Ireland may yet get the Islamic finance boost it needs

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The 15th anniversary of IFN is a good opportunity to consider the state of Islamic finance in Ireland, its beginnings nearly 10 years ago in the aftermath of the financial crisis, the framework supporting Shariah compliant transactions in Ireland, early advances and successes, the challenges and missed opportunities and its prospects for the future.

Beginnings

In the aftermath of the financial crisis that occurred in 2008, there was recognition that overleverage and excessive speculation in the financial system among other governance failings had contributed and caused the crisis with consequent tightening in the credit and bond markets. The government identified Islamic finance as possibly offering the opportunity to encourage investment into Ireland and participation of the Muslim community in the financial system and took measures to support the establishment of Islamic financial institutions.

The primary step was the Finance Act 2010 which introduced tax equivalency measures for Shariah compliant structures and to provide a mechanism whereby the Islamic capital market could be accessed by enabling the issuance of Sukuk among other Shariah compliant structures. At the time, international reports by both the IMF and the European Central Bank had identified Ireland's strengths as a jurisdiction for Islamic finance and even its prospects as a leader in the field in Europe and the potential for Ireland to be the first to issue a European sovereign Sukuk facility. The Irish government had at that time prepared its international financial services strategy, IFS 2020, clearly identifying Islamic finance as a growth opportunity in the Irish market.

Finance Act 2010 and taxation treatment

The Finance Act 2010 introduced certain amendments into Irish tax law to support tax equivalency treatment for Shariah compliant transactions such that they would not be placed at a competitive disadvantage against conventional finance structures and products. In addition, the Irish Revenue Commissioners issued a tax and duty manual in respect of the taxation treatment of Islamic financial transactions and this manual was updated as recently as November 2018 to reflect the revenues' latest positions.

Early progress

Euronext Dublin, formerly the Irish Stock Exchange, listed its first Sukuk in 2006 and since then has become a key market for the listing of international Sukuk issuances, including the US$9 billion sovereign Sukuk issued by Saudi Arabia in 2017 and other sovereign bond listings by the likes of Kuwait, Jordan, Oman and Bahrain. Corporate issuers with listed Sukuk on Euronext include Saudi Electricity, Emirates, Kuwait Energy and others.

Aviation finance was identified as a sector of opportunity given Ireland's world-leading reputation in the aircraft leasing and finance industry and aside from aircraft Sukuk listings, there have been transactions in this space including the sale in 2017 by AerCap of a portfolio of 19 aircraft valued at circa US$1.4 billion to NCB Capital utilizing Shariah compliant credit facilities.

With the benefit of Ireland's strengths in Sukuk listings, a supportive taxation framework for Shariah compliant transactions, its common law legal system (which would be broadly familiar to many Middle Eastern investors with experience in the UK market) and English-speaking jurisdiction, one might have expected rapid growth to have occurred.

However, despite some headlines and Euronext's success as a venue for listing Sukuk, the early promise of Islamic finance has failed to deliver in Ireland and despite nearly 20 Islamic financial institutions operating in the UK, there are no Islamic financial institutions established or operating in Ireland and no retail products available to the Muslim community.

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Recent progress

We in commercial law firm Philip Lee have taken the lead in Ireland in advancing the Islamic finance industry, in 2018 advising Community Finance Ireland (CFI), a social enterprise finance provider, in launching the first non-interest-bearing property finance structure specifically targeted at the Muslim community to support community groups advance their social enterprise objectives.

Following from the significant interest from the Irish Muslim community generated by the CFI product launch, in 2019 Philip Lee undertook a landmark Irish survey to quantify the demand for Shariah compliant financial products in the Irish Muslim community. The survey, the first of its kind in Ireland, confirmed significant investment gaps and opportunities within the Muslim community for compliant financial products. The findings from the 400-plus responses included:

- 98% would use an alternative financial product compliant with Islamic finance principles in preference to a conventional loan if available and cited the lack of a compliant alternative product as the reason for not purchasing a home or investment property
- 95% of respondents had an indicative budget of between EUR250,000 (US$276,811) and EUR500,000 (US$553,623) for a home with the average mortgage finance required being approximately EUR274,500 (US$303,939)
- 81% of respondents were living in rented accommodation notwithstanding that 50% of respondents had individual incomes in excess of EUR50,000 (US$55,362.3) per annum, and
- an initial day one mortgage investment opportunity of between EUR30 million (US$33.22 million) and EUR60 million (US$66.43 million) from the survey respondents alone.

In 2019, Ireland emerged as a leading hub for green and responsible finance, with Dublin overtaking London for the first time since 2014 for the number of security listings. According to Bloomberg, borrowers, including Banco Santander and EDP Finance, listed 28 green notes on Dublin's Euronext exchange in 2019 (including the Irish EUR5 billion (US$5.54 billion) sovereign green bond), topping 19 in London, according to data compiled by Bloomberg.

The number of deals finding their way onto the Irish bourse more than doubled from 13 last year. Likewise, the market for green Sukuk has been growing internationally, most recently with the announcement in November 2019 by the IsDB of its EUR500 million (US$553.62 million) inaugural green Sukuk. The Irish government has positioned Ireland as a hub for green finance as part of its revised 2019 IFS strategy, 'Ireland for Finance'. This commits to building on the success of the issuance of the Irish EUR5 billion sovereign green bond, among 27 other green bonds listed on Dublin's Euronext exchange in 2019.

During Climate Finance Ireland Week 2019 in November, Michael D'Arcy, the minister of state at the Department of Finance, committed to growing the green finance sector from EUR100 million (US$110.73 million) to EUR1 trillion (US$1.11 trillion) as soon as possible as part of the government's sustainable finance agenda. Also announced as part of Climate Finance Week, Euronext Dublin launched its center of excellence for green bonds complying with the ICMA Green Bond Principles or Climate Bond Initiative Taxonomy.

Opportunities and challenges for the future

As noted, the progress of the Islamic finance industry has been slow in Ireland and investors have tended to concentrate on the UK market and UK real estate. However, ethical, responsible, sustainable and green finance principles represent the future direction of travel in the finance industry. These principles have a lot in common with the principles and objectives of Islamic finance. Islamic institutions such as Al Rayan in the UK have already broadened their appeal and customer base beyond the Muslim community and there is a demand from the public for this type of principled ethical banking model, particularly with the shift to fintech business models. Conventional banks have been hit with a series of governance and consumer scandals, with reports on banking culture and the tracker mortgage scandal in Ireland (which has been estimated to have cost the banks upwards of EUR1 billion (US$1.11 billion)) demonstrating the gaps that exist between behavior and regulatory and public expectations.

Perhaps with some long-awaited clarity on Brexit, following the UK general election coming in December 2019, and the looming (although ever-extended) withdrawal date of the 31st January 2020, it may be that Ireland may yet get the Islamic finance boost it needs.

UK authorized institutions will most likely be unable to exercise potentially valuable passporting entitlements and Ireland could become for Islamic institutions and investors a safe place of establishment within Europe as has been the case for a host of English and international banks, insurers and asset managers that have already chosen to relocate here.

Ireland will be the only English-speaking member of the eurozone following the UK's withdrawal and with a common law legal system very similar to that of the UK, a jurisdiction with an attractive tax policy and framework which supports Islamic financial transactions, it could be the logical choice for investors and institutions in the Islamic finance industry seeking to grow in the European market in the future.