

Is 2021 the year of Sukuk?

2020 has been pivotal for Islamic finance as COVID-19 sent unforeseen and unparalleled shockwaves through global markets. Central banks rushed to support economies and institutions at the height of the crisis and pumped huge amounts of liquidity into the financial system, pushing interest rates toward record lows or even into negative territory. The result has been a jolt to markets and investor mindsets, and this has helped put the spotlight on Islamic liquidity finance as an attractive proposition driven by burgeoning demand, ample liquidity and better returns. DR SCOTT LEVY delves further.



Dr Scott Levy is CEO of Bedford Row Capital. He can be contacted at slevy@bedfordrowcapital.com.

Since 2013 when the then-prime minister David Cameron announced the UK's aspiration to become a leader in Islamic finance, the country has positioned itself as a hub for the sector. While some argue that the UK has not lived up to its vision, it remains a vital and thriving center for Islamic finance and is still one of the best places to do business in the west. One of the most exciting growth areas in 2020 has been Sukuk as issuers and investors realized the potential of tapping into the vast pool of Islamic liquidity. Sukuk, or Islamic debt securities, have been generating interest for some time stemming from when the UK became the first European country to issue Sukuk in 2014. Since then, issuance has gathered pace and by 2019 around 72 Sukuk facilities had been listed on the London Stock Exchange totaling US\$53 billion.

2020 has set the conditions for Sukuk to thrive as the industry attracts attention and firms seeking finance have found access to debt capital markets difficult. Banks that once serviced this market have retreated, considering these issues to be 'too small' to be worth their while and classifying these transactions as 'exotic', while for investors, yield has dried up in many sections of the market and the hunt for stable returns has intensified. Sukuk have generated attention by fulfilling both these demands against a backdrop of the biggest disruption to markets in modern history.

We have seen this trend first-hand. According to the Islamic Finance Development Report of 2019, the Islamic finance industry holds assets of around

US\$2.5 trillion as of 2018 and grew by an average rate of over 6% over the last six years. Compared to the total assets of global financial institutions, it is a mere 0.66% but with rising importance, based on a leading business data platform.

The growth of the market and access to capital has encouraged innovation; from the first green Sukuk issued in 2018, Sukuk have developed a diverse range of applications and become increasingly flexible to suit investors' requirements. Whether diversifying Sukuk into non-traditional sectors such as property and supply chain finance or offering investors short-dated risk — whether 30, 90 or 360 days — the Sukuk sector is vibrant and able to quickly adapt to investor demand for liquidity and it is still evolving.

The appetite among UK issuers and investors has been strong in 2020 even with the market conditions. But despite this strong sentiment and solid foundation, there is significant room for the Sukuk market to innovate and grow in 2021 and beyond.

The market has huge potential — awareness of Sukuk has grown but still needs to be raised among issuers and investors. Sukuk are well suited to current demand and investment trends. By definition, they are ethical products and should be able to tap into the same surging demand for environmental, social and governance products. Whether for social housing, building schools or green energy, it is a way for businesses to raise finance and tap into a huge pool of capital. We can therefore expect to see a continuation of the innovation in the Sukuk market and an increasingly broad range of applications to suit the demand of issuers and investors.

The rapid development of the Sukuk market has brought us on to the verge of a revolution in Islamic liquidity management. With a growing gap



between available liquidity and investable assets, we expect to see an influx of innovative products to satisfy the demand for Shariah compliant investments, particularly with the current low or negative interest rate situation not set to change anytime soon.

Compliant liquidity products based on self-liquidating, physical assets on an instant transaction lend themselves to advanced liquidity management in the money market space. We are therefore going to see the development of new liquidity management tools to allow investors to make better decisions within their overall liquidity management.

The rapid growth of Sukuk brings high expectations and increased scrutiny. Despite challenging market conditions, 2020 has seen significant innovation in the space and has paved the way for the market's evolution into a modern and essential element of an investor's portfolio. The UK's reputation as a financial center and a portal to global markets puts it in a good position to benefit from the growth of Islamic finance. The groundwork has been set; the UK now needs to seize the opportunity and foster innovation and investment in Islamic finance at a time when the financial services industry steps back to assess the way forward. ☺