

UAE Islamic finance: Steady growth through adversity

The COVID-19 pandemic and the drop in oil prices early on in the year meant that economic activity in the UAE slowed considerably in 2020, impacting the Islamic finance industry's growth, asset quality and profitability.

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Notwithstanding the effects of the pandemic, the UAE remains a promising avenue for the growth of Islamic banking and finance and the sector maintained steady growth throughout 2020, with total assets of Islamic banks increasing by circa 7.2% over the previous year according to the Central Bank of the UAE's data, compared with a circa 6.5% growth for conventional banks.

According to the Islamic Finance Development Indicator, the UAE ranked as the fourth most developed country globally in Islamic finance in 2020, with seven fully-fledged Islamic banks and certain conventional banks operating Islamic windows. According to the IFSB, over 20% of banking products in the UAE are now comprised of Islamic finance products.

Though Islamic banking and finance asset growth in the UAE throughout 2020 was reasonable, most banks reported lower profit (albeit Emirates Islamic was the only UAE Shariah compliant bank to post a loss) and higher non-performing loans (particularly problematic for Islamic banks compared to conventional banks due to the prohibition of imposing a penalty interest on defaulted payments under Shariah principles) than in previous years.

Consequently, 2020 saw some UAE banks having to close branches, and the consolidation of Islamic lenders to establish more competitive financial institutions, notably the acquisition of Noor Bank by Dubai Islamic Bank to form the largest Islamic bank in the UAE,

with total assets of more than AED275 billion (US\$74.86 billion).

Despite a slowdown in the Sukuk market globally, 2020 saw a good level of activity in both primary and secondary Sukuk markets in the UAE, not least due to the rolling-out of green and environmental, social and governance-compliant Sukuk, the focus on which could be said to be indirectly linked to COVID-19, with governments and multilateral organizations such as the IsDB going to market with landmark offerings designed to combat the fallout from the pandemic.

In that respect, it is worth mentioning the launch by Emirati real estate and retail giant Majid Al Futtaim of the Middle East's first corporate green Sukuk (US\$600 million) on the NASDAQ stock exchange in Dubai, the proceeds of which will be used to finance and refinance existing and future green projects.

According to S&P Global Ratings, the global Islamic finance industry is expected to show low-to-mid single-digit growth in 2020/21, compared with the 11.4% growth in 2019/20. Despite the slowed growth, we are of the view that the pandemic has offered an opportunity for the Islamic finance industry to move toward a more integrated growth, focusing on a higher degree of standardization and with greater emphasis on the industry's social role.

In the UAE, we saw several issuers issue Sukuk in a sustainable format in 2020 and we expect future Islamic financing to be structured similarly in the near future. We also expect that the consolidation trend will be more popular among Islamic financial institutions and banks in the UAE going forward, especially taking into consideration the current financial situation of the market. Not only that, but the events of 2020 appear to have compelled Islamic banks in the UAE to expedite their digital strategies and adopt technology quicker than may have otherwise been possible, which we



expect to further materialize in the years to come.

Although the growth of Islamic finance was hindered during 2020, COVID-19 vaccines, the stabilization of oil prices and a recovery of growth are expected to aid recovery in 2021 and thereafter, suggesting that the Islamic economy in the UAE is well set to continue growing, not only in terms of volume but also in terms of sophistication of products, adoption of technology and its increasing alignment with sustainable finance principles.

The current aim is for Islamic finance products in the UAE to reach 25% of the total banking assets in the UAE. It is clear that the government's focus on making the UAE the hub of Islamic finance and the accelerated pace of regulatory reforms in the UAE are projecting it toward that target, and we predict that growth in Islamic finance will exceed that of the conventional sectors in the coming few years.

We have seen improvements in the financial markets and the economy in the last quarter of 2020 and we envisage an increase in Islamic financings in 2021, not least by virtue of corporates looking to restructure and/or refinance, particularly in certain sectors such as hospitality and real estate. We see significant liquidity in Islamic banks, and the Islamic arms of local and regional banks in the UAE are strongly positioned for 2021. ☺