limited



⁶ Eurostat

⁷ ASEAN, European Commission

Demand for Ethical Finance - A Unique Selling Point for Islamic Finance

There is a growing awareness among the world demographics on the need for ethical financial solutions, particularly in the aftermath of the series of recent financial crises which had a severe impact on the conventional finance industry. A recent survey by the Economist Intelligence Unit (EIU) on private banking practices and strategies revealed that private bankers expected ethical investments to increase by an annual average of 9.1% for the next five years, with 31% of respondents forecasting a double-digit annual percentage increases. There is a general trend among global investors in being inclined towards socially responsible investments (SRIs).

Being an ethical investments vehicle, Islamic financial solutions have a huge potential for expansion in various territories around the globe, including in Europe where market ethical practices have long been a major concern amongst the citizens.

Europe is a major hub for investments in the global market and it is estimated there are nearly 3.4 million high net-worth individuals⁸ in Europe with investable assets worth USD10.9tn⁹. Islamic finance players have the opportunity to attract this business as the Islamic financial solutions are not restricted to Muslims alone. The ethical and socially responsible investment nature of Islamic finance is likely to appeal this segment of consumers who prefer ethical solutions to their financial needs.

Europe's ambitions in the Halal Food Business: Another Catalyst for Islamic Finance

The global halal food business is worth approximately USD685bn per year based on statistics released during the World Halal Forum 2013. Islamic finance offerings are vital

to serve the needs of the halal food business sector for Shariah-compliant financing and trade financing solutions, as mandated by a holistic Shariah system for Islamic commercial business. A number of European markets are involved in the halal food industry including the United Kingdom, France and Germany which have a sizable Muslim population in the region.

“Being an ethical investments vehicle, Islamic financial solutions have a huge potential for expansion in various territories around the globe, including in Europe where market ethical practices have long been a major concern amongst the citizens.”

Apart from these European markets, the most recent development, Italy is now emerging as a new hub for the halal food industry in Europe. The World Halal Food Council (WHFC) recently held a meeting in Rome, Italy during 26th to 30th March 2014 which gathered together representatives of the 57 Islamic states of the OIC for the first time in Italy. The event was organised by the Italian section of the Halal International Authority (HIA) and the agenda included potentials for Italy to become the hub of the halal market in the Mediterranean region. As such, with ambition to develop an ‘Italy Halal Hub’, the prospects for Islamic finance in serving this market in Europe and in Italy in particular are magnified.

Malaysia will be playing a critical role in helping support the development of Italy as the leading Halal hub in Europe, serving countries of the Mediterranean, Southeast Asia, the Balkans and European countries.

⁸ HNWI's are defined as those having investable assets of USD1m or more, excluding primary residence, collectibles, consumables, and consumer durables.

⁹ Capgemini (2013)

Malaysia is the largest halal market in the world as its range of halal certified products go beyond the food business and include sectors ranging from clothing to tourism, medicines to cosmetics and body treatments, etc. The halal food industry is a growing sector in Malaysia's manufacturing sector and as per latest statistics available, Malaysia's exports of halal products totalled RM35bn¹⁰, representing nearly 5.1% of the country's total exports.

This development, which will utilise Islamic financial solutions and investments, would serve as a catalyst to create further demand for Islamic financial services in Europe.

Alternative Source of Liquidity: Islamic finance as a multi-trillion dollar liquidity pool

In the backdrop of global macroeconomic challenges and financial pressures in major markets, the fast expanding pool of global Shariah-compliant funds over the years have become an attractive source for various sovereigns, government-related entities and corporates to tap into in order to meet their financing needs. The Shariah-compliant liquidity pool of the oil-rich GCC region as well as the rapidly emerging Muslim-dominated markets, for e.g. Malaysia, offers a diversified pool of alternative liquid funds to various entities and this has enticed a number of jurisdictions in Europe as well as in Africa and Asia to venture into Islamic finance. To date, Islamic finance has provided financing solutions across several sectors including (1) infrastructure financing, (2) government fiscal and revenue expenditure financing, (3) corporate and retail financing, (4) ethical investment solutions to corporate and retail investors, (5) trade financing for international trade, and also (6) Islamic insurance services.

Sukuk instruments have been specifically instrumental in being used as a medium to channel the Shariah-compliant funds to the various deficit entities in Europe and elsewhere. In recent years, some new and emerging jurisdictions to tap into the global sukuk market include Azerbaijan, Turkey and United Kingdom in 2010; Hong Kong, Jordan and Yemen in 2011; France, Germany and Kazakhstan in 2012; and Luxembourg, Mauritius, Nigeria and Oman in 2013. In 2014, a number of debut sovereign issuances are expected in Europe including from the United Kingdom and Luxembourg who have confirmed announcements while proposals and options are being evaluated in Ireland, France and possibly Italy. Islamic finance has the potentials to partly support the budget and infrastructure development plans of these countries by providing the necessary financing.

Governmental and Industry Support: Vital for Gaining Traction

An enabling environment and an appropriate regulatory and legislative structure, supported by the government and industry players, are critically essential for the Islamic financial sector to take root and blossom in any jurisdiction. The implementation of reforms and amendments to national financial legislations by regulators can provide the much needed level-playing field to Islamic financial institutions in order to make their offerings competitive to the conventional finance industry. Such measures also provide benefits to the consumers in the form of availability of wider range of financial services that can be availed by both domestic and global investors and issuers.

¹⁰ MIDA (2012)

Islamic Finance Related Developments in Europe in 2013/2014

Jurisdiction	Developments
<p>United Kingdom</p>	<ul style="list-style-type: none"> • Launched an ‘Islamic Finance Task Force’ in March last year: a committee mandated with (1) supporting the development of Islamic finance in UK; (2) increasing inward investment of Shariah-compliant funds; and (3) overall strengthening the economy. • During the 9th WIEF, the British Government significantly announced its intention to float a GBP200mln sovereign sukuk in 2014, as part of its commitment in sustaining its leadership as a major Islamic finance jurisdiction in Europe. • Furthermore, the British Government extended support to its capital city, London, to become a preferred market for Islamic financial instruments listings and announced the launch of a Shariah-compliant index in the London Stock Exchange (LSE) to facilitate Shariah-compliant investments at the bourse. • The British Government also sought to bolster London’s position as a centre for Islamic finance by extending its ‘Help to Buy’ mortgage scheme to loans that comply with Islamic law. Help to Buy was launched in 2013 and offers banks insurance against the risk of lending to home-buyers who cannot afford large mortgage deposits. • London-based Umex Securities has also launched an Islamic trade finance service this year targeting firms in the halal sector, addressing their limited access to Shariah-compliant working capital and financing. Umex will offer its Islamic trade finance service, called Umex Trade Bridge, first in Britain followed by other European markets, with terms ranging from 15 to 120 days and amounts between GBP50,000 and GBP250,000.
<p>Luxembourg</p>	<ul style="list-style-type: none"> • Following Britain’s symbolic move, the Grand Duchy of Luxembourg also announced plans to float its own sovereign sukuk worth EUR200mln in 2014 as part of its efforts to highlight the role of the Luxembourg Stock Exchange (LuxSE) as a domicile for international sukuk instruments. Luxembourg has traditionally been a hub for listing of international bonds, in which it is ranked first in Europe, and the jurisdiction looks to become a major hub for international Islamic financial instruments listings. • The Eurozone is set to get its first full-fledged Islamic bank, Eurisbank, which will be headquartered in Luxembourg. Having an initial start-up capital of EUR60mln, Eurisbank will have branches across the Eurozone including in Luxembourg, France, Germany, The Netherlands and Belgium. The bank intends to offer retail, corporate and private banking services and is expected to commence operations at the end of this year.

<p>France</p>	<ul style="list-style-type: none"> • In the second half of 2013, French bank Société Générale announced its plan to tap the Malaysian sukuk market with an MYR1billion (USD300.3mIn) issue. The second-largest French bank aims to tap the sukuk market in order to diversify its funding sources. The issuance is likely to take place later this year.
<p>Cyprus</p>	<ul style="list-style-type: none"> • Cyprus is preparing a framework and legislation to introduce Islamic financial tools and instruments, such as sukuk, in the island-nation which is a member of the European Union. The potential Islamic finance opportunities in the energy and electricity sectors of Cyprus are being explored. A major Islamic bank hailing from Qatar has recently agreed to extend support to the Government of Cyprus in preparing the framework and legislation.
<p>Italy</p>	<ul style="list-style-type: none"> • The World Halal Food Council (WHFC) recently held a meeting in Rome, Italy during 26th to 30th March 2014 to discuss the potentials of Italy becoming the hub of the Halal market in the Mediterranean region. • Islamic finance is also slated to take root in Italy as growing economic and financial ties between Eurozone’s third largest economy and Islamic financial hubs in the GCC are expanding. The Banca d’Italia (central bank) has hosted a number of conferences on the subject. ABI, the Italian Banking Association, is currently coordinating a working group related to the issuance of a corporate or sovereign sukuk. Italy is seeking trade and investment with wealthy Gulf Arab states. Kuwait’s sovereign wealth fund announced this year that it would invest EUR500mIn in Italian companies; Italy made a similar deal with Qatar last year.

Source: IFN, IFIS, Zawya, Bloomberg, KFH Research Limited

Growing Malaysia-EU Trade and Financial Linkages: Islamic Finance Growth Proposition

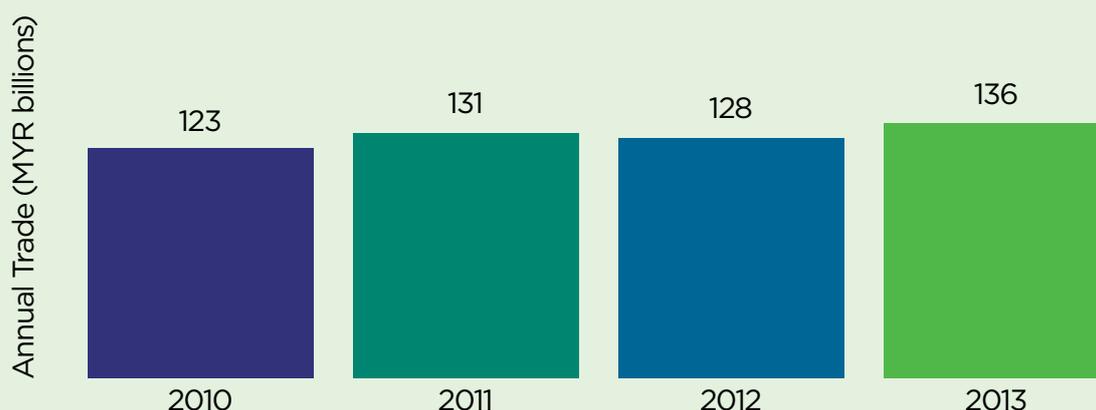
The economic and financial linkages between Malaysia and the EU has managed to grow during the last few years, in spite of the global economic difficulties on account of the global financial crisis in 2008-09; Euro sovereign debt crisis in 2011-2012 and the emerging markets funds outflow volatilities in 2013/2014. **The annual trade volume between the two markets reached MYR136bIn in 2013, up from a volume of MYR123bIn in 2010¹¹.** In terms of bilateral economic relations, Malaysia is the second most important trade partner of the EU in ASEAN¹². In 2010, negotiations were also launched for a Free Trade Agreement between the EU and Malaysia. Given that the Islamic financial solutions are available to all regardless of religious beliefs, the ethical and competitive value offerings of Islamic trade financing solutions are likely to be acceptable to contracting parties in both the EU and Malaysia providing the Islamic finance players with opportunities to support the expanding trade between these markets with Shariah-compliant financial solutions.

¹¹ Department of Statistics, Malaysia

¹² European Commission

Annual Trade Volume between Malaysia and the EU (2010-2013)

Source: Department of Statistics, Malaysia



The EU is also a relevant source of investment in Malaysia having a considerable share in the annual amount of Foreign Direct Investments (FDIs) in Malaysia. **Between 2006 and 2012, the share of EU FDI stock in Malaysia has grown from EUR9.4bln to EUR27.8bln. In 2013, the EU was the third largest source of FDI into Malaysia amounting to MYR5.2bln¹³.** Germany, the Netherlands, the UK, Sweden and France are among top foreign investors in Malaysia (along with Japan, Singapore and the United States). The growing economic and financial ties between the EU and Malaysia presents a promising opportunity for both markets to leverage on each others expertise and further contribute towards the growth and development of Islamic finance.

The Malaysian markets have been actively tapped by international institutions looking to benefit from the liquid and well established regulatory platform of the Malaysian sukuk market, including issuers hailing from Europe, Middle East and Asia. The EU-Malaysia financial linkages provide ample opportunities for sovereign, quasi-sovereign and corporate institutions in each market to tap the Islamic financial sector through sukuk instruments by listing in the exchanges of the respective markets.

In Europe, the London Stock Exchange (LSE) and the Luxembourg Stock Exchange (LuxSE) are among the major bourses in Europe which facilitate international sukuk listings. To date over USD38bln has been raised through 53 issues in the LSE while EUR5.5bln has been raised through 16 issues on the LuxSE. Bursa Malaysia, which is the top sukuk listings platform globally, attracts a number of domestic and international issuers and a cross-listing of financial instruments amongst these three markets can enable sukuk issuers to attract a diversified pool of investors across regions.

Islamic fund management and Islamic investment banking services is another area which stands to benefit substantially and a number of European investment banks have set up subsidiaries/representative offices in Malaysia to take advantage of lucrative opportunities offered by the Islamic capital markets. To date, European investment banks operating and offering Shariah-compliant Islamic capital market services (including sukuk underwriting/arranging) include

¹³ Delegation of the EU to Malaysia

Aberdeen and Zurich in asset management and HSBC, Standard Chartered, The Royal Bank of Scotland, BNP Paribas, Deutsche Bank, and Credit Suisse in other services.

The Malaysian markets have the highest number of Islamic funds at 266 as at end-2013 while their assets under management are the second largest in the world at approximately USD16.4bln¹⁴. The LuxSE also has 45 Islamic investment funds (regulated and non-regulated) with total assets under management at over EUR5bln¹⁵. Meanwhile, the LSE has seven Shariah-compliant Exchange Traded Funds and two Shariah-Compliant Exchange Traded Products while there are four Shariah-compliant funds domiciled in UK with assets under management of USD16.5mln¹⁶ as at end-2013.

The bilateral relations between Malaysia and the EU have also been gaining prominence as Malaysia is EU's second largest trading partner in ASEAN while EU was the largest source of FDIs into Malaysia in 2012. The deepening economic and financial linkages between Malaysia and the EU provide tremendous opportunities for both markets in the Islamic financial sector. Malaysia's role as the frontrunner in innovation and creative development of Islamic financial markets provides ample opportunities for increased cross-border activities, enhanced collaborations and fostering mutual linkages in the Islamic financial sector with the EU given the growing interest in individual EU jurisdictions to develop the sector. The enhanced linkages are reflected through the increasing number of European banks in Malaysia's shore to offer Shariah financial services and partnerships for Islamic finance development at industry and regulators levels that have been initiated.

Conclusion

The interest in Islamic finance in Europe has been reignited following symbolic announcements by the UK and Luxembourg to issue sovereign sukuk in 2014. The Islamic financial sector in Europe, although small with assets between USD50bln and USD60bln in 2013, has promising potentials to gain traction given the fast expanding bilateral ties between the EU and the Islamic financial hubs of the GCC and Malaysia. Islamic finance is fast gaining ground in these hub markets and the growing economic and financial linkages with the EU are likely to create more opportunities for Islamic finance to play a role in facilitating these transactions.

Moving forward, the rapid development of Islamic finance in various parts of the world including in Europe, Central Asia, North and Sub-Saharan Africa, Australia, and North America are all examples of the practicality of Islamic financial solutions for all stakeholders, regardless of religious beliefs. Islamic finance aims to provide alternative and ethical financing solutions to all and the latest developments in Europe give credence to this. It is expected that Islamic financial solutions can further enhance the trade and financial linkages between the EU and the various OIC countries where Islamic finance has deep presence.

¹⁴ KFH Research Limited

¹⁵ Luxembourg Stock Exchange

¹⁶ London Stock Exchange / KFH Research Limited

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