KEY POINTS

- Emirates has funded the acquisition of four new Airbus A380-800 aircraft using the world's first shari'a compliant sukuk structure guaranteed by an export credit agency.
- The structure, which combines elements of a typical *ijara* sukuk with traditional ECGD guarantee arrangements and asset level security, has established a readily adaptable model with clear potential for application across many types of asset financing.
- There are significant possibilities for export credit agencies and other corporate issuers to replicate this model to fund the acquisition of different asset classes.

Authors Katherine Hensby and Stuart Mason

A new gold standard for shari'a compliant asset finance?

This article examines the recent issuance by Emirates of the world's first shari'a compliant certificates guaranteed by an export credit agency. The issuance continues to pave the way for shari'a compliant investment beyond its traditional market territories and this article considers the possibilities in this area for sovereigns, corporate issuers and investors.

INTRODUCTION

Emirates has come to the market with a recent shari'a compliant issuance of English law US$ 913,026,000 2.471 per cent. trust certificates due 2025 (Emirates' certificates) which are dual listed on the regulated market of the London Stock Exchange and on NASDAQ Dubai (Emirates' issuance). The Emirates' issuance is not only significant for the airline itself. The Emirates' issuance is the world's first sukuk financing supported by an export credit agency. With the benefit of an export finance guarantee from The Secretary of State of Her Britannic Majesty's Government acting by the Export Credits Guarantee Department (operating as UK Export Finance) (the ECGD) the Emirates' issuance follows hot on the heels of the successful £200m sovereign sukuk 2014 issuance by HM Treasury (HM Treasury sukuk).

The proceeds of the Emirates' certificates are to be used by Emirates to finance the acquisition of four new Airbus A380-800 aircraft (the Aircraft). Emirates and the ECGD have used various existing legal techniques to develop a structure that is appealing to investors not only because the securities are shari'a compliant but that also affords investors the benefit of the ECGD guarantee, the coverage of which is equal to the amounts due under the Emirates' certificates. The Emirates' certificates offer investors the ability to invest in Emirates, the Middle East's largest airline wholly owned by the government of Dubai's Investment Corporation of Dubai, with their only practical exposure being to the government of the UK (UK Government). Therefore it is no surprise that on issuance the Emirates' certificates were many times oversubscribed and saw a strong demand from global investors.

With the potential investor base wider and more diverse than for a conventional capital markets issuance, and investors able to take comfort that the acquisition is guaranteed by a highly rated sovereign, the Emirates' issuance represents a key turning point in asset finance, with a structure readily adaptable to the needs of different investors, as well as different asset classes.

SETTING THE BAR

It comes as no surprise that the UK is keen to promote its credentials as a leader in Islamic finance. The UK Government is vocal about its vision to use Islamic finance to facilitate inward investment and strengthen the UK economy and in June 2014 became the first non-Muslim sovereign to issue a sukuk to the international capital markets. The HM Treasury sukuk was part of a concerted and ongoing strategy by the UK Government to establish the UK as the western hub for Islamic finance, a vision which has ensured that the relevant regulatory framework and tax legislation are now in place to bring sukuk on a level playing field with conventional capital markets issuances. The ECGD backing of the Emirates' issuance demonstrates the UK's continued commitment to this strategy.

The structure of the Emirates' issuance deviates from the gilt-like structure of the HM Treasury sukuk and rather relies on the more typical features of an *ijara* sukuk. In particular, contrary to the HM Treasury sukuk, the Emirates' issuance includes the appointment of a delegate to represent investors in certain decision making processes. Combining elements of a typical *ijara* sukuk, traditional ECGD guarantee arrangements with asset level security, the Emirates' issuance is readily adaptable for different types of asset financing. It also provides a structure that is attractive to those corporate issuers who are keen to attract capital markets investors for the financing of their asset acquisitions rather than rely solely on traditional syndicated bank lending. Similarly the structure has much to offer the investor: a shari'a compliant security with the backing of a guarantee from a highly rated sovereign.

EMIRATES' CERTIFICATES: THE STRUCTURE

The key features of the Emirates' issuance are set out below:

- The proceeds of the Emirates' certificates issued by Khadrawy Limited as trustee and issuer (Trustee) are utilised by the Trustee to purchase rights to travel on certain airline passenger routes operated by Emirates together with the rights in related services provided by Emirates to passengers

Biog box

Katherine Hensby is a senior associate and Stuart Mason is an associate, in the London office of Clifford Chance LLP. Katherine and Stuart are both members of the firm's Corporate Finance Trusts and Debt Capital Markets Practices and each has extensive experience on a variety of Islamic finance and capital markets transactions. Email: katherine.hensby@cliffordchance.com and stuart.mason@cliffordchance.com / www.cliffordchance.com.

travelling on such routes.

- Upon purchase of the said rights to travel, the Trustee contributes the rights to travel and the balance of the issuance proceeds of the Emirates' certificates to a trust used to procure the purchase of the Aircraft from Airbus. Once delivered the Aircraft are leased to Emirates as sub-lessee. Rental amounts payable by Emirates as sub-lessee flow back through the structure to satisfy payment of periodic distribution amounts to investors holding Emirates' certificates.
- As surety for non-payment by Emirates of amounts due under the structure, the ECGD under an ECGD guarantee irrevocably and unconditionally guarantees payments due in respect of the Aircraft leases. Documented under market standard ECGD documentation, the amount guaranteed by the ECGD under the terms of the ECGD guarantee is equal to the amounts due under the Emirates' certificates and is intended to fund payments due thereunder.
- Security (which includes, among other things, a charge over the accounts) is granted by the lessor and lessee of the Aircraft in respect of Emirates' payment obligations under the various transaction documents and this security is held on trust by a security trustee in favour of the ECGD.
- The Emirates' issuance is in part distinguished from a typical *ijara* sukuk issuance and from other types of asset financing. Rather than an entitlement to redeem the Emirates' certificates upon the occurrence of a default prior to their scheduled dissolution date, the sole right of recourse of holders is to make a claim on the ECGD guarantee with no recourse to the Aircraft. At any time after a claim has been made on the ECGD guarantee, payments on the Emirates' certificates shall be made by the ECGD under the terms of the ECGD guarantee and on a date corresponding with the due date for payment under the Emirates' certificates.
- In the event of a non-payment by the ECGD under the ECGD guarantee, the holders of the Emirates' certificates shall not be entitled to accelerate the Emirates' certificates, but shall only be entitled to direct the delegate to claim any guaranteed amounts which remain unpaid under the ECGD guarantee.

THE NEW GOLD STANDARD FOR SHARI'A COMPLIANT ASSET FINANCE?

The relevance for the UK of the Emirates' issuance is clear. In supporting the Emirates' issuance, the ECGD has ensured that Emirates continue to look to the European produced Airbus A380-800 model rather than to Airbus' competitors for their new aircraft. The Emirates' issuance has also established a structure that is ready for adaptation by export credit agencies as a means of attracting shari'a compliant investment for locally manufactured assets of various asset classes or even local projects.

The component parts of the structure of the Emirates' issuance are not novel: a standard form ECGD guarantee with asset level security coupled with an *ijara* sukuk. The structure employs these tried and tested mechanics to open a new door to a vibrant existing market – the potential of which for the UK and its western counterparts has yet to be fully realised. The ECGD was able to offer a guarantee over the financing of the Aircraft, in part because the infrastructure to allow a shari'a compliant sukuk issuance to finance the Aircraft was already in place, a result of the HM Treasury sukuk. What remains to be seen is if the Emirates' issuance will form a precedent to be used by other export credit agencies across Europe and potentially further afield. In particular it will be interesting to see whether Euler Hermes in Germany and Coface in France will be keen to replicate the structure of the Emirates' issuance considering that they have often provided similar guarantees to support Airbus produced aircraft in Europe. In order to issue such a sukuk, it may be the case that Germany and France will need to enact similar legislation to that of the UK Government.

CONCLUSION

The importance of the Emirates' issuance cannot be overstated. With obvious benefits for export credit agencies, corporate issuers and investors, the Emirates' issuance demonstrates a key moment in the development of shari'a compliant asset finance transactions. The UK Government benefits under this issuance from promoting locally produced Airbus aircraft. Similarly, with access to a wider pool of investors and the competitive pricing of the Emirates' issuance offering, Emirates have been able to obtain lower cost financing than that offered by traditional syndicated lending, clearly an attractive option when financing asset purchases. The nature of the UK Government guarantee in respect of the shari'a compliant Emirates' certificates makes the prospect of investment highly attractive to both Islamic and conventional investors, with the investors' exposure only to the underlying highly rated sovereign rather than the corporate issuer itself. It is likely that we will see the components of the Emirates' issuance model being widely used by the ECGD and other export credit agencies, and with appropriate legislative reform it is increasingly clear that other non-Islamic jurisdictions could join the UK in realising the potential of government backed shari'a products. ■

Further Reading:

- The emergence of the Turkish sukuk market [2014] 9 JIBFL 978.
- The impact of the UK sovereign sukuk: only the beginning? [2014] 9 JIBFL 599.
- LexisNexis Loan Ranger blog: Sukuk reaches Western markets.