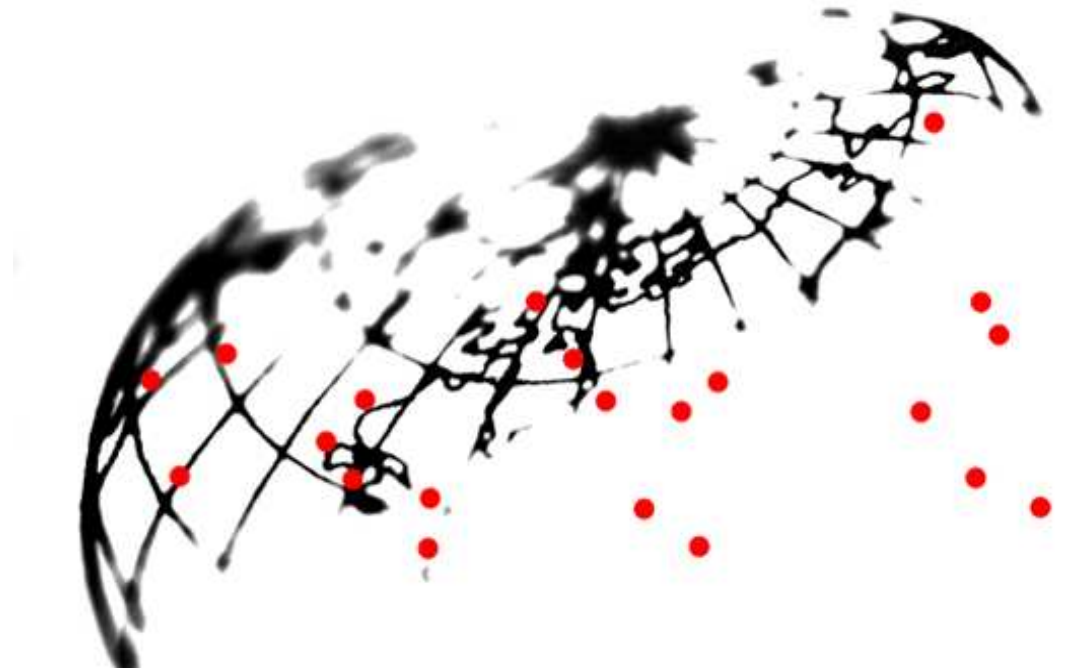


The Response of Islamic finance to the recession

12 May 2009

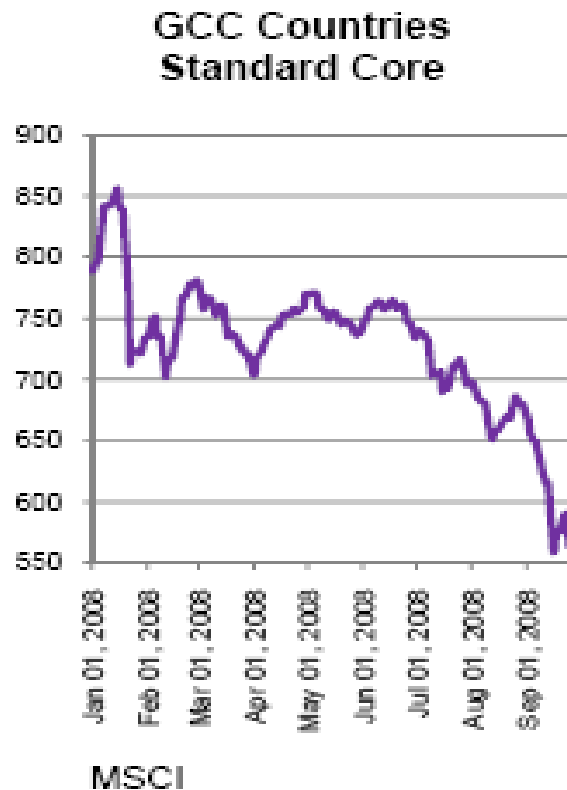
Farmida Bi, Partner



Islamic Finance: A different model

- September 2008 – confidence
- Islamic banks had not invested in toxic assets, held actual assets representing their investments (often real estate and equity) and were not over-leveraged
- Investors were moving funds to IFIs from conventional FIs
- Expected to resume normal activity in Q1 2009
- By end of November 2008, change of mood:
 - falling real estate prices
 - dependence on international FIs for funding

The state of the markets



- **Total losses in Arab capital markets: \$224bn**

- **Total GCC losses: \$140bn**

- Saudi Arabia: \$67bn

- Qatar: \$26bn

- Kuwait: \$20bn

- UAE: \$27bn

- Abu Dhabi: \$15bn

- Dubai: \$12bn

- Oman: \$3bn

- Bahrain: \$2bn

Sukuk

- Global sukuk issuance in Q4 2008 was the lowest since 2002
- 2008 was a worse year for sukuk than 2006 and 2007
- Decline is global – South East Asia and GCC

Syndicated Lending

- Islamic syndicated lending increased from US\$19.6 billion in 2007 to US\$27.2 billion in 2008
- Islamic syndicated lending froze almost completely in Q4 2008

Bookrunners and Arrangers

- CIMB Islamic and HSBC Amanah remained the top two sukuk bookrunners in 2008 (as in 2007)
- Average amount credited to each bookrunner in the top ten dropped from US\$2.379 billion in 2007 to US\$936 million in 2008
- In syndicated lending, average amount of lending arranged by each of top 10 arrangers decreased from US\$1566.86 billion in 2007 to US\$1132.14 in 2008

Character of equity in Islamic finance

- Discrete private equity opportunities:
 - mid cap c. \$50 - \$100 million
 - Undervalued with growth potential
 - Transferable technologies or services
 - Energy and renewables – not green-field
 - Cash generating businesses
- Move towards Shariah 'based' rather than Shariah 'compliant' financing

Impact on Sukuk (1)

- Islamic bond issuance grew enormously between 2004 and 2007, increasing by 49% in 2005, 153% in 2006 and 79% in 2007
- 2007 – sukuk issuance equalled US\$46.65 billion
- Reasons:
 - Easy access to credit
 - High oil prices
 - Sentiment in favour of Islamic financing

Impact on Sukuk (2)

- Reasons for decoupling theory:
 - IF separated from global conventional credit markets
 - Islamic markets had matured and were not dependant on oil price
 - Real underlying assets provided protection against the credit crunch

BUT

- Sukuk issuance fell by 66% in 2008
- GCC – 50% drop
- South East Asia - 75% drop

Financial performances (1)

- Market data shows that Islamic investors have suffered less than conventional investors
- Some sectors in Islamic finance (e.g. Takaful) have shown resilience to global market dislocation
- Shariah investing continues to attract market share from conventional Western investors as well as the Islamic investment community (S&P press release 21 April 2009)
- Takaful insurance displays strong resilience
- IFI are not risk immune

Financial performances (2)

- Some IFIs have registered a positive growth in 2008 (e.g. Al Rajhi Bank (KSA) and Kuwait Finance House) posted high profits in 2008.
- Others have severely suffered (e.g. Dar Al Istithmar in Kuwait, DIB).
- S&P Shariah Indices has registered losses for the 1st quarter of 2009 : S&P global benchmark index of Shariah-compliant benchmark index of Shariah-compliant companies and S&P global BMI Shariah index both declined more than 6%

Reasons for the Impact

- Drop in the oil price
- Severe liquidity shortage – impacted construction sector
- Decline in real estate prices
- Most investors in sukuk were conventional FIs
- Capital flight – speculative funds assuming revaluation of currencies pegged to US dollar
- Lack of disclosure in market – sudden collapse of Khaleej Bank, Investment Dar troubles, default of Global Investment House
- Ratings downgrades – impacts investor confidence
- AAOIFI Statement on purchase undertakings

Consequences of the Impact

- Central Banks are telling IFIs to reduce exposure to real estate below 30% and to invest in home countries only for rest of 2009
- Fall in equity prices
- IFIs are small – top 25 IFIs only have Shariah compliant assets in excess of US\$5 billion

Are there any opportunities?

- Western firms seeking Islamic financial support need to better understand what IFIs are looking for
- IFIs are not in the business of bailing out the Western banking system – other non-Islamic ME investors may be willing to help out
- Role of Islamic ‘windows’ in conventional banks contrasts with role of ‘fully Islamic’ financial institutions
- Misconceptions about liquidity in the Gulf States

Implications going forward (1)

- IFIs and scholars will not tolerate 'lip service'
- There will need to be genuine efforts to structure products that are more genuinely Islamic in both form and substance
- May be some opportunity for debt financing of 'brands' and establishing new banking relationships
- Islamic banks still need liquidity – Western banks can provide that if willing to lend
- Islamic capital markets – ijara structure likely to dominate
- Linkage between Islamic markets and conventional markets

Implications going forward (2)

- Mezzanine Islamic finance:
 - convertible Sukuk
 - convertible Murabaha
 - intercreditor issues
 - tranching
- Pressure on the IFIs to:
 - improve risk management techniques
 - Develop an inter-bank market for liquidity
- Growing interest from non-classical regions (e.g. Russia)
- Are we going to see a new era of Islamic finance emerging from the crisis?

Predictions for the future

- Recovery in Q4 2009
- Increased interest in the sector from conventional industries/countries eg France, Singapore
- Continuing interest in real estate for IFIs – likely to be buying opportunities in 2009
- Private equity and M&A – energy renewables, pharmaceuticals, food-stuffs and IT
- Regional infrastructure projects will continue – other projects delayed
- Debt v Equity – equity will remain preferred option
- Foreign investments

How we are rated on Islamic finance

- *“The leader in this sector by a substantial margin”*
Legal 500 - 2007 and 2008
- *“the broadest Islamic finance offering on the market”* Chambers and Partners 2009
 - *“Best Takaful Law firm 2008”*
International Takaful Summit Awards
 - *“Best Islamic finance law firm 2008”*
Islamic Business and Finance and Islamic Finance News

Farmida Bi

Partner

Norton Rose LLP

+44 (0)20 7444 5842

farmida.bi@nortonrose.com



Farmida Bi has specialised in capital markets transactions for over 16 years and has advised on English and New York law debt and equity capital markets transactions (including Islamic finance and securitisations), emerging markets, regulatory issues, structured finance and mergers and acquisitions.

Farmida is a recognised expert in the Islamic capital markets field and is listed as a leading individual for Islamic Finance in Chambers & Partners.

Farmida qualified as a solicitor in 1992 and as a New York attorney in 1999. She was a partner at Denton Wilde Sapte in London from 2002 to June 2008 and joined Norton Rose LLP as a partner on 1 July 2008.

Farmida Bi - CV continued

Farmida has acted for the lead managers on many of the leading Sukuk issues including:

- Advising Emirates National Securitisation Corporation as securitisation structurer and adviser, Morgan Stanley & Co. International plc and Standard Chartered Bank as Managers in connection with a US\$210 million Floating Rate Secured Notes due 2037 Shariah compliant RMBS securitisation by Tamweel PJSC.
- Advising Barclays Capital and Dubai Islamic Bank as joint lead managers on the issue by PCFC Development FZCO of US\$3.5 billion Pre-IPO convertible trust certificates (Sukuk al-Musharaka) due 2008.
- Advising HSBC as sole book runner and lead manager on an issue of US\$225 million trust certificates (Sukuk Sharikat Melk) due 2011 on behalf of Sharjah Islamic Bank.
- Advising Dubai Islamic Bank, HSBC and Standard Chartered Bank as lead managers of US\$550 million Sukuk issue by Emirates airlines, the first airline Sukuk and the world's largest corporate Sukuk to date.
- Advising Dubai Islamic Bank and Standard Bank as lead managers on a debut, gold settled, rated, Sukuk issue by the Dubai Metals and Commodities Centre Authority.
- Advising Citigroup, HSBC, and Dubai Investment Bank as joint lead managers on the US\$1 billion Sukuk by the Dubai Civil Aviation Authority

Our international practice



Presentation disclaimers

- 1 No individual who is a member, partner, shareholder, employee or consultant of, in or to any constituent part of Norton Rose Group (whether or not such individual is described as a “partner”) accepts or assumes responsibility, or has any liability, to any person in respect of this presentation.
- 2 Any reference to a partner means a member of Norton Rose LLP or a consultant or employee of Norton Rose LLP or one of its affiliates with equivalent standing and qualifications.
- 3 This presentation is not intended to give legal advice and, accordingly, it should not be relied upon. It should not be regarded as a comprehensive statement of the law and practice in this area. Readers must take specific legal advice on any particular matter which concerns them. If you require any advice or information, please speak to your usual contact at Norton Rose Group.

CORPORATE FINANCE • FINANCIAL INSTITUTIONS • ENERGY AND INFRASTRUCTURE • TRANSPORT • TECHNOLOGY



NORTON ROSE