

ISLAMIC INTERBANK MARKET & SUKUK

السوق
البنكية
الإسلامية
الدولية



International
Islamic
Financial
Market

Sukuk issuance – Corporate & FI's, & Their Role in the Islamic Inter-bank Market

By

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 **ISLAMIC FINANCIAL
MARKETS CONFERENCE**
AND SPECIALIZED WORKSHOPS
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Agenda

- Interbank Market & Liquidity
 - Interbank markets
 - Conventional LM
 - Principles of sound LM
 - Challenges of LM in Islamic Banks
- Sukuk
 - An overview
 - Problems & Challenges
 - Towards Islamic Interbank MM market
- Way Forward, S/T MM Sukuk, REMMS
 - Features
 - Structure
 - Benefits
 - Risks

Interbank Markets & Liquidity

Interbank Market



- A term used to describe professional markets between banks
- *Most commonly used to refer to*
 - the wholesale market in forex, *but also used for*
 - funds traded overnight to satisfy reserve requirements at the central bank

Source: Reuters Financial Glossary



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Interbank Market: a Tool for Liquidity

Liquidity → free spending power

- Money, fully liquid, other assets vary (in degrees)
- Liquidity: ease of converting an assets to cash with little or no loss of value;
- Liquid assets:
 - cash
 - deposits in other banks
 - short term liquid securities
- Liquidity & profitability two divergent objectives

- More than listing
- Is there a buyer when you are a seller?
- More than negotiable
- At what price?



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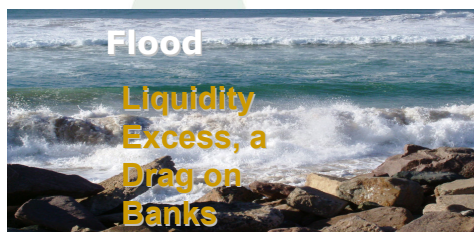
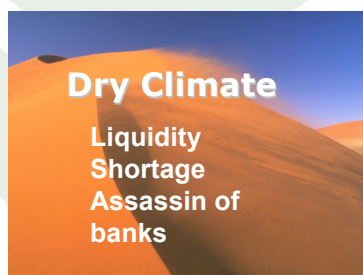
Interbank Markets



Interbank Markets: (private & public) arrangement to absorb transitory liquidity shocks

- An insurance for the banks
- Market efficiency: how interbank market investments (of different maturities) respond to expected liquidity shocks

Liquidity Management; Ability to Withstand Storms



Credit for this Graphics: Dr. Syed Salman Ali, IIFM

Conventional Liquidity Management

- ❑ Negotiable CDs
- ❑ Commercial Papers
- ❑ Bankers Acceptance
- ❑ Treasury Bills
- ❑ Treasury Bonds/Guilds
- ❑ Govt. & Corporate Bonds
- ❑ Financial Derivatives
 - Options
 - Swaps
 - Future
- ❑ Repos
- ❑ Interbank Markets
- ❑ Lender of Last Resort



Liquidity Risk

❑ Investment Firm's Definition:

"liquidity risk includes both

- the risk of being unable to fund [its] portfolio of assets at appropriate maturities and rates, and
- the risk of being unable to liquidate a position in a timely manner at reasonable prices."

J.P. Morgan Chase (2000).

❑ Regulators' Definition:

- "risk to a bank's earnings and capital arising from its inability to timely meet obligations when they come due without incurring unacceptable losses."

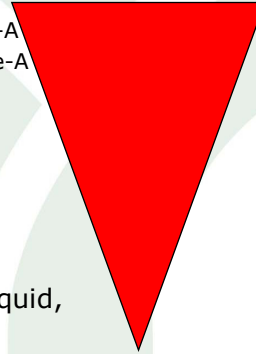
Office of the Comptroller (2000)

- ❑ Many different risks culminate in liquidity risk

LM 101



- Risk Pyramid (Conventional)
 - Blended portfolio from Triple-A down to Single-B
 - Can interpolate risk between Triple A and Single-A
 - Cannot extrapolate risk from lesser risks to triple-A
- Access to determinate amount of cash
- When you need it
- Preservation of capital on demand
- Free from price risk
- Undoubted quality low credit risk
- Fiduciary or trust money should be both liquid, safe & price risk free
- Sound risk management principles apply
- Need a quality Triple-A overnight instrument with stable capital values

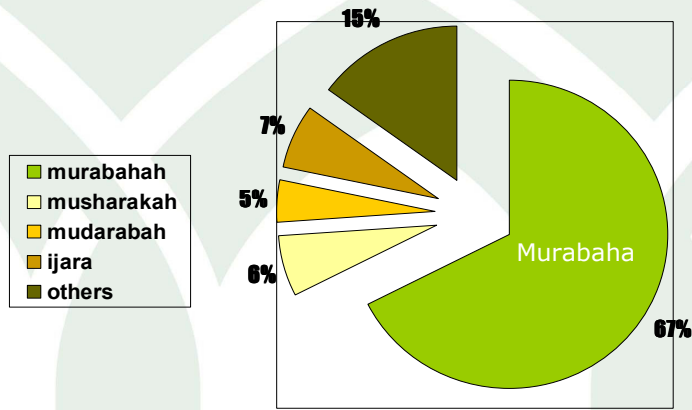


Level Playing Field?



- Excess Liquidity in Islamic banks
 - Serious business risk
 - Islamic financial institutions are almost 50% more liquid as compared to conventional financial institutions. a recent study
 - Out of US\$ 13.6 billion total assets of Islamic banks in the study US\$ 6.3 billion were found to be in liquid assets
- Underutilization of financial resources
- Lower income and higher cost
- Loss of competitiveness

Islamic Banks' Assets Portfolio

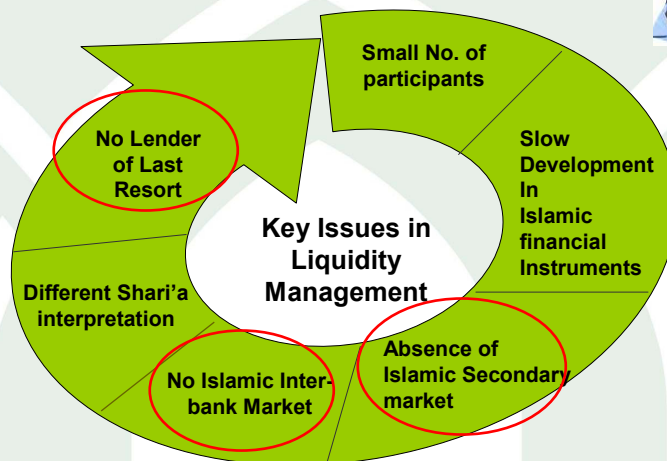


Source: Iqbal Munawar, Ausaf Ahmad & Tariqullah Khan (1998), *Challenges Facing Islamic Banking*, Jeddah:IRTI

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Key Issues in Liquidity Management



Credit for this diagram: IIFM

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LM in IFIs



- ❑ Commodity Murabaha
- ❑ Commodity Murabaha
- ❑ Commodity Murabaha
- ❑ Commodity Murabaha
- ❑ Deposit Management
- ❑ Sukuk
- ❑ Infrastructure Institutions
 - Liquidity Management Center
 - IIFM

Challenges of L.M In IFIs

- ❑ Investments long dated – deposits are short
 - massive gap, asset/liability mismatch
 - Massive liquidity problem
- ❑ Can not borrow when there are withdrawals
- ❑ Excess liquidity
- ❑ Overwhelming use of Muarabaha
- ❑ Sukuks oversubscribed, no secondary market
- ❑ Shortage of instruments
- ❑ Lack of liquidity ironically increases demand for liquidity
- ❑ liquidity vehicles cannot withstand a \$100m injection or withdrawal
- ❑ Malaysia, is an exception where Islamic interbank market do exits (believe it not)



Overview of issues



Liquidity surplus

- **Liquid:** Islamic Financial Institutions ("IFIs") are almost 50% more liquid than their conventional counterparts
- **Low returns:** Limited short term investments, and so IFIs earn low returns

Liquidity shortage

- **Interbank market:** IFIs have no real ability to tap short-term funds to meet cashflow requirements
- **Lender of last resort:** Most banking failures are due to liquidity shortages. There is a need for a "lender of last resort". Well known issue was Ihlas Finans in Turkey

Maturity mismatch

- **Long term assets:** IFIs main investments are long-term, e.g. sukuk and project finance
- **Short term liabilities:** IFIs main funding is from short-term customer deposits
- **Gap:** IFIs have a mismatch risk



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Courtesy: HSCB Amanah



SOURCES of LIQUIDITY RISK



- ❑ Incorrect judgment and complacency
- ❑ Unanticipated change in cost of capital
- ❑ Abnormal behavior of financial markets
- ❑ Range of assumptions used
- ❑ Risk activation by secondary sources
- ❑ Break down of payments system
- ❑ Macroeconomic imbalances
- ❑ Contractual forms
- ❑ Financial Infrastructure deficiency



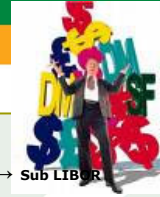
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Problems with Commodity

Murabaha

- ❑ **Higher costs:** →less competitive than conventional→ Sub LIBOR
- ❑ **Lack of standardization, all Murabahas are not equal**
- ❑ **No secondary market, no sales, capital blockade**
- ❑ **Bilateral transactions, thus higher counterparty risk**
- ❑ **Back to back (or reverse) *murabaha* needed for maintaining liquidity (Tawarruq not approved by all)**
- ❑ **Break clause? some scholars approve, however expensive**
- ❑ **Flow of funds away from Muslim economies**
- ❑ **Not contributing in any real growth or development**
- ❑ **Operational, credit, dispute, & legal risks (receivables realization)**
- ❑ **Limited supply of commodity. How much metal in the world?**
- ❑ **Interim solution: was supposed to be an interim solution until..**



Islamic MM Malaysian Experience

The Islamic Inter-bank Money Market (IIMM)

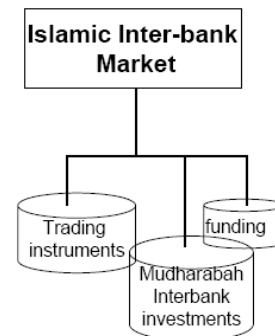
Introduced on 3 January 1994 based on Mudharabah
Facilitates funding for IFIs

Inter-bank Trading of money market instruments:

Based on debt trading principles; Instruments – Government Investment Issues (GIIs), Islamic Treasury Bills (ITBs), Islamic Acceptance Bills (IABs), Bank Negara Negotiable Notes (BNNNs);

Inter-bank Investment:

Placement and acceptance of funds based on Mudharabah, profit sharing contract and shorter tenure i.e. up to 12 months maturity.



Source: Bank Negara Malaysia

Type of Islamic MM Instruments in Malaysia

- ❑ **Mudarabah Interbank Investment (MII)**
- ❑ **Wadiah Acceptance**
- ❑ **Government Investment Issue (GII)**
- ❑ **Bank Negara Negotiable Notes (BNNN)**
- ❑ **Sell and Buy Back Agreement (SBBA)**
- ❑ **Cagamas Mudharabah Bonds (SMC)**
- ❑ **When Issue (WI)**
- ❑ **Islamic Accepted Bills (IAB)**
- ❑ **Islamic Negotiable Instruments (INI)**
- ❑ **Islamic Private Debt Securities**
- ❑ **Ar Rahn Agreement-I (RA-i)**
- ❑ **Sukuk BNM Ijarah (SBNMI)**

Sukuk

Million Dollar Qs

- Can they cure Liquidity Management problem for IFI ?**
- Can they help in developing Islamic Interbank Markets?**

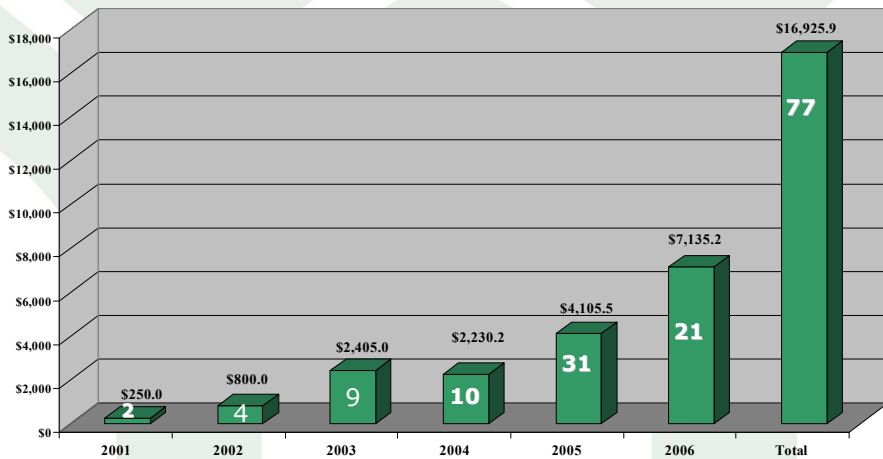
Sukuks Overview

- **Sukuk:** financial certificate, an Islamic equivalent of bond
 - Securitized assets
 - Assets-backed securities
 - Must have an underlying tangible assets transaction
 - **Ownership**
 - **master lease agreement**
- **Hard asset backed:**
 - **It must be backed by a real asset, (land, or equipment),**
 - **Sukuk mean dealing in a real asset, not simply trading paper**
- **Primary condition:** Assets on the balance sheet of the issuing entity
- **The Sukuk model:**
 - **Derived from the conventional securitization process**
 - **SPV to acquire assets & to issue financial claims on the assets**
- **Financial assets claims:** → a proportionate beneficial ownership

Types of Sukuk

- Ijara Sukuk
- Mudaraba Sukuk
- Musharaka Sukuk
- Murabaha Sukuk
- Istisna'a Sukuk
- Salam Sukuk
- Other types
 - Sukuk Al Wakala, Sukuk Al Muzra'a, Sukuk Al Musaqqa, Sukuk Al Muqarasa, Sukuk Ijara Mowsufa Bithimn, Sukuk Manfaa Ijara, Sukuk Manfaa Ijara Mowsufa Bithimn and Sukuk Milkiyat Al Khadamat
 - AAOIFI issued standards for 14 different Sukuk types

Growth of Sukuk in \$M*



Source: LMC Bahrain, Jan 06

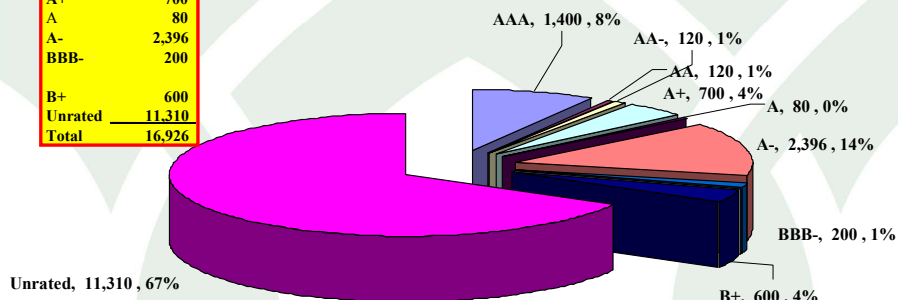
* Does not include many Malaysian Sukuks due to Shariah issues

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Global Sukuk by S&P Rating

| | |
|---------|--------|
| AAA | 1,400 |
| AA | 120 |
| AA- | 120 |
| A+ | 700 |
| A | 80 |
| A- | 2,396 |
| BBB- | 200 |
| B+ | 600 |
| Unrated | 11,310 |
| Total | 16,926 |

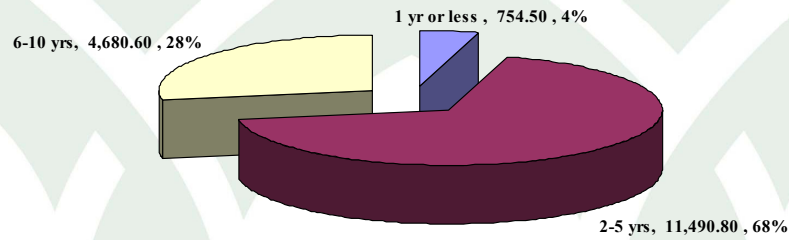


Source: LMC Bahrain, Jan 06

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Global Sukuk by Tenor



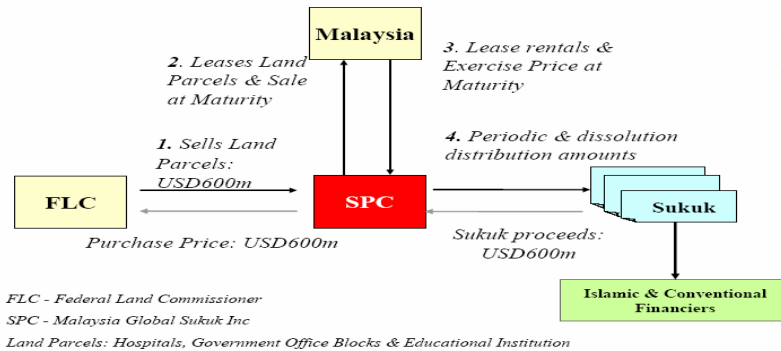
Only a fraction (about 4%) of Sukuk are for less than a year

10 Largest Sukuk (Jan. 07)

| Issuer | Issue Date | Country | Issue Size (US\$'M M equivalent) | Margin/ Tenor | Rating/ Listing |
|---|------------|--------------|----------------------------------|----------------------------|--|
| PCFC Sukuk (Corporate) | Jan-06 | UAE | 3,500 | 7.125-10.125%/ 2 Years | - |
| Dubai Global Sukuk FZCO (Govt) | Nov-04 | UAE | 1000 | 6m LIBOR + 0.45%/ 5 Years | Govt. rating applicable |
| SABIC Sukuk (corporate) | Jul-06 | Saudi Arabia | 800 | SIBOR + 0.40 % | - |
| Government of Qatar (Govt) | Sep-03 | Qatar | 700 | 6m LIBOR + 0.4% / 7 Years | S&P: A+ / Lubuan & Luxembourg |
| Pakistan International Sukuk Co. Ltd.(Govt) | Jan-05 | Pakistan | 600 | 6m LIBOR + 2.2% /5 Years | S&P: B+ Luxembourg |
| Malaysia Global Sukuk (Govt) | Jul-02 | Malaysia | 600 | 6m LIBOR + 0.95%/ 5 Years | S&P: A- / Bahrain & Lubuan |
| Emirates Airline Sukuk | Jun-05 | UAE | 550 | LIBOR + 0.75% / 7 Years | - |
| Wings FZCO (Corporate) | Jun-05 | UAE | 550 | 6m LIBOR + 0.75%/7 Years | Luxembourg S&P: AAA Fitch: AA / Luxembourg , Lubuan & Bahrain |
| Islamic Development Bank (Corporate) | Jun-05 | Inter'l | 500 | 6m LIBOR + 0.12% / 5 Years | S&P: AAA Fitch: AA / Lubuan & Luxembourg |
| IDB Trust Services (ISDB) (Corporate) | Aug-03 | Inter'l | 500 | 6m LIBOR +0.12% /5 Years | S&P: AAA Fitch: AA / Lubuan & Luxembourg |
| Sub Total (55% of Total) | | | 9,300 | | |

An Example: Malaysian Global Sukuk

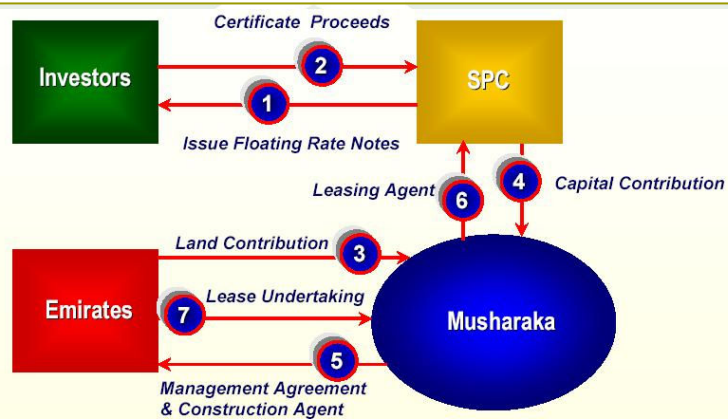
Transaction Structure



Credit for this slide: BMA presentation, Feb., 2004.

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Wings FZCO Sukuk

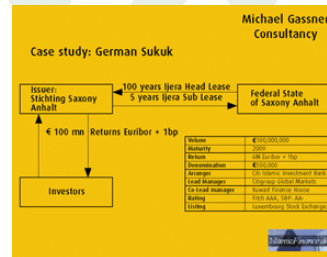


SPC – Wings FZCO (80% owned by Emirates and 20% owned Dubai Islamic Bank acting as Trustee for Investors)
 Investors – Certificate holders

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German State Sukuk, a Pleasant Surprise

- ❑ \$ 100m 5 year Sukuk issued by state of Saxony-Anhalt
- ❑ Saxony-Anhalt a new state of Germany after reunification
- ❑ State debts are guaranteed by federation of Germany
- ❑ Rating of AAA by Fitch and AA- by Standard & Poor's
- ❑ Citigroup, Lead Manager & KFH Co-Lead Manager
- ❑ Approval form Citi Islamic Bank Shari'ah Board
- ❑ Underlying: buildings owned by Ministry of Finance
- ❑ Sale & leaseback structure
- ❑ SPV registered in Netherlands
- ❑ A variable rent (EURIBOR+1%)
- ❑ Listed at Luxembourg Exchange
- ❑ Reason to choose Sukuk:
 - Broaden the investor basis
 - Access to different funding sources
 - Promote the location



Sukuk in US

- ❑ \$165.67 million Sukuk by Houston, Texas based East Cameron Partners (ECP)
- ❑ First ever Shariah compliant gas backed securitization
- ❑ ECP gas reserves are in shallow waters (off the coast of Louisiana)
- ❑ BSEC is the arranger & Merrill Lynch the Book runner
- ❑ A two-tier structure
 - A purchaser SPV (in Delaware) to acquire the assets
 - An Issuer SPV (in Cayman Islands) to issue the Sukuk & use the proceeds to invest in the Purchaser SPV by way of a Shariah-compliant Funding Agreement,"
- ❑ This deal, claimed BSEC, also has two other "firsts"
 - First ever Islamic securitization rated by S&P,
 - First securitization embedding Shariah-compliant hedges

Malaysian Khazanah Sukuk

- \$750 million issued in Oct '06 by Khazanah, a Finance Ministry sub
- Arranged by CIMB, HSBC & UBS
- Khazanah owns a 40 percent stake in Telekom, Malaysia, national telecom utility, 7 percent set aside for this transaction
- Sukuk represent interests in a trust constituted by the issuer & are exchangeable into shares of Telekom Malaysia
- World's first exchangeable & effectively equity-linked Sukuk
- Sukuk pays an coupon of 1.25%, YTM of 5.07% pa (equivalent to US 5-year mid swap over 3 basis points). It comes from dividend income of Telekom shares
- An exchange premium of 19% over 1-day volume weighted average price of Telekom shares on Sept. 27, 2006
- Listed on the Labuan & Hong Kong Exchange
- A call option exercisable by Issuer at the end of year 3.
- Order book was oversubscribed 6 times
- **Shariah acceptance outside Malaysia?**



DJ & CITI Sukuk Index

- First global Sukuk index
- Criteria
 - issue size of \$250 million,
 - minimum maturity of one year
 - minimum rating of BBB-/Baa3 by leading rating agencies
- Index at the onset was tracking only seven Sukuk



Malaysian Sukuk Controversy



- ❑ LMC & DJ-City Index excludes most Malaysian corporate Sukuks
- ❑ This is primarily due to Islamic private debt securities (IPDS), based on sale of receivables
- ❑ Issues backed by sale of so-called debt, are frowned upon by scholars in Gulf & Pakistan, but Malaysian scholars have okayed them
- ❑ The Malaysian IPDS market is by far the largest Islamic corporate issuances market
- ❑ At the beginning of 2005 outstanding IPDS issues in the market totaled just under RM 90 billion.
 - Currently, IPDS issues account for 45 % of the Malaysian corporate bond market



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Sukuk Revisited



- ❑ Hot issue, some innovation & variety. Now time for better quality
- ❑ Need more financial engineering. No imitation of conventional
- ❑ No default, truly hard asset backed, it can get sick but will never die
- ❑ Sukuk Market is growing fast
 - Most issues are over-subscribed, setting new records
 - Oil revenues \$300B+ in GCC in 2006, demand is mounting
 - Successful issues, listing & rating in international markets (US, UK, Germany etc), KSA & Pakistan now in the game
 - Dubai Ports, customs & FZ convertible Musharaka Sukuk of \$3.5B (\$11B subscribed)
- ❑ Still Limited supply
 - Conservative estimate of IF market \$300-500 B
 - Sukuk issued so far, about \$17B
 - Galaxy of Islamic Investments still lack variety
- ❑ No Secondary market or active trading, "buy & hold",
- ❑ Primary market has to expand
- ❑ Benchmark LIBOR, thus doubts and criticism



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Sukuk Revisited



- Instrumental for increasing width & breadth of IFI offerings
- Higher development costs, but it could be rewarding in L.T.
- Trading floor need to be opened
- More corporate issues are needed
- Sukuk Index & first Sukuk Fund are positive signs
- Sukuks are being considered by global financial heavyweights so..
- Over a Billion \$ issued by Bahrain, more ST, Salam Sukuks
- As Bonds are off limit, Islamic investors need portfolio stabilizers
- Do not address liquidity problem yet, still mostly mid term
 - Shortage of credit lines to IFI has led to an increase in cash holdings but lack of instruments creates a liquidity trap
 - There needs to be a truly global-sized liquid inter-bank market where institutions can park their liquidity reserves

Sukuk Revisited



- Innovative ideas:
 - Performance/GDP linked sovereign Sukuk
 - Corporate Sukuk linked to KPI i.e. sales, GM
 - Musharaka/Mudaraba pools for SME (need for micro-credit)
 - Innovative credit enhancement/risk reduction features i.e. equalization reserve, smoothing
 - Handsome rewards for risk sharing. No default. Variable return risk
 - Islamic Commercial Papers
 - Islamic bankers acceptance

A Breakthrough Idea!

Short Term Money Market Sukuks

REMMS®



REMMS®

Real Estate Backed Money Market Sukuk



- Sharia'h compliant securities based on RE & its cash flows
- Objectives:
 - Liquid, safe, & price risk free
 - stable & steady income
- Target Initial Issue: US \$4 Billion
- Rating Target: AAA or higher
- Projected Returns: Short term money market rates
- Maturity: 30 days to 180 days
- Market making by global institutions
- Backed by quality real estate portfolio in US & Europe
- Long term credit leases to top rated corporations
- Conservative Shariah structure to maximize acceptance

REMMS® : Underlying Properties

- Grade "A", high quality/prime trophy properties
- Well diversified core portfolio of 15-20 properties
- Commercial real estate
 - Office Buildings
 - Retail Shopping Centers
 - Special purpose institutional property
 - Industrial
- All across US & Western Europe
- No tenant in unaccepted lines of business
- Long term triple net leases (net of taxes, maintenance & Insurance)
- Tenants; highly rated corporations
- Stable and predictable cash flows from rentals
- Professional management
- Owned by institutional investors
- No mortgages recorded
- Predicable risk & return profile



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REMMS® : Two Types of Investors

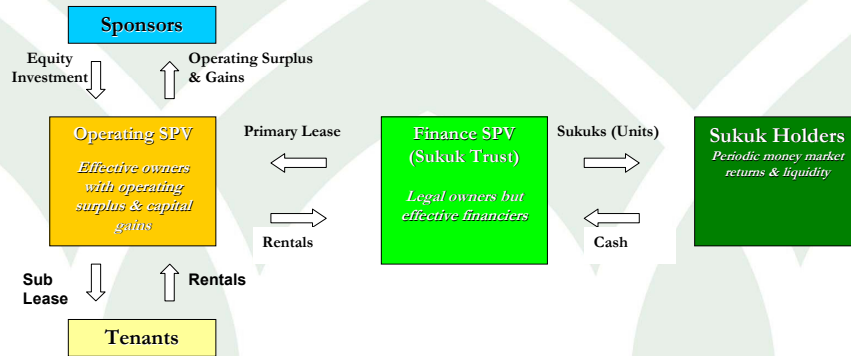
- **Real Owners (Sponsors)**
 - Effective owners with risks & rewards of real estate ownership
 - Participate in 20% upfront equity investment
 - Investment horizon: 10-15 years
 - Modest predictable operating income, potential capital gains
 - Projected IRR: 12%-25% p.a.
 - Limited partners in a fund
- **Sukuk holders** (Effective Financiers)
 - Legal title holders of Real Estate (but effectively financiers)
 - Participate in 80% financing of acquisition through Sukuk
 - Monthly cash distribution from rental income (3%-6% p.a.)
 - Ownership certificates (Sukuks) are easily transferable
 - Price guarantee based on property purchase agreement
 - All cash flows are known in advance to avoid Gharar
 - There are some though minimal risks



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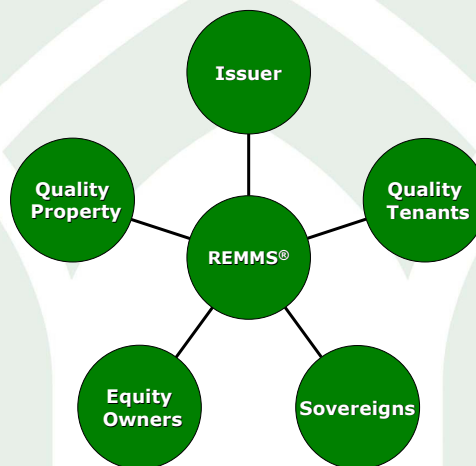


REMMS®: Simplified Structure



REMMS®: Multiple Cushions

Risk Reduction for Sukuk Holders



REMMS®; Overview

- ❑ A simple concept; has been in discussion for some time
- ❑ Due Credit to Mr. Abdulhak El Kafsi, & Ahmed Adil (E&Y)
- ❑ Effective financing through Sukuk issues rather than typical borrowing from the banks
- ❑ Optimal equity investment (20%) by sponsors to maximize returns
- ❑ Effective benefits of real estate portfolio ownership i.e. rental income & capital gains stay with the sponsors
- ❑ Sukuk holders receive periodic money-market returns
- ❑ Specific legal entities or SPVs are created & used for various roles in the transaction
- ❑ Sponsors & Sukukholders have a irrevocable Bai Al Arboon agreement to sell/buy properties at an agreed price (most probably at the purchase price)



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REMMS®; Benefits

- ❑ High yield
 - MM (LIBOR+) rates, compared to Sub Libor Murabaha rates
- ❑ Stable & predictable income
- ❑ Shorter tenor
- ❑ Long term financing at lower MM rates (vs. Mortgage rates)
- ❑ Highly liquid, overnight potential
- ❑ Price risk insulation
- ❑ Real Estate assets can absorb massive amounts
- ❑ Traditional love affairs of M.E investors to RE
- ❑ Interbank secondary market tradability
- ❑ Highly rated, standardized instrument
- ❑ Real estate backing & cash flows to reduce risks
- ❑ RE & its CFs to satisfy scholars strict requirements
- ❑ Stability & strengths of RE to offset S.T spikes
- ❑ Leverage to Islamic R.E investors



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REMMS®; Risks & Issues

- Refinancing risks
- Real Estate risks
 - Property prices risk
 - Vacancy risks
- Money market rates risks
- Credit risks
- Residual value and valuation risks
- Operational risks
- Asset safeguarding risks
- Counterparty risks (operating SPV & tenants risks)
- Sukuk placement & redemptions risks
- Profit margin risks (spread/operating SPV & Sukuk holders)
- Foreign exchange risks
- Performance risks
- Regulatory, legal and taxation risks
- Shariah Issues
 - Bai Al Arboon Agreement

REMMS®; Big Problem Asset – Liability Mismatch

- Fundamental error, long term asset, real estate being financed from short term Sukuk
- Solution: standby standard Islamic financing arrangement by a major bank or Sukuk purchase commitments
 - Borrowing from banks up to 80% value has never been a problem
 - Sukuk purchase commitments/underwriting
- Primary reason for issuance of Sukuk is to fill the gap
- Due to shortage of Islamic MM instruments, refinancing every 1-6 month cycle will not be a problem

REMMS®: Phase A, Acquisition

- ❑ RE Advisor identifies & proposes a property for acquisition
- ❑ Sponsors commit to purchase, Advisor finalizes due diligence
- ❑ Modalities of leasing structure established
- ❑ Closing formalities are completed in the name of newly established SPV.
- ❑ Finance SPV issues Sukuks against the property.
- ❑ Finance SPV pays sponsors the funds raised from Sukuk issues.
- ❑ Finance SPV mandates Advisor to manage the assets on behalf of Sukuk holders.

REMMS®: Phase B, Regular Operations

- ❑ Finance SPV will lease the properties to Operating SPV at money market rate
- ❑ Operating SPV will sub-lease property to a quality top rated tenants
- ❑ Sub lease payments to cover primary lease payment + spread
- ❑ Difference in sub-lease income and primary lease costs (spread) will accrue as an Operating Surplus in operating SPV
- ❑ Finance SPV regularly collects rents and distributes to Sukuk holders

REMMS®: Phase C, Disposal

- ❑ Operating surplus accrues to sponsors
- ❑ Capital gain opportunities realized
 - Payback finance SPV
 - Finance SPV redeems Sukuks
 - Operating SPV payout to sponsors
- ❑ Sponsors uses Arboon (call option) to buy property from Sukuk holders (to realize capital gains)
- ❑ Sukuk holders have Arboon (put option) to sell property at cost (to preserve principal in a down market)
- ❑ Bai Al Arboon Agreement (Put and call options) are tried and tested for being Sharia'h compliant

Summary

- ❑ Interbank market is a must for liquidity
- ❑ Need of a safe & price risk free instrument
- ❑ Vast use of Murabaha & its limitations
- ❑ Sukuk came long way
- ❑ Still supply is limited
- ❑ No secondary market for Sukuk
- ❑ A breakthrough idea, REMMS
- ❑ MM Sukuk backed by quality real estate
- ❑ Highly liquid & tradable instrument
- ❑ Asset liability mismatch & possible solutions

Thank You

Your comments are welcome

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Types of Sukuk

- **Ijara Sukuk**
 - Leasing structure with purchase option
 - stand-alone assets (identified on the balance sheet)
 - Rental rates can be fixed or floating
 - Cash flow from leases passed through (coupon & principle payments)
 - Efficient medium-to-long term mode of financing
 - Cross-border applications for an increasing range of asset classes
 - Usually an SPV, an entity/intermediary between issuer & Sukukholders
 - Due to SVP, low risks to bank, nor subject to bank regulation
- **Mudharabah Sukuk**
 - An agreement made between capital provider & an entrepreneur to enable the entrepreneur to carry out business projects,
 - Predetermined profit sharing ratios (participation or trust financing).
 - In case of losses, born by funds provider only
- **Musharaka Sukuk**
 - Similar to the Mudaraba
 - both parties provide financing to the projects
 - in case of losses, both parties will lose proportionate to capital

Types of Sukuk

□ Murabaha Sukuk

- Based on the traditional notion of purchase finance
- Relatively straightforward structure
- Declared mark-up integrated in selling price with a deferred payment.
- IFI purchases equipment/goods then sells to customer at cost + profit
- IFI securitizes the transactions with a proportion of the fixed mark-up

□ Istisna'a Sukuk

- Used for the advance funding of a major projects or large items of equipment i.e. turbines, power plants, ships or aircraft
- construction/manufacturing financing
- IFI funds the manufacturer/ contractor during the construction, acquires title & on completion either immediately passes title to developer on agreed deferred payment or, leases
- if the Sukuk are listed during the Istisna'a period, the Sukuk should be traded only at par as the underlying assets does not exists yet. (Debt can't be traded according to Islamic law)

□ AAOIFI issued standards for 14 different Sukuk types

- **Other types:** Sukuk Al Wakala, Sukuk Al Muzra'a, Sukuk Al Musaqa, Sukuk Al Muqarasa, Sukuk Ijara Mowsufa Bithimn, Sukuk Manfaa Ijara, Sukuk Manfaa Ijara Mowsufa Bithimn and Sukuk Milkiyat Al Madamat.



Types of Sukuk

Salam Sukuk

- a sale, seller undertakes to supply a commodity to buyer at a future date in return for an advanced price paid in full on the spot
- Price is in cash but the supply of the good is deferred
- As a form of financing, the purchaser is able to acquire assets by advance payment at a discounted price & subsequently sells upon delivery
- Salam Sukuk, a type of a forward contract forbidden under Shariah law unless there are strict conditions to eliminate uncertainty
- It differs from Istisna'a Sukuk in that, the purchase price for assets must paid in full & delivery date must be fixed

