



# Thomson Reuters Zawya Sukuk Perceptions and Forecast Study 2014

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# Contents

Foreword.....	6
Executive summary.....	8
<b>KEY MILESTONES IN THE GROWTH &amp; DEVELOPMENT OF THE SUKUK MARKET.....</b>	<b>11</b>
Sukuk market overview.....	13
By Market of Issuance: Domestic vs. International.....	14
By Region & Country.....	16
By Sector.....	18
By Rating.....	20
By Listing Stock Exchange.....	22
<b>OPPORTUNITIES.....</b>	<b>26</b>
Untapped Potential.....	28
Tunisia: an exit from crisis with cautious optimism.....	29
Morocco paving the way for sukuk.....	36
Heading east in search of capital: Sukuk issues outside the OIC.....	39
Mid ground markets are competing with sukuk land to benefit from wider investor base.....	45
Turkey Sukuk Development Overview.....	47
Analysis: Turkish Sukuk Law.....	51
Towards a bigger Turkey sukuk pot: Potential Issuers.....	53
Pakistan Sukuk Overview: Innovation driven by sharia requirements.....	55

New Horizon Investors face reinvestment risks replacing high fixed coupon sukuk.....	64
While Investors still seek secured debt, there is a growing appetite for riskier papers with attractive yields in the face of reinvestment risk .....	66
Sukuk maturity profiles: Where will longer-term tenors come from?.....	68
Perpetual sukuk leading Islamic markets to greater risk sharing .....	71
Investors are seeking investment-based instruments .....	73
2013's innovative sukuk structures .....	75
GCC issuers are diversifying their funding through cross border sukuk issuance.....	83
International sukuk: a need for more disclosure and better transparency.....	86
<b>CHALLENGES .....</b>	<b>90</b>
Insights of international sukuk and bonds in the GCC and Malaysia in 2013 .....	92
Danger lurking for bond and sukuk portfolio managers .....	93
Sukuk vs. bonds .....	94
Sukuk pricing.....	95
Fixed Income vs. Equity .....	96
Cost of sukuk .....	97
Sukuk vs bonds .....	98
Liquidity & Tradability Risk .....	100
Regional distribution in the primary market drives sukuk movements.....	101
While the type of investor distribution drives the frequency of sukuk movement .....	102
More than 70 % of investors would like to liquidate their investment and book profits in less than 5 years.....	103
Despite investors preferring to hold sukuk for 1 to 3 years, most of them categorize sukuk as HTM on their balance sheets .....	104
Sukuk Liquidity and Tradability Risks .....	105

Asian countries go straight down the middle between asset-based sukuk and asset-backed sukuk.....	111
Sharia Criticisms against Sukuk.....	112
<b>SUKUK DEMAND AND SUPPLY EQUILIBRIUM.....</b>	<b>117</b>
Sukuk Demand .....	119
On average, global investors expect to allocate at least 40% to Islamic financial products.....	120
Around \$150 million of Islamic financial Institutions' investment portfolio is allocated to sukuk.....	121
However, investors still expect scarcity of sukuk papers in the next couple of years .....	122
And lead arrangers match investors in the sukuk supply forecast .....	123
Lead arrangers and issuers say the main reason for issuing sukuk is to diversify their sources of funding .....	124
Sukuk & Demand gap is expected to drop significantly by 2018 to \$187.4 billion from \$230 billion in 2014.....	126
Survey Methodology .....	127
Ex-post analysis .....	129
Sector Distribution.....	130
Geographical Distribution .....	131
<b>APPENDICES .....</b>	<b>132</b>
Glossary .....	133
Thomson Reuters Zawya Sukuk Survey 2014 .....	134
Top Sukuk pipeline 2013-2014 .....	151
International Sukuk Issued in 2013.....	152
International Lead Arranger League Table (YTD Q3, 2013) .....	153
International Sukuk Industry League Table (YTD) .....	154
Acknowledgements .....	155
Notes.....	156

# Foreword



DR SAYD FAROOK  
Global Head of Islamic Capital Markets  
Thomson Reuters

Thomson Reuters welcomes you to the second Sukuk Perceptions & Forecast Study for 2014.

This Study provides a much-needed overview and forward looking analysis of the global sukuk market, taking stock of the key challenges and issues affecting the industry. The Study is complemented by the findings of our Sukuk Forecast & Perceptions Survey, a comprehensive survey that delivers insights and preferences from a wide range of investors and issuers. The survey results provide insights on the preferences of investors and expectations of key players.

The global sukuk market, today worth over \$237 billion, continues to drive the growth and development of the Islamic finance industry. The appetite for sukuk remains strong, with \$80 billion worth of sukuk issued this year at the time of publication. Notably, cross border sukuk issuances are gaining momentum as both investors and issuers seek diversification.

New sukuk markets are opening up, with a number of countries working to finalize regulations to allow the issuance of sukuk. Countries such as Morocco, Nigeria, Oman, South Africa and Tunisia have shown great interest in issuing sukuk in 2014, particularly to support and fund several infrastructure projects. We also look forward to the United Kingdom's debut sovereign issue next year.

Yet, several challenges remain unresolved, and are blocking the growth of the sector, even as the market deepens and expands. Deficiencies still persist in the areas of transparency, standardization, and liquidity in the secondary market, mainly due to limited trading mechanisms and the different treatment of certain structures in different jurisdictions.

We believe that studies such as this are essential for understanding the challenges and issues affecting the industry and developing strategies to address them. We expect this Study to be of interest of to a wide range of public and private sector stakeholders. In particular, the findings of our survey will assist issuers to assess market appetite for potential issuances and assist lead arrangers, originators and advisors to better understand the scope of opportunities available.

We would like to thank all authors and experts who have contributed to this report, as well as the sponsors who have supported the development of this study, specifically Emirates NBD, Barwa Bank, and Azzad Asset Management.

In addition, we are grateful to Thomson Reuters management, particularly Basil Mofteh (Managing Director, Middle East, Africa and Russia) and Russell Haworth (Managing Director, Middle East and North Africa) for their foresight to invest heavily in the development of the Islamic financial services industry, and their continuing staunch support of our work.





# Executive Summary

**2013 came down with a thud; sukuk value and volume reached a high in 2012 on the back of big-ticket deals; with fewer of these as of Q3 2013 the market plunged.**

For the period under consideration – the first 9 months of the year – issuance plunged 27.5% to \$79 billion from the high of \$109 billion for the same period last year. In our market survey of lead arrangers and investors, both sides agree that global market interest rates are the most important factor affecting sukuk pricing. This was played out – the market lost Q3 as credit spreads widened and hesitant issuers waited out for stability over the (already traditional lull period of) summer after the Fed's first talk of tapering its bond-buying stimulus in May. Issuer interest picked up in September after weaker U.S. economic signals ruled out a slowdown in quantitative easing but 2013 full year global sukuk issuance is unlikely to top 2012's high of \$137 billion.

**Despite the drop in sukuk value this year we see a rise in sentiment outside the traditional powerhouses Malaysia and the GCC as growth in smaller sukuk markets and developments in new ones signal opportunities for the years to come.**

Our survey points to issuer and investor interest particularly for North African markets and our data registers increasing activity for Turkey and Indonesia. In a year of limited cross-border issuance, the growth of newer markets like Turkey satisfies geographical diversification (to a small extent) but it really is 2014 that investors are looking forward to.

## 2014

Around \$8 billion of international sukuk will be maturing in 2014, and most of these are fixed. Balance sheets will be seeking high yields with strong credits. Investors may turn to stronger Malaysian and GCC papers (including the Islamic Development Bank's \$10 billion new sukuk programme that will be listed on NASDAQ Dubai) but the good news is that even with the expected spike in rates next year, the outlook for 2014 for emerging market fixed-income investors is bright, with many expecting the asset class to turn positive. To add to the expected

increase in issuance from Malaysia and the GCC next year, new players such as Oman, Tunisia, Morocco, and Egypt are expected to come to market, and investor expectation is for the continued growth of the Turkish and Indonesian markets. The Turkey sukuk pot is filling up -at the time of publication Turkiye Finans had announced plans to issue more sukuk next year, in both lira and foreign currency and most indicators point to the Turkey sukuk pot only filling up.

## Challenges

Around 70% of lead arrangers surveyed believe that liquidity and tradability drive the price gap between sukuk and bonds. Improved liquidity and tradability in the sukuk market took a small step in the right direction this year with the IILM's first sukuk of \$490 million issued on August 2. But the market believes there is still a long way to go. Our survey findings point to a few main issues: a lack of global international Islamic banks, a lack of dedicated traders providing tradable prices, and, despite investors preferring to hold sukuk for 1 to 3 years, most of them categorise sukuk as hold-to-maturity on their balance sheets, hence weakening liquidity and tradability. With sukuk market liquidity a function of higher supply, growth in total sukuk will help improve liquidity. In this regard 2013's precipitous drop does not do the aggregate any favours. Additionally, the global sukuk market is relatively small and young, and the lion's share of its papers is domestic. A higher pace of international sukuk issuance from the GCC, Malaysia, Turkey and Indonesia will help improve liquidity. But challenges also persist for international sukuk. In this Report we point to main issues: the need for a more coherent understanding of contractual enforceability from both legal and sharia perspectives, and better disclosure with regard to a "true sale" and the underlying ownership of sukuk assets. While we present the market perspective on these, the sharia viewpoint is not forgotten, and this Report also lays out sharia criticisms against sukuk, outlining sharia responses and views on the evolution of sukuk structures from being asset-backed to asset-based to blended-assets to asset-light. In addressing the need for the global sukuk market to use more risk-sharing contracts, we see the advent of the perpetual sukuk - whose structures mix debt and equity – as a bright spot. The success of a clutch of these out of the GCC will hopefully pave the way for continued innovation and use of the perpetual sukuk. Connecting all these (and more) issues, finally we present our projection and forecast of sukuk supply and demand for the coming years.



## Supply and Demand Assessment

Our survey points to brighter issuer and investor sentiment for 2014; all are expecting next year's total sukuk value to be higher than this year's even as the market expects rates to go up. The biggest sukuk markets are expected to continue contributing high volumes, and the sukuk horizon is expanding with new issuers coming on board. However, demand is still expected to outstrip supply. We expect the sukuk demand and supply gap to narrow to \$187.4 billion in 2018 from \$230 billion in 2014. This is based on a conservative forecast of total growth of the sukuk market of 30% for 2014, thereafter slowing in line with the growth of total Islamic financial assets – 20% for 2015, and then 15% for each year of 2016 to 2018.



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Chapter One  
Key Milestones in the Growth  
& Development of the Sukuk Market



*Sukuk value and volume  
have consistently grown  
in the last five years but  
plunged in 2013*

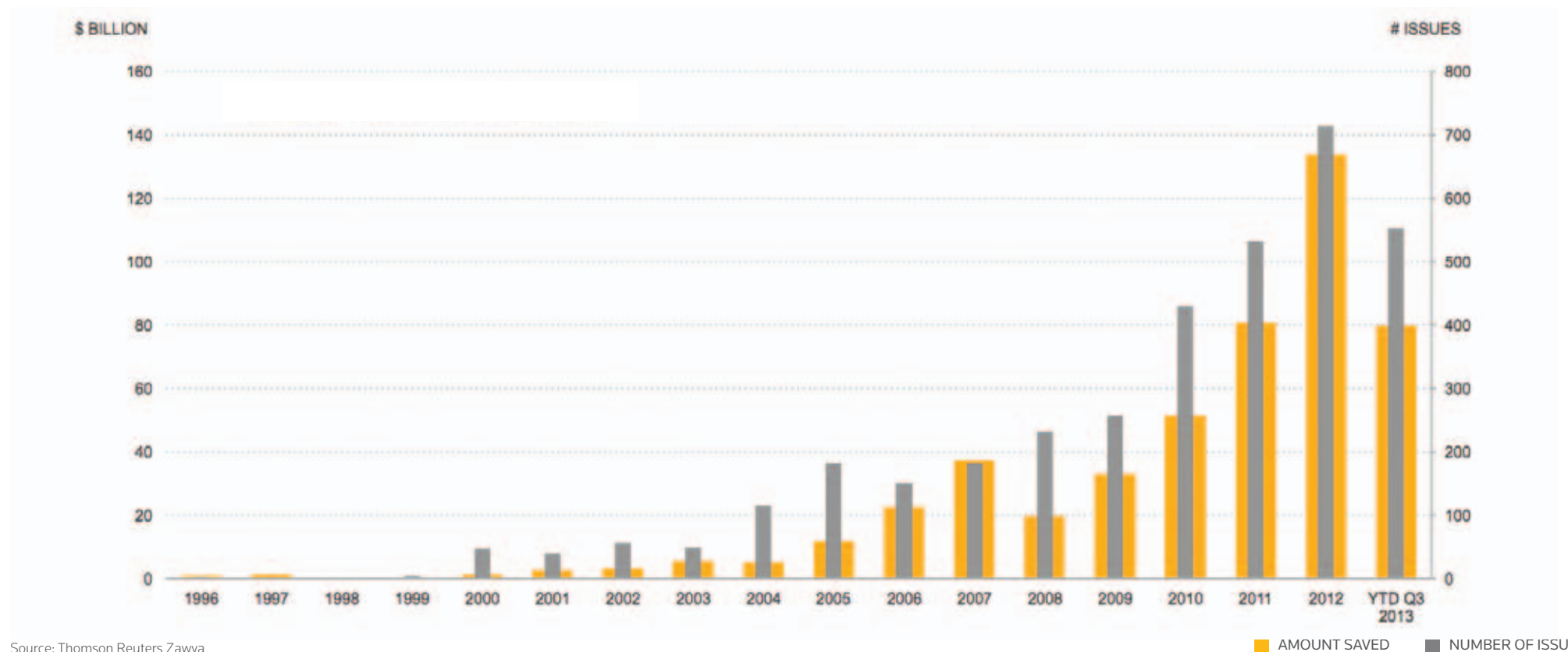
## Sukuk value and volume reached a high in 2012 on the back of big-ticket deals; with fewer of these as of Q3 2013 the market plunged

### Sukuk Market Overview

Despite optimistic outlook for the sukuk market this year, 2013 has witnessed a tremendous drop in sukuk volume due to far fewer big deals compared to 2012, and the prospects of the U.S. Federal Reserve reducing their bond purchase volumes, which have caused markets to be anxious about the fixed income market. As the U.S. Fed decided against tapering stimulus, issuers returned to the market with many big issuances, led by GACA's \$4 billion issue in October.

The total number of sukuk issuance as at end Q3, 2013 was \$79.70 billion (552 issues) compared to the higher \$109 billion (532 issues) for the same period in 2012.

### GLOBAL AGGREGATE SUKUK HISTORICAL TREND (1996 - Q3 2013)



Source: Thomson Reuters Zawya

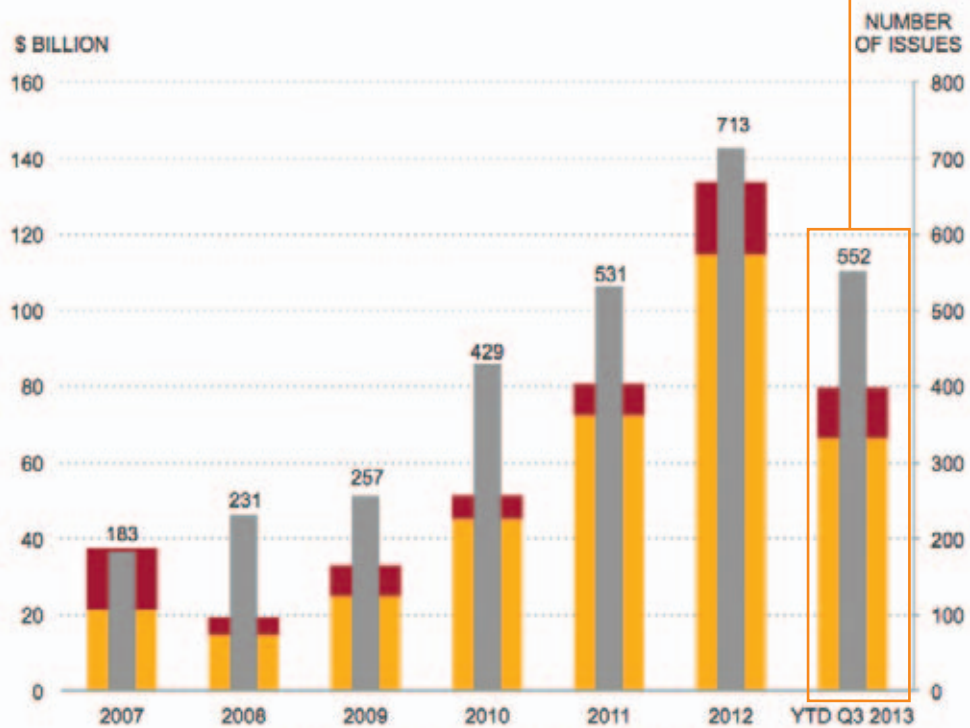
■ AMOUNT SAVED ■ NUMBER OF ISSUES

## Investors and traders have started looking for more value in local issuance with familiar credit

By Market of Issuance: Domestic vs. International

International sukuk (Eurobond) issuance stood at \$13.11 billion (16% of global sukuk issuance) for the first nine months of 2013 compared to a higher \$19.1 billion (14% of global sukuk issuance) for 2012. Domestic sukuk issuance amounted to \$66.6 billion (84%) for the first nine months of 2013 compared to a much higher \$114.62 billion for 2012.

### GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY MARKET OF ISSUANCE (JAN '02 - SEP '13)



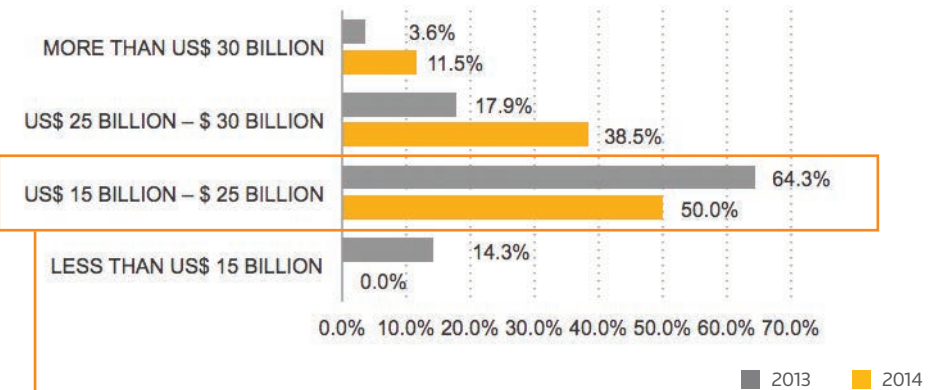
Source: Thomson Reuters Zawya

■ DOMESTIC SUKUK ■ INTERNATIONAL SUKUK ■ NUMBER OF ISSUES

### SUKUK SURVEY RESULTS

	Respondants	Skipped
SELL SIDE	29	6

SELL SIDE: What volume of international sukuk issuance do you expect in 2013 and 2014? The total international sukuk issuance in 2012 was US\$ 19 billion and H1 2013 was US\$ 11 billion.

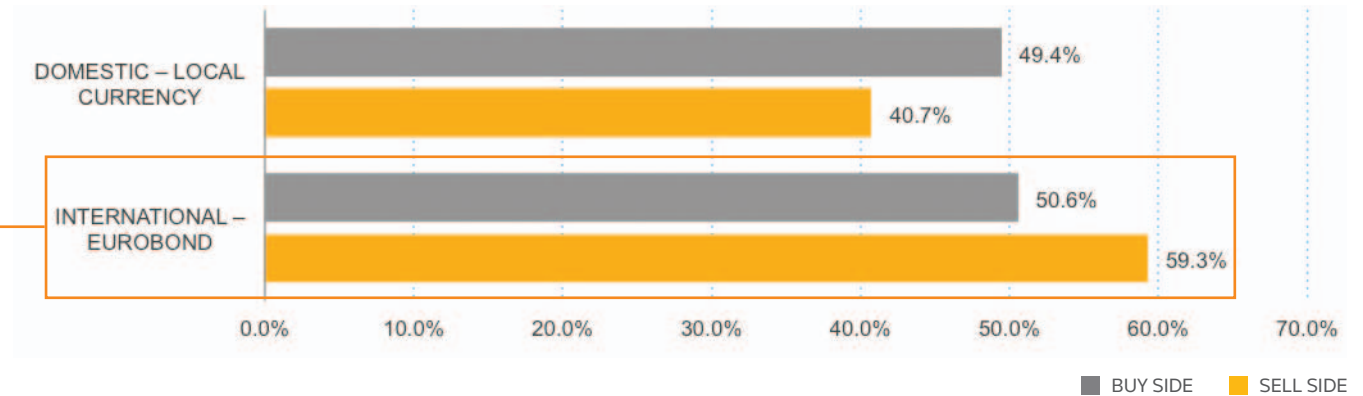


The expectation of a majority of lead arrangers for total volume of international sukuk issuance for 2013 and 2014 are consistent with last year's survey results (most expected range was \$15 billion - \$25 billion). This shows that the market is expecting steady growth of sukuk issuances in spite of the oft-touted high demand.

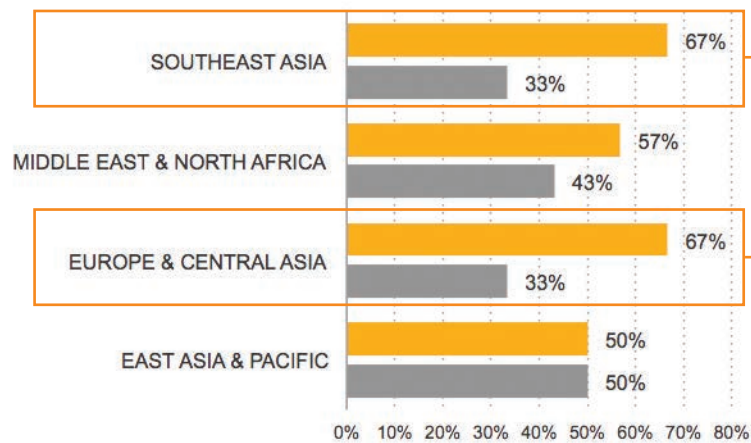
What is the most expected/preferred type of sukuk issuance/investment in 2013 and 2014?

International – Eurobond issuance is both expected and preferred by market players, although the sell side's expectation and preference for international papers outweigh the buy side's.

A significant change, however, has been registered for the buy side – compared to last year's expectations investors' and traders' preference for international issuances dropped as local currency papers offer better pricing. 71.7% of the buy side preferred international papers last year compared to 50.6% this year.



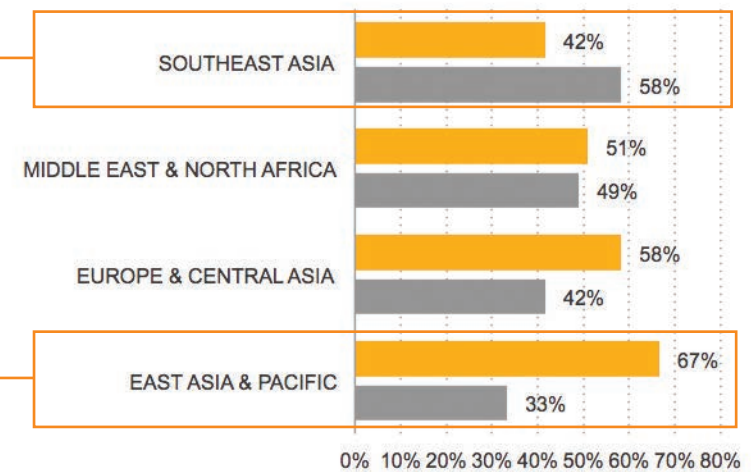
SELL SIDE: REGION BREAKDOWN



Sell Vs. Buy Side

Supply and demand gap in Southeast Asia: Issuers and their representatives from Southeast Asia expect more international sukuk while investors and traders from the same region prefer domestic sukuk, most probably due to better pricing and higher liquidity in active local markets such as Malaysia and Indonesia.

BUY SIDE: REGION BREAKDOWN



INTERNATIONAL – EUROBOND DOMESTIC – LOCAL CURRENCY

INTERNATIONAL – EUROBOND DOMESTIC – LOCAL CURRENCY

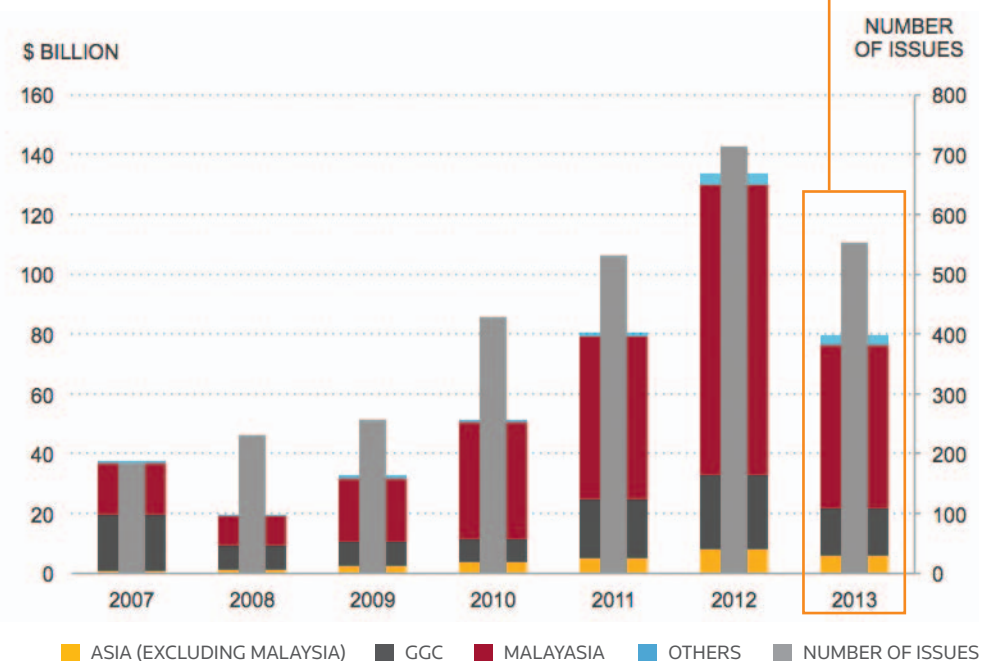
## Last year saw exceptionally high issuances from Malaysia but 2013 will finish on much lower levels

### By Region & Country

Despite the significant drop in sukuk volume in Malaysia in 2013, the country still dominates value and volume of sukuk globally. Malaysia issued \$54.33 billion sukuk in the first nine months of 2013, followed by Saudi Arabia (\$8.69 billion), UAE (\$5.17 billion) and Indonesia (\$5.03 billion). We see steady growth for Turkey, as participation banks tap the sukuk market with Tier I and II issuances.

Malaysia stood out in terms of domestic market issuance in Asia, followed by Indonesia. Pakistan also suffered from a significant drop in sukuk volume compared to last year. (For an assessment of Pakistan's sukuk market please refer to Suleman Muhammad Ali's article in this report.)

### GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY REGION (JAN 07 - SEP 13)



Source: Thomson Reuters Zawya

### GLOBAL AGGREGATE SUKUK ISSUED BREAKDOWN BY COUNTRY (JAN 96 – SEP 13)

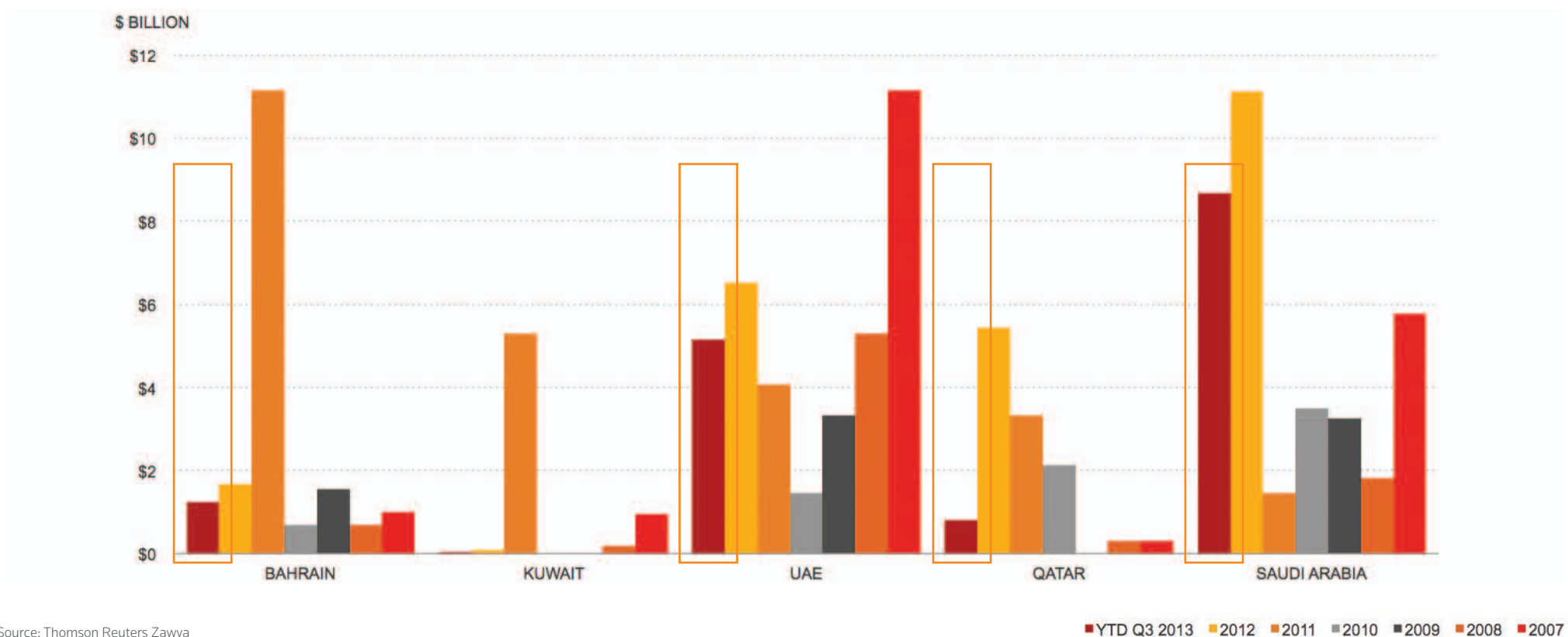
COUNTRY	NUMBER OF ISSUES	AMOUNT ISSUED (\$ MILLION)
Malaysia	2438	324,576.9
UAE	73	47,876.4
Saudi Arabia	64	39,296.0
Indonesia	216	19,924.1
Qatar	19	19,245.6
Bahrain	273	13,918.5
Pakistan	57	6,348.9
Turkey	9	5,469.7
Brunei Darussalam	95	4,980.7
Kuwait	22	2,992.4
Singapore	9	984.2
United States	3	765.7
United Kingdom	5	279.1
China	3	274.7
Yemen	2	251.5
Sudan	3	220.9
Germany	2	190.9
Gambia	242	149.2
Iran	4	132.8
Jordan	1	120.3
Japan	1	100.0
Kazakhstan	1	73.3
France	1	0.7
<b>GRAND TOTAL</b>	<b>3,543</b>	<b>488,172</b>



GCC sukuk issuances for 2013 are mostly driven by Saudi Arabian and UAE corporate issuances worth approximately \$6.32 billion and \$3.35 billion respectively for the first nine months of 2013 compared to \$5.21 billion and \$4.55 billion for 2012. Total Issuances out of Qatar plunged significantly from \$5.45 billion in 2012 to \$824 million for the first nine months of 2013 due in large part to the exceptionally large \$4 billion Qatar government issue in July last year.

An early October 2013 issuance out of Saudi Arabia (neither included in the above figure nor the chart on this page) - the General Authority of Civil Aviation (GACA) sukuk totaling SR15.211 billion (\$4.056 billion) – achieved a profit rate of 3.21%. Remarkably, the government-backed Saudi Riyal sukuk was issued in one single tranche on one maturity and price, making it the largest single-tranche sukuk ever issued in Saudi Arabia.

### GCC SUKUK HISTORICAL TREND BREAKDOWN BY COUNTRY (JAN 07 - SEP 13)



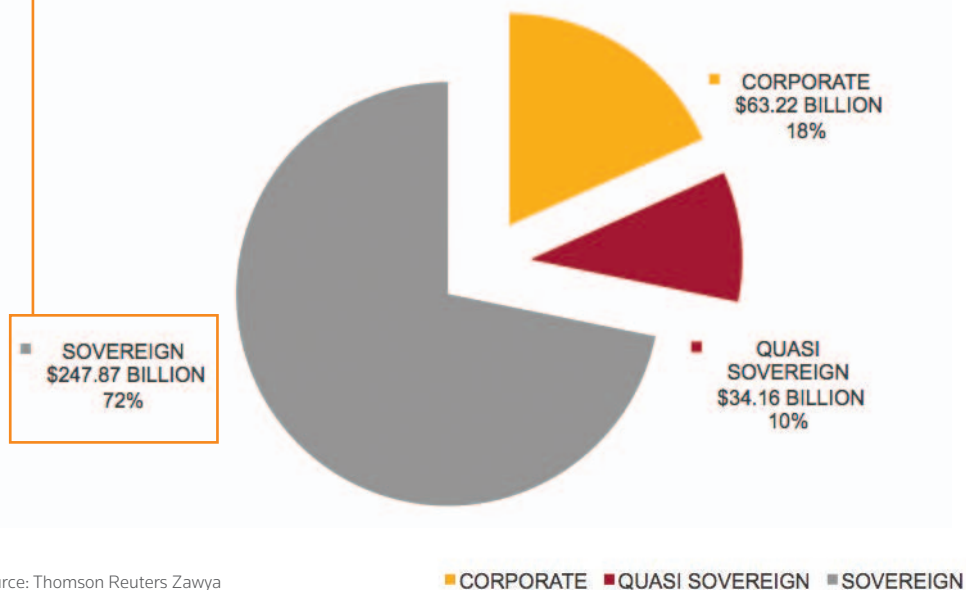
## Investors drift away from financials towards sovereign and industrial risk.

### By Sector

Governments remain the most active issuers across the history of the global sukuk market, with Malaysia's government leading. Sovereigns have issued a total of \$280 billion since 1996. In the last three years, 82% of global sukuk issuance came from governments and quasi government bodies (\$282 billion) while only 18% were issued by corporates (\$63 billion).

Malaysia had a total of \$325 billion sukuk issued from 1996 to Q3 2013, with 67% sovereign, 13% quasi and 20% corporates. GCC corporates are far more active in the sukuk market than their sovereigns but the total pot of both GCC sovereigns and quasi sovereigns very marginally edge out corporate issuance. A total of \$123 billion GCC sukuk were issued from 1996 to Q3 2013, made up of 49% corporates, 20% quasi and 31% sovereign.

GLOBAL SUKUK ISSUED IN LAST THREE YEARS BREAKDOWN BY ISSUER TYPE (JAN 10 - SEP 13)



Source: Thomson Reuters Zawya

GLOBAL AGGREGATE SUKUK ISSUED BREAKDOWN BY SECTOR (JAN 96 – SEP 13)

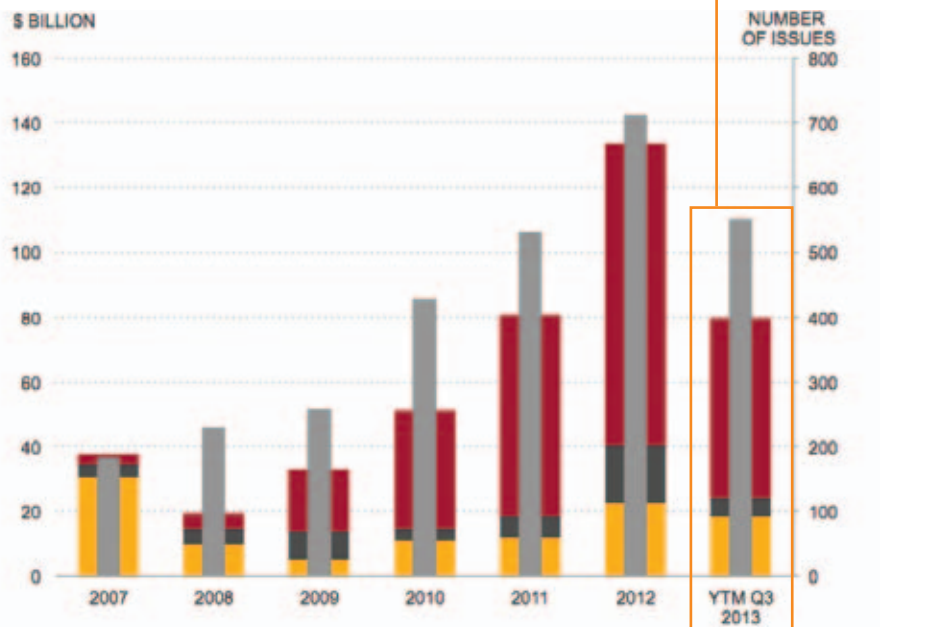
SECTOR	NUMBER OF ISSUES	AMOUNT (\$ MLN)	MARKET SHARE
Agriculture	92	3,492	0.72%
Conglomerates	14	2,723	0.56%
Construction	400	14,307	2.93%
Consumer Goods	39	751	0.15%
Education	5	64	0.01%
Financial Services	396	61,927	12.69%
Food and Beverages	35	2,313	0.47%
Government Institutions	1,356	280,523	57.46%
Health Care	29	544	0.11%
Industrial Manufacturing	64	1,536	0.31%
Information Technology	7	29	0.01%
Leisure and Tourism	5	1,361	0.28%
Mining and Metals	10	442	0.09%
Oil and Gas	109	14,613	2.99%
Power and Utilities	366	33,342	6.83%
Real Estate	182	24,949	5.11%
Retail	16	167	0.03%
Services	36	3,672	0.75%
Telecommunications	74	6,039	1.24%
Transport	308	35,377	7.25%
GRAND TOTAL	3,543	488,172	100

Sovereign issuance still account for the lion’s share of the market as of Q3 2013. Despite socio-political unrest in the Middle East, Arab governments have kept up their sukuk momentum; Bahrain leads, followed by Saudi Arabia, Qatar and UAE. They mostly focused on the Eurobond market except Bahrain which enjoys an active local sukuk market.

Sovereign and quasi-sovereign issuers from Malaysia, Indonesia and Pakistan maintained high issuance volumes mostly in their domestic markets. However, despite the growth in the number of sukuk, there is a slight drop in value issued due to Malaysia’s larger-than-normal issuances last year.

For the first nine months of 2013, around 70% of sukuk issued were from government institutions (compared to 65% in 2012) while power and utilities beat the financial sector with 9.2% compared to 3.7% last year. Financial sector issuance dropped to 9% compared to 12% last year and the transport sector also plunged to 2.3% from 11.2%, mostly due to unfavourable market conditions.

**GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY ISSUER TYPE (JAN 07 - SEP 13)**



Source: Thomson Reuters Zawya

■ CORPORATE ■ QUASI SOVEREIGN ■ SOVEREIGN ■ NUMBER OF ISSUE

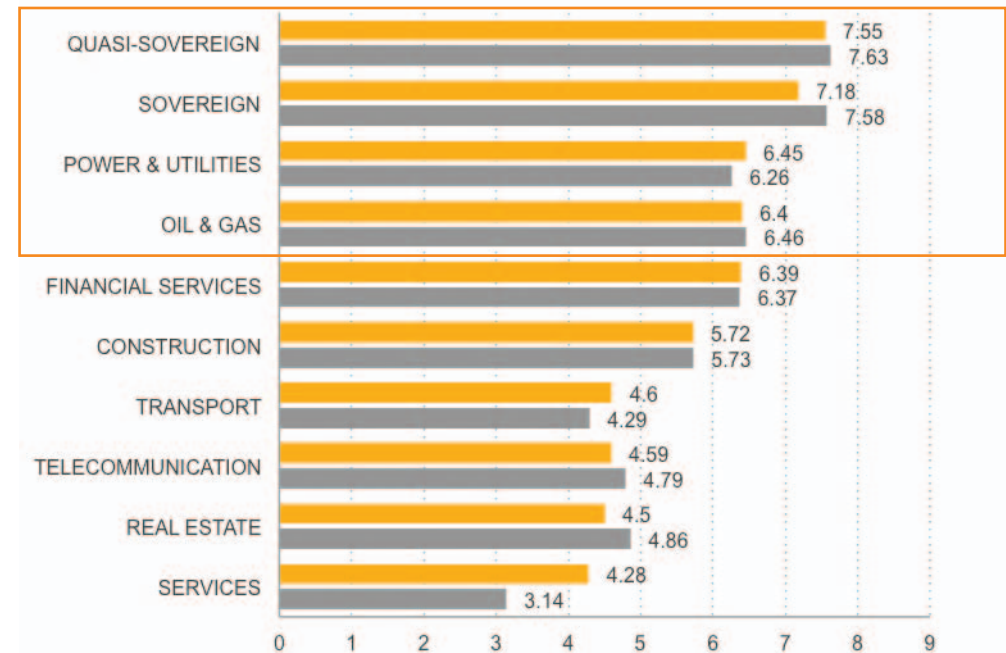
**SUKUK SURVEY RESULTS**

Sell Side (lead arrangers and issuers) most expect quasi-sovereign issuances, followed closely by sovereigns, oil & gas, and financial services, largely due to growing funding need for many infrastructure projects.

Similarly, the Buy Side (investors and traders) prefers to invest in quasi-sovereign issuances, then sovereigns, followed by power & utilities due to their solid credit and high cash inflow.

	Respondants	Skipped
SELL SIDE	29	6
BUY SIDE	57	63

Please rank the following sectors according to expectation/preference of sukuk issuance/ investment in 2013 and 2014.



Source: Thomson Reuters Zawya

■ BUY SIDE ■ SELL SIDE

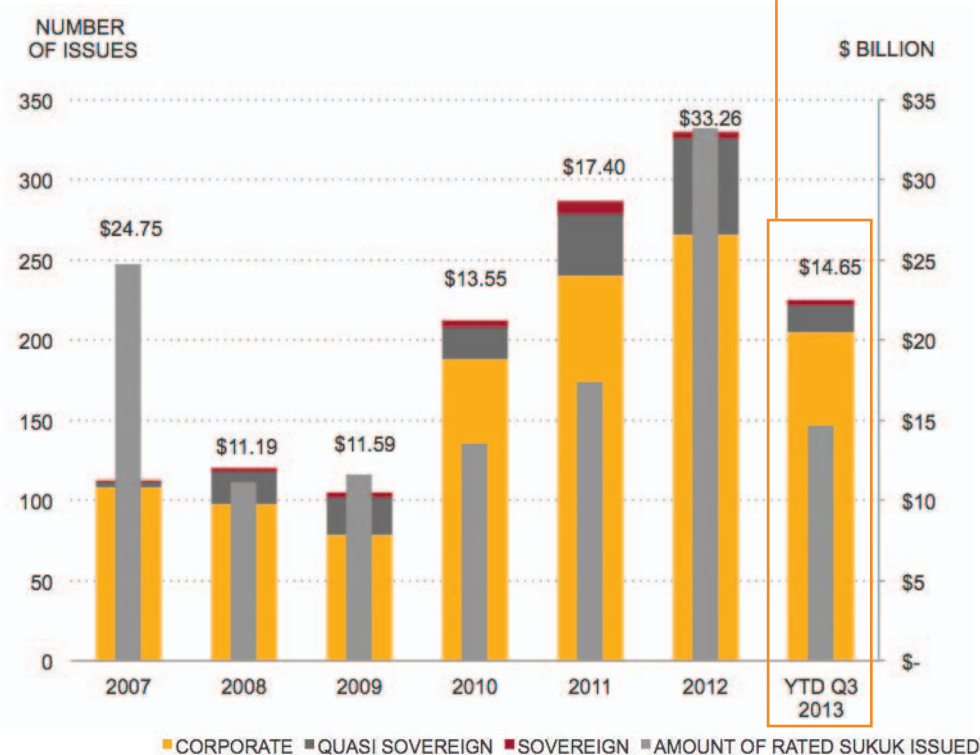
## The market is looking for assurance through ratings...

### By Rating

During the past five years, the majority of rated sukuk were corporates who needed to gain market confidence in their credit risk. Most of these corporates do not enjoy government support and depend solely on their own performance; therefore, unlike government and government-linked entities, they require rating support.

41% of the number of global sukuk issued in the first nine months of 2013 were rated (225/552) compared to 46% (330/713) in 2012.

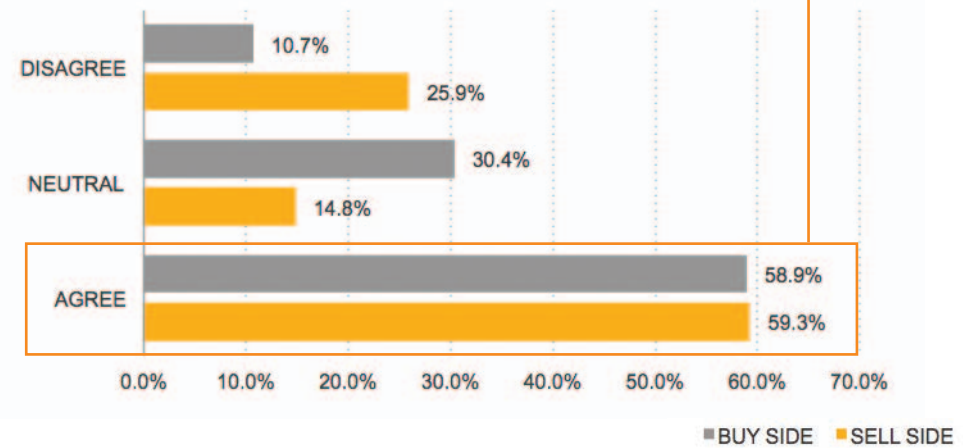
### GLOBAL SUKUK HISTORICAL TREND BREAKDOWN RATING VS. TYPE OF ISSUER (JAN 07 - SEP 13)



### SUKUK SURVEY RESULTS

Most lead arrangers and investors agree that sukuk rating is important for investing in sukuk.

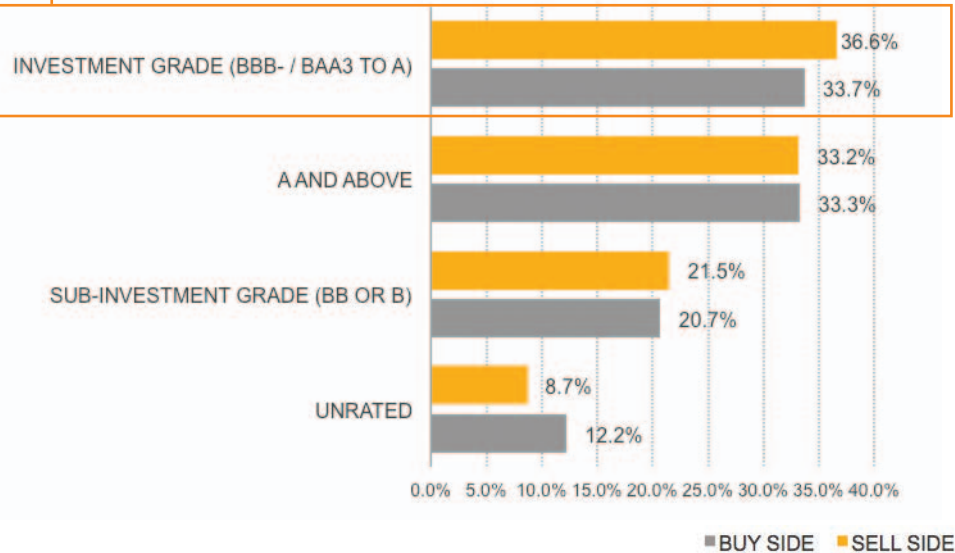
#### Sukuk rating should be compulsory



	Respondants	Skipped
SELL SIDE	27	8
BUY SIDE	56	64

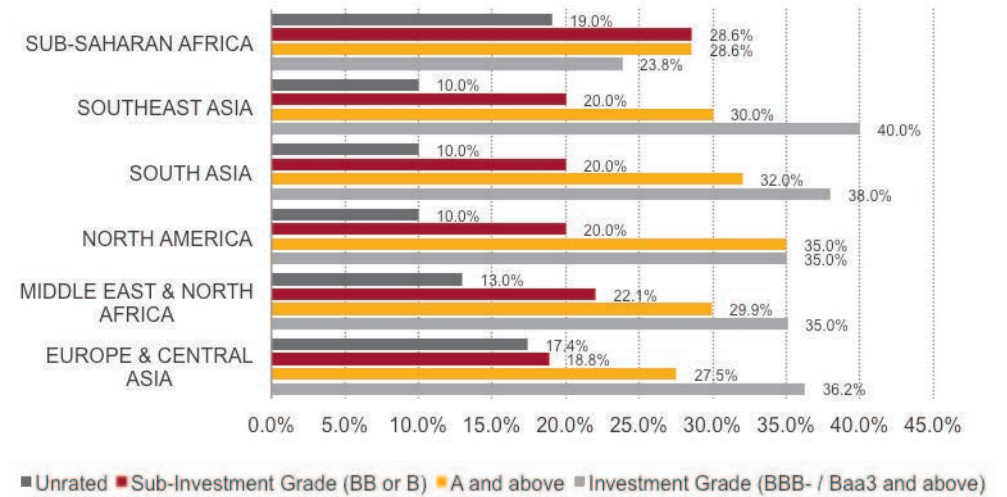
Investors have historically preferred A and above papers, but both buy and sell sides from different regions foresee higher risk adjusted premium in the higher yielding lower grades of investment grade sukuk.

What is your most expected/preferred credit quality of sukuk issuance/ investment in the coming two years?

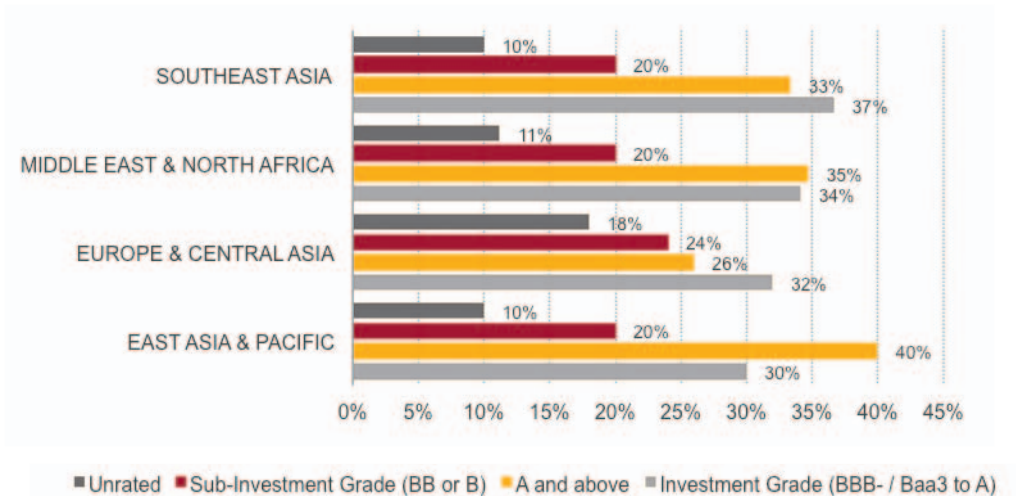


	Respondants	Skipped
SELL SIDE	27	8
BUY SIDE	58	62

BUY SIDE: REGION BREAKDOWN



SELL SIDE: REGION BREAKDOWN



## ...And transparency of sukuk transactions through listing

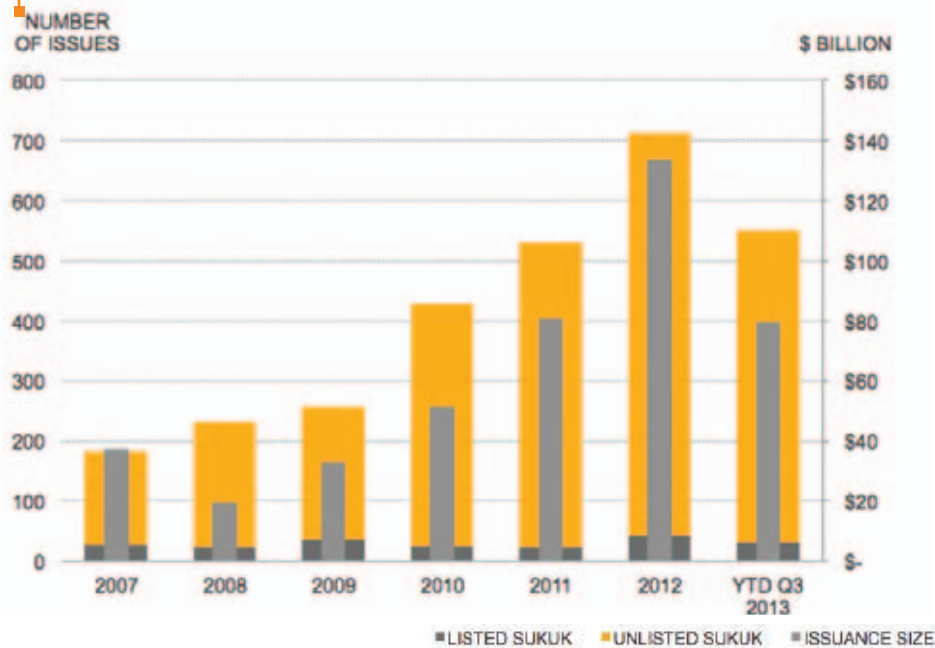
### By Listing Stock Exchange

As most sukuk papers are traded over the counter, the need for listed sukuk has been neglected despite its significance for transparency.

Only around 6% of global sukuk issued were listed in the last couple of years (\$16.57 billion as at Q3 2013 and \$21.4 billion in 2012).

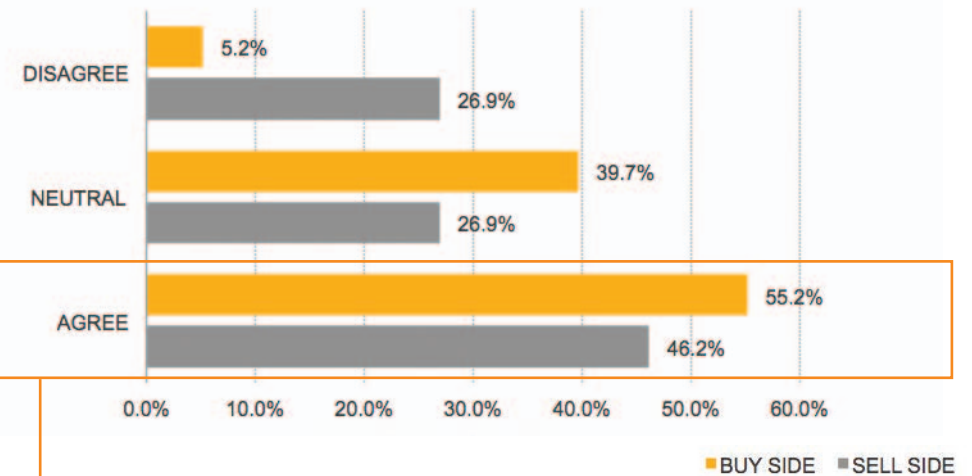
32 out of 520 (6.15%) were listed in the first nine months of 2013, an ever so slightly higher proportion than the 41 out of 672 (6.1%) in 2012. London, Nasdaq Dubai, Saudi Arabia and Bursa Malaysia are the top stock exchanges holding most of these listed sukuk; London Stock Exchange is home to most listed international sukuk while the others hold listed domestic issues, which facilitates exchange of these papers within local markets.

GLOBAL SUKUK HISTORICAL TREND BREAKDOWN LISTED VS UNLISTED (JAN 07 - SEP 13)



### SUKUK SURVEY RESULTS

#### Sukuk rating should be compulsory



	Respondants	Skipped
SELL SIDE	26	9
BUY SIDE	58	62

Similar to last year's survey results, about half of the lead arrangers and 55% of investors believe that sukuk listing should be compulsory compared to a 26.9% split between those on the fence and those who disagree.



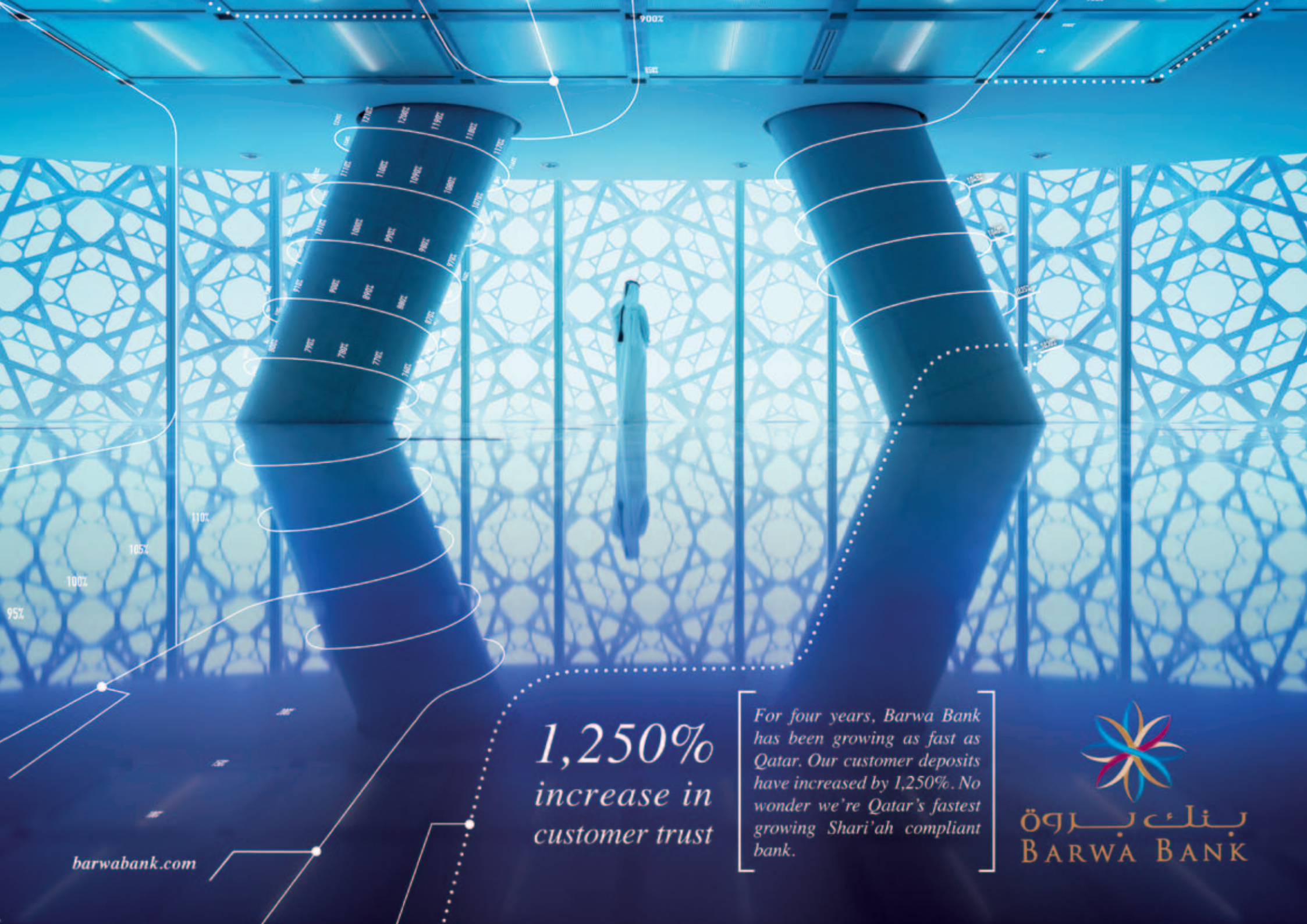
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Since we started four years ago, Barwa Bank has been growing as rapidly as Qatar. Our assets have grown 1,000%, helping make us Qatar's fastest growing Shari'ah compliant bank.



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*1,250%  
increase in  
customer trust*

*For four years, Barwa Bank has been growing as fast as Qatar. Our customer deposits have increased by 1,250%. No wonder we're Qatar's fastest growing Shari'ah compliant bank.*



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# Chapter Two

# Opportunities



*Many emerging and frontier markets are paving the way for sukuk market development by first establishing suitable regulations.*



## African countries have the highest potential for sukuk growth. But first they must establish enabling frameworks

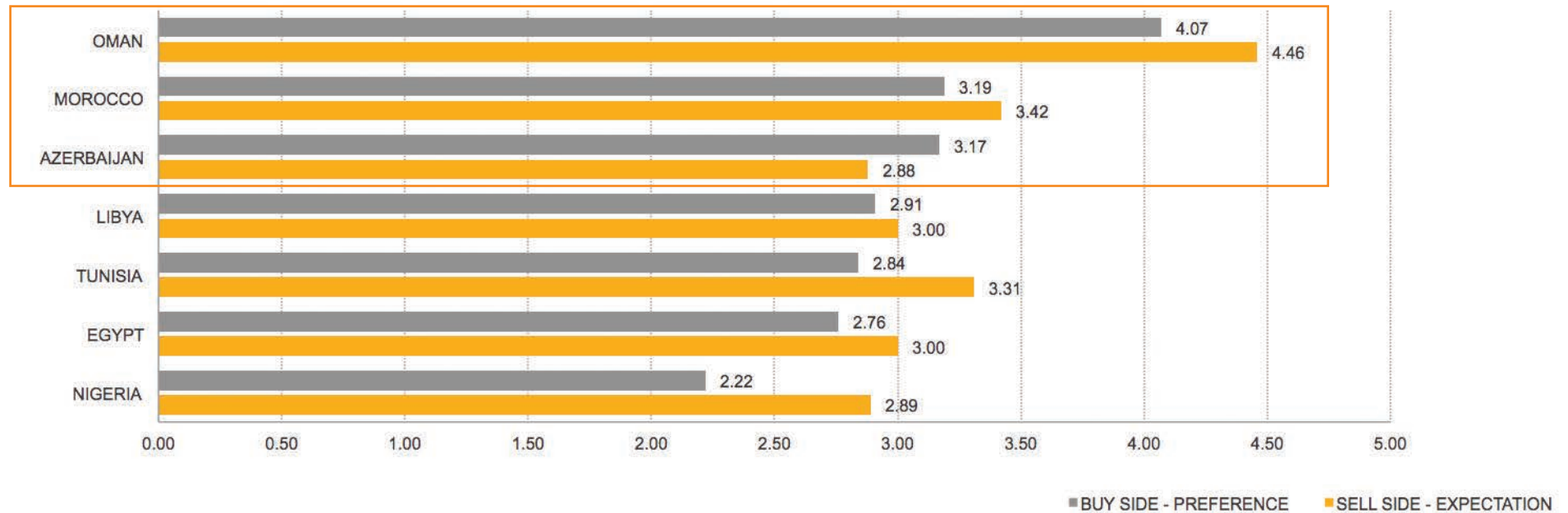
### Untapped Potential


Investors tag Oman as the most attractive emerging Islamic finance market for sukuk investment. Similarly, lead arrangers most expect sukuk from Oman. These results are perhaps reflective of positive perception and sentiment towards Oman's fledgling Islamic finance sector that has received full government support with the establishment of industry-specific legislation and infrastructure. Noticeably, both sellers and buyers favour North African countries such as Tunisia, Libya, Morocco and Egypt to issue and invest in sukuk. All these North African jurisdictions have signalled greater interest and support for Islamic finance post-Arab Spring, and are working to establish new frameworks and/or strengthen current structures for Islamic finance. Tunisia, Morocco and Egypt debut sovereign sukuk are in the pipeline for 2014.

	Respondants	Skipped
SELL SIDE	25	10
BUY SIDE	54	66

Note: Final quantitative findings for this question is based on an average of the ranking for each option.

### Which of the following emerging markets is the most attractive for sukuk investment/issuance?





*Tunisia's parliament passed a law allowing sukuk in July this year. The country holds significant sukuk potential.*

## Tunisia: an exit from crisis with cautious optimism

By Mohamed Araar

Head of Department – Central Bank of Tunisia

### TUNISIAN SOVEREIGN SUKUK SPOTLIGHT

Tunisia is struggling to overcome a current account deficit, high unemployment and low per capita GDP while making the transition to a more transparent and democratic form of government. Governance constraints and weak institutions have led to calls for new institutional rules for the transition process to a new democracy which is meant to drive Tunisia's economy forward. The country has also been faced with headwinds from Europe's protracted economic slowdown which has resulted in weak exports to the European Union. Sukuk has been identified as an important avenue to plug the Tunisian government's deficit, and raise financing for the country's infrastructure and development needs. The current situation in Tunisia, however, poses many challenges for a sovereign sukuk issuance, chief of which is its sovereign rating.

Weaknesses and Threats	Strengths and Opportunities
<ul style="list-style-type: none"> <li>• Risk of instability both at the national and international levels caused by:               <ul style="list-style-type: none"> <li>– Political uncertainty (democratic transition)</li> <li>– Security threats (fight against terrorism)</li> </ul> </li> <li>• Weak finances at government-owned banks</li> <li>• Sizeable external pressures on the country's balance of payments</li> <li>• Europe's economic health, as it impacts Tunisia's exports (70%), FDI (70%) and tourism (75%)</li> </ul>	<ul style="list-style-type: none"> <li>• Easing in political tensions on the ground - agreement between the governing coalition and the opposition on the appointment of a caretaker government and on a consensual base for the constitution and elections</li> <li>• Reform program for macroeconomic stabilization, higher inclusive growth and a renewed social contract:               <ul style="list-style-type: none"> <li>– Strengthening budgetary stability (fiscal and external buffers)</li> <li>– Fixing vulnerabilities in the banking sector</li> <li>– Promoting private sector development</li> <li>– Social security and labour market reforms</li> </ul> </li> </ul>

### TUNISIA'S RATINGS

Tunisia's sovereign rating was downgraded in 2013 due to the slow progress made by the government to resolve domestic political unrest, leading to a negative impact on the country's macroeconomic situation (imbalances in the current account deficit, budget deficit and plunge in international reserves.) As of this writing, the three major rating agencies have changed Tunisia's rating outlook to negative. The latest downgrade, as of this writing, came from Standard and Poor's (S&P) who pushed foreign long-term credit rating to B from BB- in August 2013. Moody's lowered the country's foreign debt rating to Ba2 from Ba1 in May before its annual visit in September, and Fitch moved the country from BBB- to BB+, the highest non- investment grade rating, in December 2012. Fitch has indicated that the rating will remain unchanged. Rating and Investment Information, Inc. (R&I) is the only rating agency which maintained the lowest investment grade of BBB- for Tunisia in February 2013 before its annual visit in July and this is expected to remain unchanged. (Editor's note: Since the writing of this article, at the end of October, 2013 Fitch further downgraded Tunisia's



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Head of Department at the Central Bank of Tunisia in charge of operational risk (International Finance) and certified from the Reserves Advisory and Management Program (RAMP) from the World Bank. He holds a Masters' Degree in Islamic Banking, Finance and Management with distinction from Markfield Institute of Higher Education (MIHE) /Gloucestershire University, UK (in march 2012). He has authored a dissertation 'Unlocking the potential of Sukuk in support of economic development: Tunisia Case Study'. He is a fellow of the Institute of Islamic Banking and Insurance IIBI, London. He is a member of the academic committee in the Tunisian committee of Islamic Finance COFIT, a body which promotes the Tunisian Islamic finance Industry. He has been a delegate, speaker and participant at international Islamic finance conferences, seminars and workshops related to Islamic finance framework and potential issuance of sovereign Sukuk in Tunisia.

long-term foreign currency issuer default rating (IDR) to BB- from BB+ and local currency IDR to BB from BBB-, with outlooks on both IDRs negative.)

While there are downsides that will stifle investor appetite and confidence, several agreements with multilateral and international organisations have eased the pressure on Tunisia's downgraded sovereign ratings and provided comfort to the country's ability to meet its financing needs.

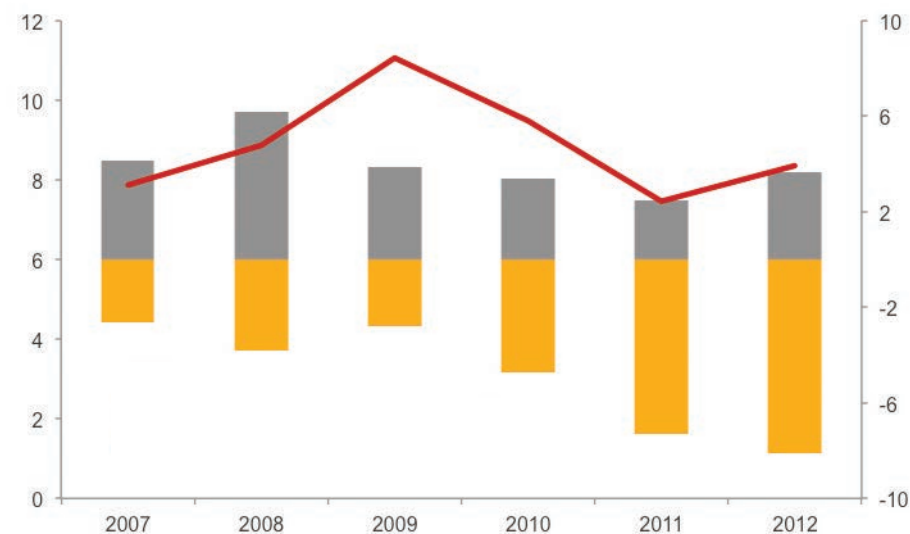
### TUNISIA'S LONG TERM RATING (FOREIGN CURRENCY)

Moody's			
May 29, '13	Feb 28, '13	Jan 19, '11	Apr 17, '03
Ba2	Ba1	Baa3	Baa2
S&P			
Aug 16, '13	Feb 19, '13	May 23, '12	Mar 16, '11
B	BB-	BB	BBB-
Fitch			
Oct 30, 13	Dec 12, '12	Mar 2, '11	May 24, '01
BB-	BB+	BBB-	BBB
R&I			
Oct 25, '12	Jan 17, '11	Mar 30, 07	Jan '94
BBB-	BBB	A-	BBB+

### THE STATE OF TUNISIA'S PUBLIC PURSE

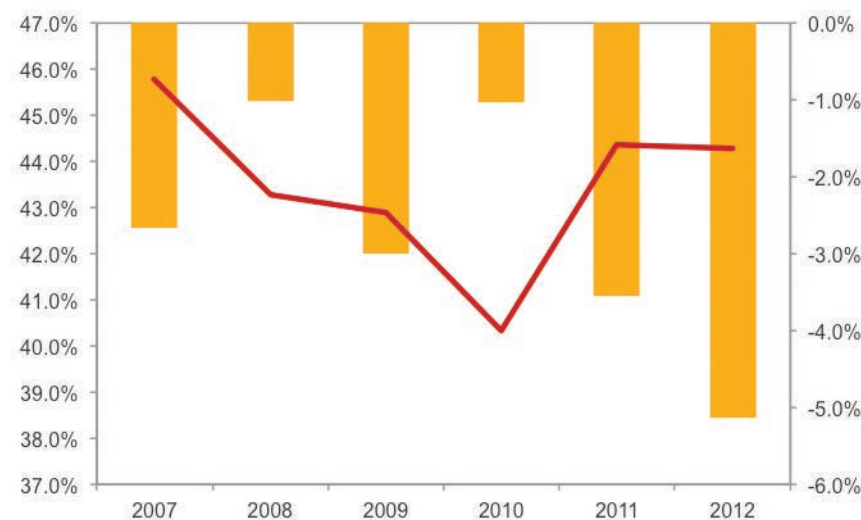
Since the January 14, 2011 ousting of President Zine El Abidine Ben Ali following the Tunisian revolution, there has been an increase in government expenses – rises in salaries, compensation and debt service – and government investment expenses - infrastructure, regional development, and agriculture. To stimulate demand, the government in 2012 carried out an expansionary budget policy which deteriorated public finances and increased fiscal deficit (5.4% of GDP) while decreasing currency reserves (equal to 3.8 months of imports in December 2012). Nevertheless, debt has remained contained at approximately 44% of GDP in 2012.

To fund the increased level of expenditure, Tunisia borrowed TND 4.76 billion (US\$3.05 billion) in 2012, of which TND 3.25 billion (US\$2.08 billion) was in the form of external drawdowns.



■ FDI (IN % OF GDP) ■ CURRENT ACCOUNT (IN % OF GDP) ■ GROSS OFFICIAL RESERVES (IN USD BILLIONS)

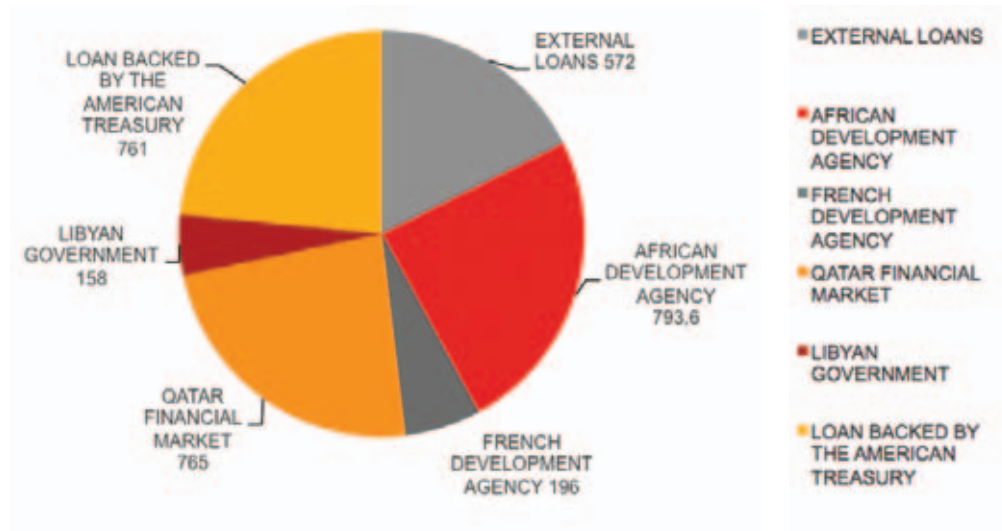
Source: Central Bank of Tunisia and IMF



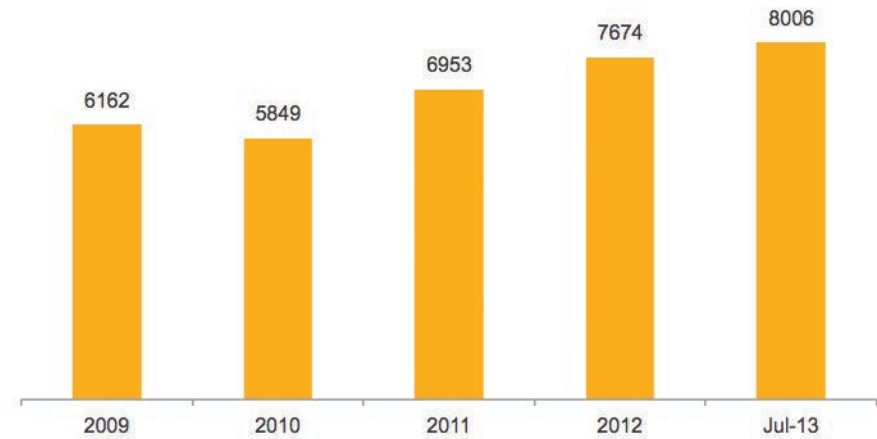
Source: Tunisia Ministry of Finance

■ BUDGET BALANCE (IN % OF GDP) ■ PUBLIC DEBT (IN % OF GDP)

EXTERNAL DRAWDOWNS IN MILLIONS TND

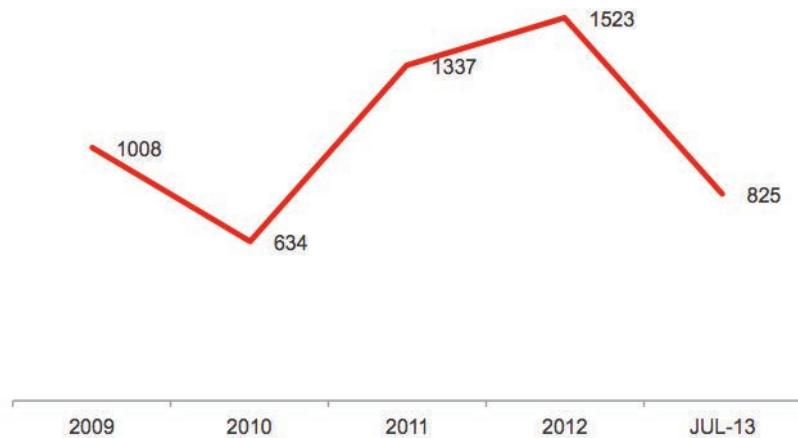


TREASURY BONDS ISSUED IN MDT



Source: Tunisia Valeurs July 2013

TREASURY BONDS (FUNDS RAISED IN MTD)



Source: Tunisia Valeurs July 2013

■ TREASURY BONDS

Additionally, ongoing pressure on public finances led to an increase of 14% compared to 2011 on the local market in Treasury issues totalling TND 1.52 billion (US\$0.97 billion) in 2012.

In 2013, the Tunisian government introduced the issuance of TND 1,000 million sukuk in the Finance Act for the current year. This is still dependent on the passing of the appropriate legislative framework. The national constitution assembly adopted a legislation for sukuk on July 17, 2013 (Law No. 30 dated July 30, 2013) in order to introduce sovereign sukuk, and this legislation calls for some new regulations to be put in place, such as the need to establish a company with a special status attached to the Ministry of Finance to guarantee circulation of sukuk without any constraints, and the identification and fulfilment of certain specific conditions which are appropriate for assets to be leased (equipment, buildings or other facilities). This last consideration is especially pertinent for ijara sukuk, what with the government mainly concerned with plugging its liquidity gap in the budget deficit.



### Recent agreements that have taken the pressure off Tunisia's downgraded rating

Tunisia: official external financing	2013 (Millions of U.S. dollars)				
	Year	Q1	Q2	Q3	Q4
Total	2239.1	100.1	309.8	109.8	1471.4
Bilateral	200.0		200.0		
IFIs	800.0				800.0
AfDB	300.0				300.0
World Bank	500.0				500.0
Other	1239.1	100.1	109.8	109.8	919.4
Samurai bonds and other market financing	399.9				
Project aid w/o donor breakdown	439.1	100.1	109.8	109.8	119.4
Sukuk	400.0				400.0
Memorandum Item:					
Grants	248.0				248.0
IMF Financing (BOP support)	650.1		150.1	149.8	350.2

Source: Tunisian authorities; and IMF staff estimates

Tunisia's downgraded ratings have made access to financing projects and businesses more costly, but the steps taken by the Deauville partnership, notably with financial backers such as the U.S. Treasury and the Japan Bank for International Cooperation (JBIC), have reduced financing costs.

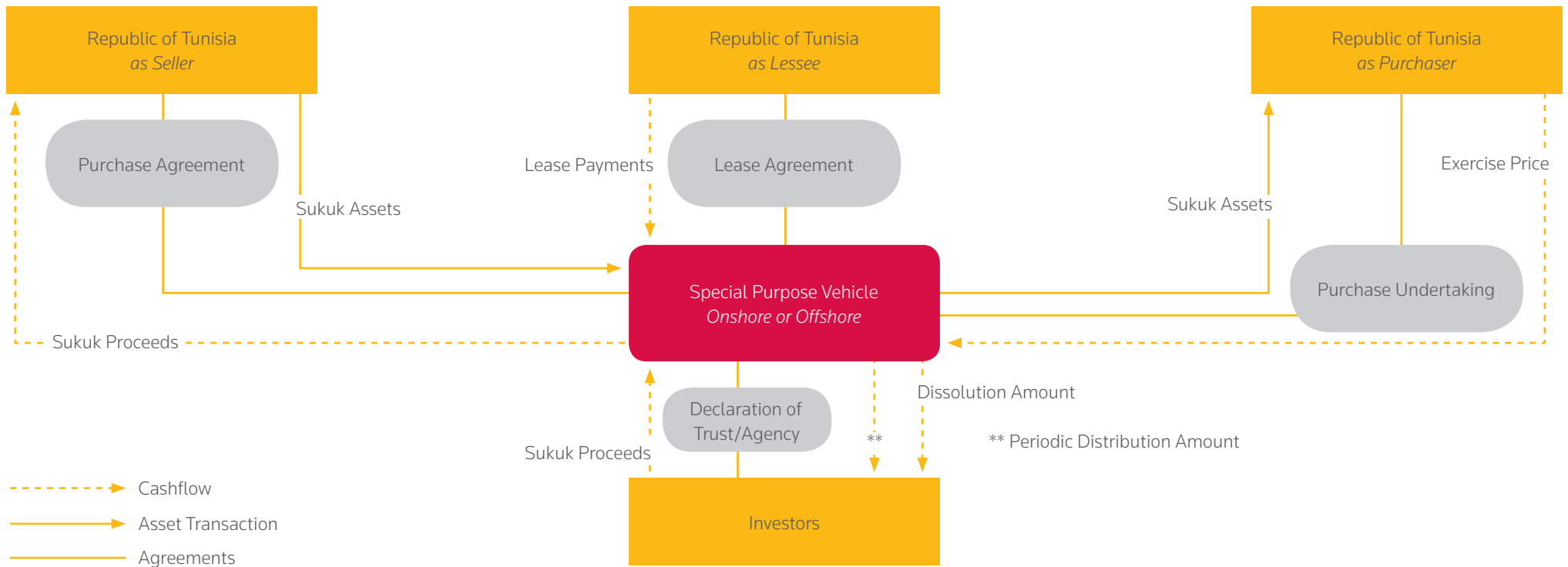
Strengthened FDI inflows, sustained multilateral and bilateral loans, and access to capital markets boosted liquidity in foreign currency reserves expressed in days of imports to approximately 104 days at the end of August 2013 while public external debt is still limited to nearly 30% of GDP at the end of 2013.

Tunisia has also successfully negotiated a 24-month stand-by International Monetary Fund (IMF) arrangement for an amount equivalent to US\$1.74 billion to be repaid in five years at an interest rate of approximately 1.08% to ensure that reserve coverage remains above the minimum of three months of imports, even if financial markets cannot be tapped as planned (e.g. the issuance of sukuk in December 2013 would require a broad regulatory reform.)

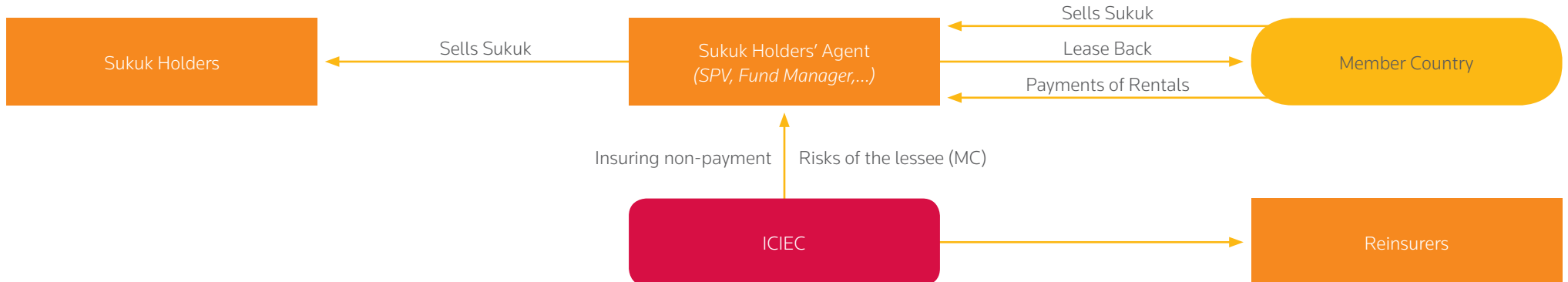
### ENABLING ENVIRONMENT FOR ISLAMIC FINANCE: THE GOVERNMENT SUKUK MARKET

Tunisia's use of Islamic finance is increasing, with primary focus on financing for development although the country's established partnership strategy agreements with the Islamic Development Bank (IDB) also extends to the development of Islamic finance in the private sector. Through agreements with the IDB Tunisia will receive nearly US\$1.2 billion during the period 2013-2015; funds that are to be used for cooperation in priority areas based on a planned program. Tunisia received US\$200 million for the C Rades- Combined Cycle Power Project and the IDB is planning to hold a 25% stake in Zitouna Bank, the first Islamic bank in the country that was established in 2009.

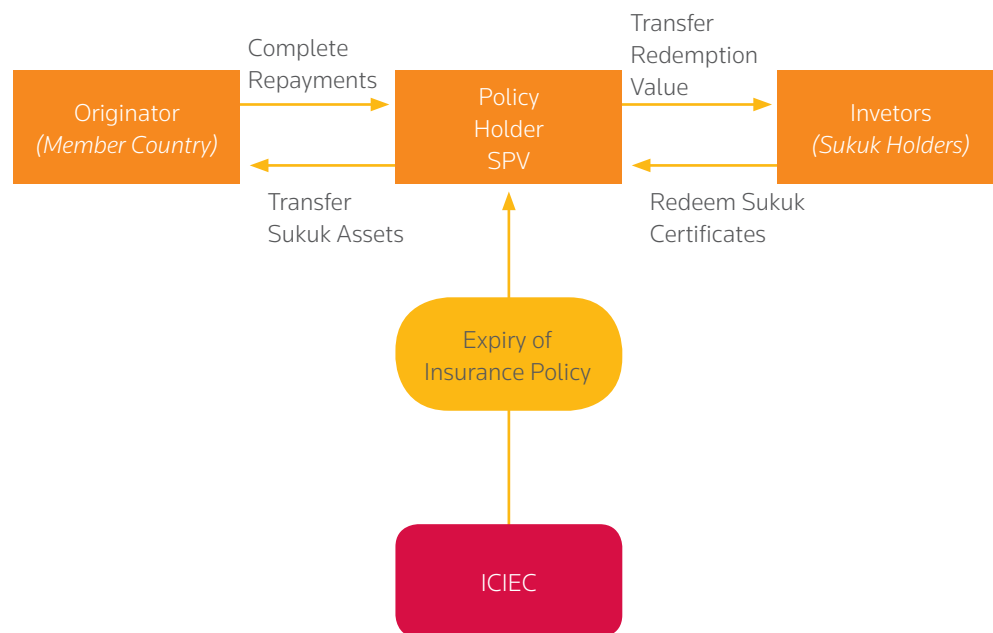
The IDB has also pledged its support for the country's first ever sukuk program worth US\$ 600 million, by offering financial guarantee for the sukuk. This has been planned by the IDB's credit and political risk insurance arm the Islamic Corporation for the Insurance of Investment and Export Credit ICIEC). ICIEC's guarantee will help ease investors' concerns about Tunisia's financial position, and enable the sovereign sukuk issuer to raise financing from international financial markets for infrastructure investment and other development projects.



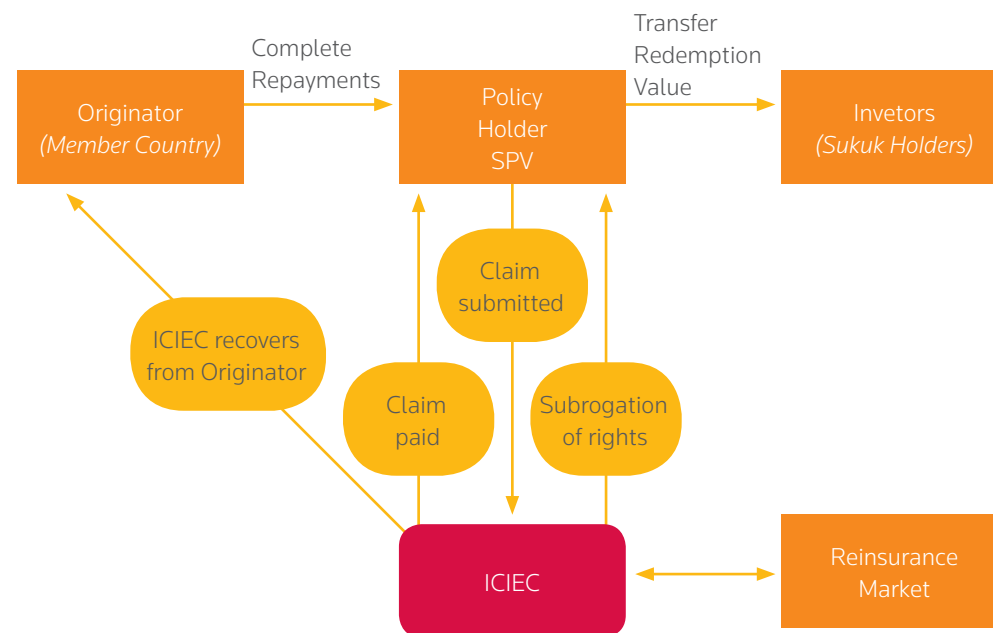
MECHANISM OF ICIEC'S SUKUK POLICY



## REDEMPTION STAGE



## IN CASE OF CLAIMS



## What to expect by the end of 2013:

- The IDB will offer a practical and sharia-compliant form of guarantee with regards to AAOIFI standards (17) since it is given by an independent party but the Tunisian government has yet to make a formal application to take up this offer and to issue a sovereign sukuk as planned because of the current political transition which has taken longer than expected.
- The Government has yet to establish an independent entity attached to the Ministry of Finance which is wholly-owned by the Republic in accordance with, and to operate in conformity with, Article 7 of Law Number 30 for the purpose of participating in the issuances of sukuk to the extent authorized by the Finance Act for the current year.
- The issuance of sovereign sukuk by the government of Tunisia will create a benchmark and activate a serious plan for the further development of a sukuk capital market in Tunisia and the further development by the regulators of a standard approach for sukuk issuance which will enable the environment for Islamic finance in the country.

*In the maghreb, Morocco will give Tunisia a run for its sukuk money; the kingdom has huge infrastructure projects that require financing.*



## Morocco paving the way for sukuk

By Redha Al Ansari

Sukuk Analyst –Islamic Finance- Thomson Reuters

Morocco's Islamic finance sector is relatively underdeveloped compared to their neighbours' in North Africa. The country is finalizing a law that will permit the sovereign, and corporate bodies to issue sukuk. The current securitization law was enacted in 2002 and was later amended in 2010 to widen the range of eligible assets and to permit institutions other than banks to use securitization. At the end of 2012, the government passed another amendment to the law to pave the way for sukuk issuance. The country has shown greater interest in Islamic finance following the election of the moderate Islamist Justice and Development party that came into power in 2011 post-Arab Spring protests.

The new 2012 amendment to the sukuk law allows issuers to target both domestic and international investors. It also allows the government to use any government or government related entities' tangible assets to back any sovereign sukuk issuances. Other than the government, other eligible issuers are corporate and public institutions with minimum capital of MAD 5 million (approx US\$ 600,000) and who have been in operation for a minimum of three years.

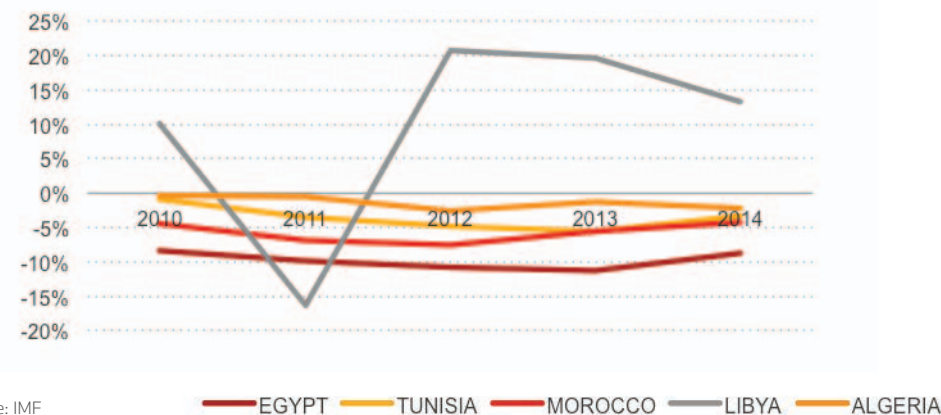
### 2013 DEVELOPMENTS

#### Sovereign

In June 2013, the Islamic Development Bank (IDB) announced that it would support Morocco by buying its first sovereign sukuk, rather than offering the country more financing. There are two merits to this support. First, Morocco will issue its first sukuk with more confidence knowing there is a large institutional investor, and raise funds in a sharia-compliant manner.

#### Corporates

The appetite for issuing sukuk on the corporate level is strong. A survey conducted by the Moroccan financial market authority (CDVM) in 2012 revealed that 9 out of 10 institutions would be interested to issue sukuk if the law permitted it.



Source: IMF

### Financials

In Aug 2013, three banks - Attijariwafa Bank, Banque Centrale Populaire (BCP) and BMCE Bank indicated their intentions to issue foreign-currency bonds this year to boost their liquidity levels. The banks are more likely to issue conventional bonds instead of sukuk, given that the sukuk law has not been finalized. One of the reasons for these banks to bolster liquidity is the expansion of their operations in Africa. Expansion is in line with government vision for Morocco's financial institutions to expand into Africa in order to develop the country into a regional financial hub.

### State of Morocco's public purse

Morocco's fiscal account position is slightly better than Egypt's. When the government of Egypt announced its intention to issue sovereign sukuk, it had a clear purpose of how to use the proceeds - to fund the high fiscal deficit account which was estimated to be 11.3% of the country's gross domestic product (GDP) as of 2013. Morocco, on the other hand, while potentially using sukuk proceeds to plug its 5.5% budget deficit, is keener to boost its liquidity as well as establish a benchmark for corporate and quasi-sovereign entities to raise funds through sukuk. Additionally, a sovereign issue would help the country develop its domestic Islamic finance sector, one of the key items on the new government's agenda.

### Local investor base

The Northern African country can also rely on the local investor base. The amount of assets under management by Moroccan mutual funds reached US\$28 billion in 2012, making up more than 25% of the country's GDP. Interestingly, in the midst of the Arab Spring, as MENA markets fell into a downward spiral, Moroccan funds achieved the highest performance figures on a regional level and delivered very competitive returns on sharia-compliant funds on a global level.

### Financing the real economy

While Morocco's plans for the country's Islamic finance sector appear to be clearly defined, the government must take concrete steps to promote sound economic policies. The country has the ingredients to grow sukuk given the increased investor base demanding quality sharia-compliant assets with attractive yields. Sukuk by its nature remains more secure than conventional bonds, hence providing increased investor confidence. In addition, the cost of issuing sukuk in Morocco will gradually become cheaper compared to bonds in relation to documentation and structuring as sukuk structures are becoming more standardized.

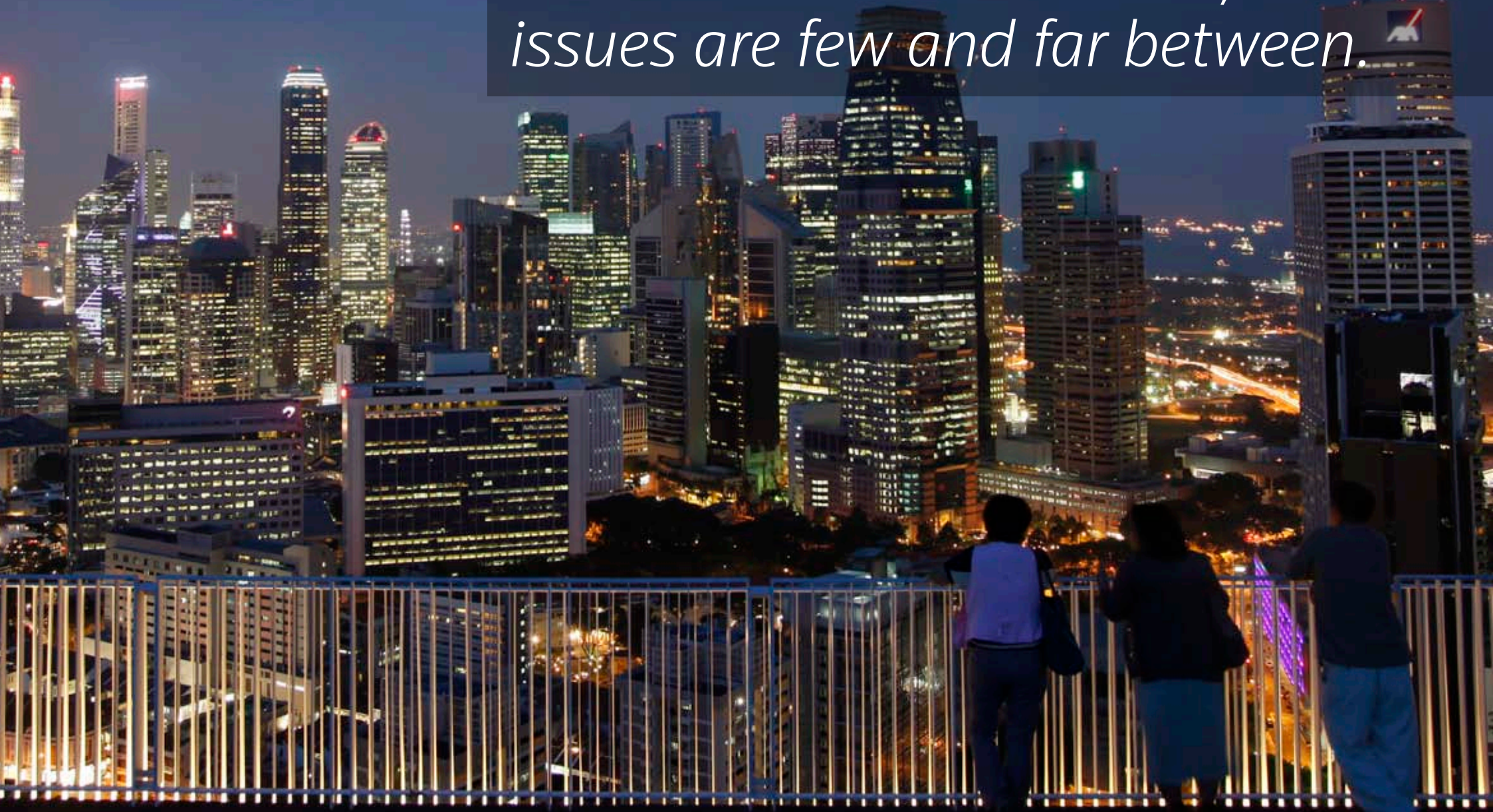
One area of sukuk which has remained largely untapped is project sukuk which Morocco could capitalize on with its infrastructure projects. In the MENA region especially, there have been a couple of sukuk issuances to finance projects: the General Authority of Civil Aviation (GACA) in 2012 and Saudi Aramco Total Refining and Petrochemical Co (SATORP) in 2011. Interestingly, SATORP sukuk carried a tenor of 14 years which is not typical for most sukuk issuances which are normally between five to seven years. Still, the paper was over-subscribed 3.5 times. This indicates growing investor confidence in longer-tenor project sukuk.

However, project sukuk normally use the istisna structure followed by ijara once the project is completed. If the Moroccan government decides to adopt AAOIFI standards to regulate its sukuk market, the tradability of istisna and ijara structures become limited on the secondary markets as AAOIFI standards require 51% completion of the project to be tradable. Therefore, investors will need to hold on to their investment until it becomes tradable.

There are also a few good reasons why Morocco can develop its Islamic capital market faster than neighbouring countries. The government is supportive in terms of initiating the establishment of a robust capital market environment. In addition, headwinds from the EU, whose members account for some of Morocco's strongest trading partners, will allow the country to diversify its investor base by attracting Middle Eastern countries, especially GCC countries who are simultaneously seeking to geographically diversify their investments. Morocco also enjoys a stable political environment as well as an investment grade rating of BBB/BBB/Ba1 from Standard & Poor's, Fitch and Moody's respectively, which is the second highest grade in the continent after South Africa. Morocco's investment environment is more favourable than Sudan's and Gambia's, the only African countries that regularly issue sukuk. Both countries remain unrated.

Country	Sector	Structure	Size
<b>Pipeline</b>			
Australia – SGI – Mitabu	Solar energy	Ijara (first 20 years) then Musharaka	A\$ 550 million
Malaysia – Syarikat Prasarana Negara Bhd	Transportation & Railways	Possibly Istisna	RM 1 billion
<b>Issued</b>			
Saudi – GACA (October 2013)	Airport	Murabaha	SAR 15 billion
Saudi – Aramco (SATORP) (October 2011)	Greenfield	Istisna Ijara – Forward Lease	US\$ 1 billion

*Outside the OIC countries, sukuk issues are few and far between.*



## Heading east in search of capital: Sukuk issues outside the OIC

By Blake Goud

Community Leader – Thomson Reuters Islamic Finance Gateway

As oil prices rose during the first decade of the 21st century and Islamic finance became more prevalent, there was significant importance attached to the flows of money to the oil producing countries in the Arabian Gulf region. The attention for most of the 2000s focused on ways in which some of these funds could be attracted back in the form of investments in sukuk issued by Western sovereigns and corporates.

With relatively few exceptions, the results have been disappointing for investment banks seeking to arrange these offerings, although the few that have occurred have met with strong investor demand. The continued interest of Western corporates and sovereigns to tap a new investor base has met with several problems, whether technical (structuring or tax and regulatory issues) or political (with anything related to Islam or the Arab world attracting undue political attention from some segments). In the future it may not end up being Western issuers that fill the gap, but issuers from the emerging markets outside of the OIC.

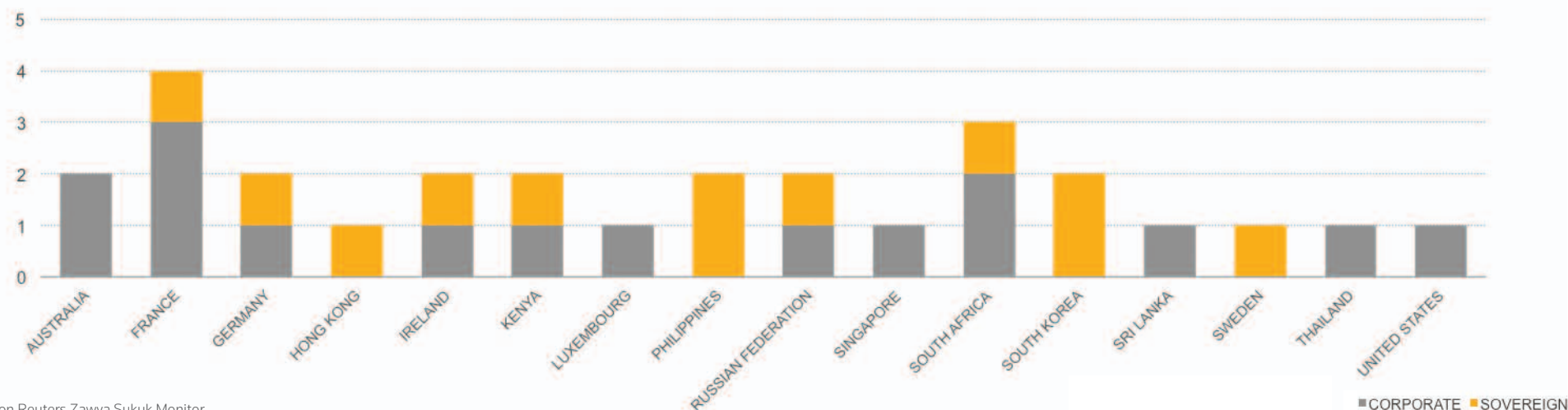
### Notable Sukuk Issued, Announced and Rumored as of September 4, 2013

Issued	Originator	Structure	Country	Currency	Year	Size (\$M)	Coupon	Tenor
	Monetary Authority of Singapore Sukuk	Ijara	Singapore	SGD	2009	157.41	n/a	n/a
	GE Capital Sukuk	Ijara	United States	USD	2009	500	3.88%	5 Years
	World Bank Hilal Sukuk	Ijara	United States	USD	2009	100	3.04%	5 Years
	Nomura Holdings Sukuk	Ijara	Japan	USD	2010	100	Floating	2 Years
	Swiber Capital Sukuk(Tranche 1)	Al-Wakala Bel-Istithmar	Singapore	SGD	2013	118.66	6.50%	5 Years
	IILM Short Term Sukuk	Wakala	Malaysia	USD	2013	490	Floating	3 Months
Announced								
	SGL - Matibu Sukuk	Istisna	Australia	MYR		149.27	n/a	7 Years
	Societe Generale Sukuk	Unknown	France	MYR		304.28	n/a	15 Years
	South Africa Sovereign Sukuk	Ijara	South Africa	USD		500 - 700	n/a	5 Years
	Islamic Bank of Thailand Sukuk	Unknown	Thailand	THB		159.97	n/a	5 Years
Rumoured								
	Airport Authority Hong Kong Sukuk	Ijara	Hong Kong	-		-	n/a	-
	Kenya Sovereign Sukuk	Unknown	Kenya	-		500	n/a	-

Source: Zawya Sukuk Monitor. All data as of September 4, 2013



## Announced & Rumoured Sukuk 2013/14



Source: Thomson Reuters Zawya Sukuk Monitor

However, that does not mean that sukuk have been closed to investors or issuers outside of the OIC region. There have been notable sukuk issued by the International Finance Corporation, the private sector arm of the World Bank, as well as GE Capital. Other global issuers have included Japanese bank Nomura, and the European insurance and takaful firm FWU Group. The list is even longer when considering the possible issuers—those who are rumoured to be considering sukuk or those who have announced sukuk offerings but not yet issued them. (Editor's note: Since the writing of this article, the UK government announced on October 29, 2013 plans for a debut £200 million sovereign sukuk slated for sale in 2014.)

### Sukuk issues ex-OIC: OECD financial centres

Any analysis of the sukuk market for issuers from outside of the OIC region has to consider many other factors besides just the total to-date issuance volume to determine the likelihood for future issuance and the promise in the sukuk markets for companies from various countries. To start with, look at the pattern of issuance by country and volume which shows how small the ex-OIC sukuk issuance is, as well as how concentrated it is in issuers from a few countries.

The countries where issuance is the largest are Singapore, the United Kingdom and the United States, all countries that represent sizeable OECD financial centres. Other OECD countries with financial centres are also included: China (Hong Kong), France, Germany, Japan, Luxembourg and Switzerland. Absent from the list is only Ireland (Dublin), Australia (Sydney) and Canada (Toronto).

Table 2: Sukuk issued by companies based outside the OIC

	2004-2009	2009	2010	2011	2012	2013	Total
China	-	-	-	183.2	-	91.6	274.7
France	-	-	-	-	0.7	-	0.7
Germany	133.5	-	-	-	55.0	-	188.5
Luxembourg	-	-	-	-	-	490.0	490.0
Japan	-	-	100.0	-	-	-	100.0
Singapore	122.1	275.5	39.4	-	368.2	301.8	1106.9
Switzerland	200.0	-	-	-	-	-	200.0
United Kingdom	249.5	-	10.0	500.0	163.4	-	922.8
United States	165.7	600.0	122.1	499.3	195.1	-	1582.1
<b>Total</b>	<b>870.8</b>	<b>875.5</b>	<b>271.4</b>	<b>1182.4</b>	<b>782.3</b>	<b>883.4</b>	

Note: Includes sukuk issued by OCBC's Malaysia subsidiary under Singapore, Esso Malaysia short-term sukuk under United States, HSBC ME and HSBC Amanah under United Kingdom, and Nestle's Malaysia subsidiary under Switzerland. Source: Thomson Reuters Zawya Sukuk Monitor and IFG analysis

Ireland is represented in the future issuers and has also attracted much interest as a country to domicile funds to access the European market and the Irish Stock Exchange is rising in popularity as a place to list sukuk. The lack of activity from Canada and Australia is surprising given the large role that commodity extraction and export plays in their economies, an overlap that would be expected to generate interest from investors familiar with the business models of the likely issuers.

As noted in Table 2 the data for Switzerland, the UK and the US includes sukuk issued by their regional subsidiaries in Malaysia (Switzerland and the US) and the GCC (UK) which depending on the degree of local control could be excluded from this table which would significantly reduce the total issuance volume by these countries (by \$200m for Switzerland, \$652.6 million for the UK and \$816.4 million for the US). With these excluded, the total ex-OIC sukuk issuance volume tumbles by nearly half, although the list of countries remains largely static.

The historical picture of sukuk issuance outside of OIC countries is largely OECD concentrated and focused on countries where the financial system is well developed. The future may not necessarily follow the same trajectory, and even within OECD countries, the representation is shifting away from the UK and US (who have a combined 1 sukuk announced or rumoured) and towards Germany and France, which account for 6 (more than 20% of the total) and are joined by Ireland and Australia, which have yet to see a sukuk issuer, but have a combined 4 in the pipeline including potentially an Irish sovereign sukuk. ((Editor's note: This article was written before the UK government announced on October 29, 2013 plans for a debut £200 million sovereign sukuk slated for sale in 2014, which will take announced or rumoured UK and US sukuk to 2 as of Oct 31, 2013.)

### Sukuk and non-OECD countries

These OECD countries are joined by a diverse number of emerging Islamic finance markets like Kenya, the Philippines, Russia, South Africa, Sri Lanka and Thailand. Some of these countries are familiar to the pipeline even if they have never seen a sukuk issuance like Russia, South Africa and Kenya. Others are newer entrants whose Islamic finance industries are frequently overlooked due to their small size.

Some potential issuing countries in Sub-Saharan Africa could be considered promising on the basis of their governments having recently tapped international bond markets (e.g. Kenya, Nigeria or Rwanda). In these countries, the appetite for switching to sukuk would likely depend on whether sukuk offers a cheaper financing alternative.

For Nigeria, the local currency denominated sukuk from Osun State, issued in early October 2013, may provide a path for other issuers, although a sovereign sukuk remains unlikely unless conditions change dramatically. One driver of that type of dramatic change would be the Federal Reserve in the US normalizing policy within the context of stronger global growth. As a result, the bond markets may become more expensive relative to sukuk where sukuk can see a lower elasticity in yield relative to benchmark interest rates due to the supply shortage, provided investors show an openness to new regional exposures.

From the list of potential issuers that are in the pipeline already, there are a few like South Korea's sovereign and the Tatarstan's (Russia) regional sukuk which have been in the pipeline for many years without ever being issued. Others like the Goldman Sachs sukuk were proposed in 2011 and put on indefinite hold following a controversy about the sharia-compliance of the structure used (it used a commodity murabaha). In addition to the sukuk officially on the rumoured/announced list, there are previous issuers like GE Capital and the IFC who have expressed interest in issuing sukuk again, as well as potential issuers like Boeing Capital, who have expressed interest in the concept but not moved forward with the process.

Furthermore, some countries where these issuers are located may make it more difficult or costly to establish a sukuk programme due to regulatory restrictions (for financial institutions in particular) or tax policies that would lead to high tax costs compared to conventional bond issuance as a result of asset transfer taxes (e.g. stamp duties) that have not been removed or waived for sukuk issuers to put Islamic and conventional finance on equal footing.

### More non-OIC issues likely but will remain choppy

In contrast to the OIC countries—particularly in the GCC and Malaysia—the development of sukuk is proving to be a longer process than many anticipated in recent years. That is likely to continue into the future as issuers probe for more information on sukuk structures, and watch the reaction of sukuk primary markets to rising interest rates.

Provided that the sukuk markets avoid asymmetric shocks like highly publicized questions about sharia-compliance and the cost of issuance remains similar to or below the cost of conventional issuance, we are likely to see sukuk issued by non-OIC sovereigns and corporates although issuance is likely to remain choppy unless there is a catalyst that either makes sukuk issuance significantly cheaper than conventional bonds, or we see shifts in the market that deter investors from exploring sukuk markets.



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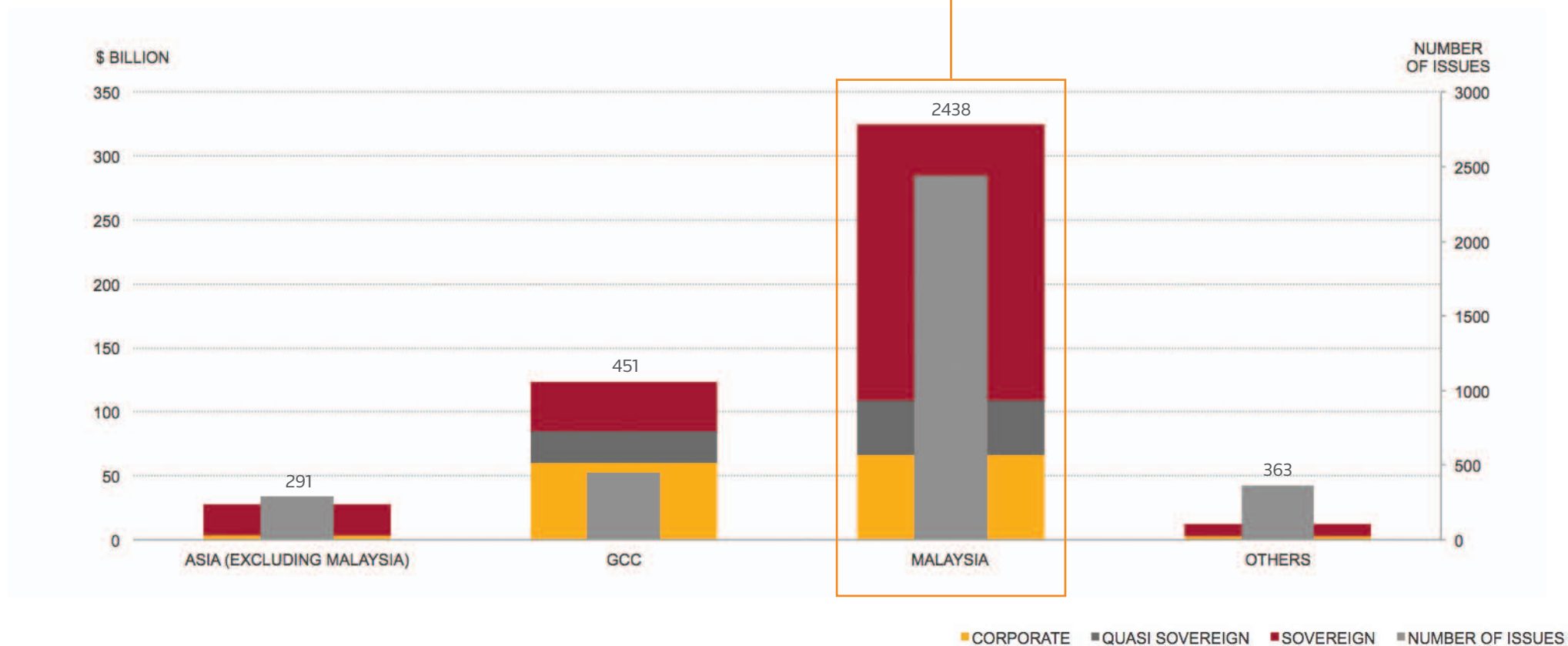
*Markets are increasingly looking to sukuk as an alternative financing solution; sukuk is slowly gaining more ground.*

## Growing Opportunities

*Mid ground markets are competing with sukuk land to benefit from wider investor base*

Malaysia and the GCC are the two traditional sukuk powerhouses. Malaysia is home to 69% of the total number of sukuk issued from 1996 to Q3 2013; this adds up to 2,438 (over \$325 billion) international and domestic Islamic papers issued. GCC total issuance accounts for 12.7% of global aggregate sukuk with 451 sukuk issued (over \$123 billion). In the last three to five years new entrants such as Pakistan, Indonesia and Turkey have slowly made their presence felt in the global sukuk market. There are many other countries that are not regular sukuk issuers; there have been a handful of corporate sukuk issuance out of the UK, France and Germany, for example, and on October 29, 2013 the UK government announced plans for a debut £200 million sovereign sukuk targeted for 2014 issue. (For a discussion on sukuk issues ex-OIC countries please refer to Blake Goud’s article in the preceding section.)

GLOBAL AGGREGATE SUKUK BREAKDOWN BY REGION (Jan 96 - Sep 13)

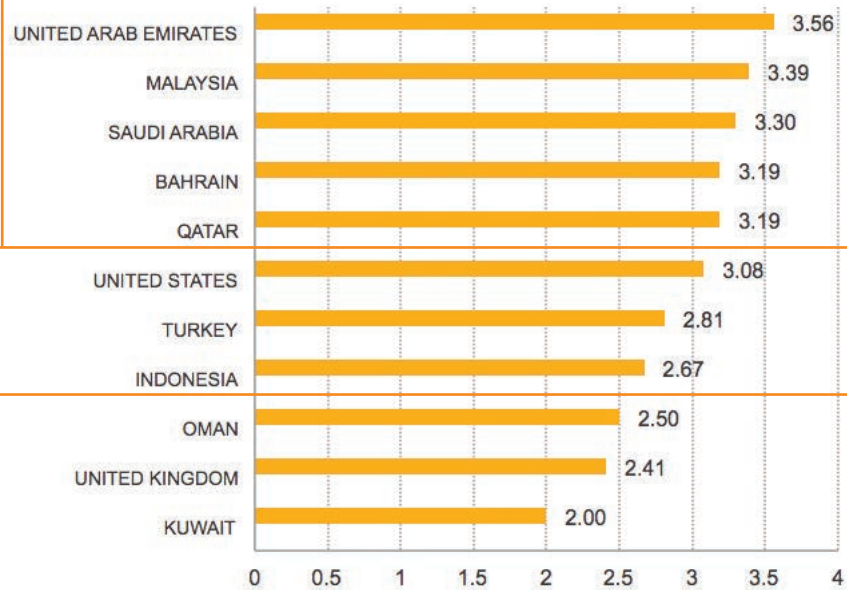


UAE, Malaysia and Saudi Arabia are the top sukuk investment locations for 2013 and 2014.

There is a growing appetite towards the United States from investors and traders who may be looking to diversify their risk into developed economies (the UK also figures in this mix). Investors show a preference for existing markets that are witnessing sharp sukuk growth such as Turkey and Indonesia.

	Respondants	Skipped
BUY SIDE	61	59

**BUY SIDE:** Out of the following group of locations, please rank the top 5 you would prefer for sukuk investments for the rest of 2013 and 2014.

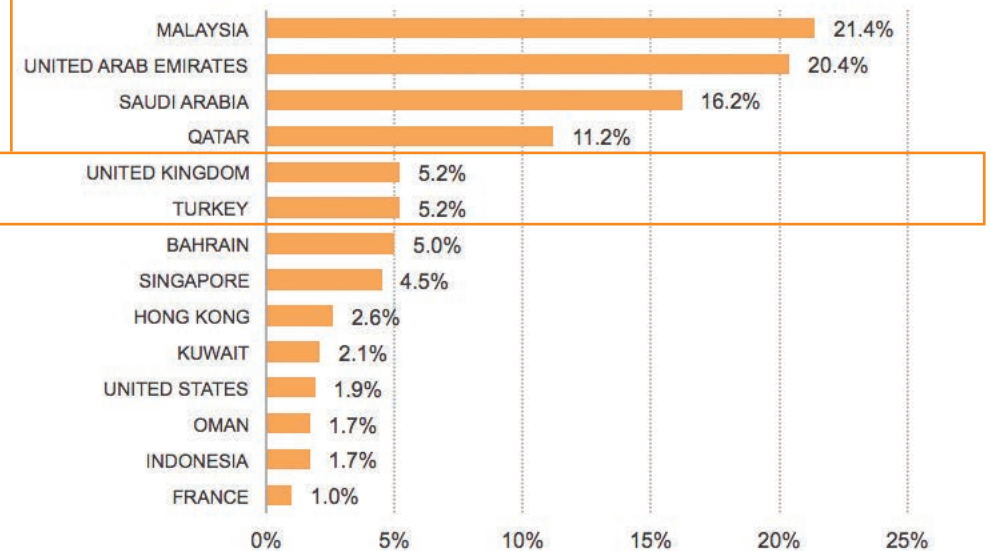


Lead arrangers put Malaysia as the top location they expect for sukuk issuance followed by UAE, Saudi Arabia Qatar, UK, Turkey and Bahrain.

The Sell side is also looking to Turkey to benefit from the high demand and wider investor base. UK comes into the top five; this forward sentiment could be based on recent high-profile initiatives by the UK government to push Islamic finance in the country, including the Islamic Finance Task Force formed in March 2013. (Note: the survey was conducted before the UK government announced its sovereign sukuk plans on October 29, 2013.)

	Respondants	Skipped
SELL SIDE	29	6

**SELL SIDE:** Out of the following group of locations, please rank the top 5 you would prefer for sukuk issuance for the rest of 2013 and 2014.



■ SELL SIDE - Expectation



*The Turkey sukuk pot is filling up,  
with increased government support.*

## Turkey Sukuk Development Overview

By Jarmo T. Kotilaine

Chief Economist, Bahrain Economic Development Board

Turkey is widely recognized as one of the most promising markets for sukuk, a development that reflects both the desire of the authorities to diversify the financial sector as well as the growing importance of the country's sharia-compliant participation banks. Given the size of the economy and its recent track record of economic stability and resilience, the growth potential for sukuk – known locally as lease certificates – is considerable and increasingly viewed as one of the more exciting opportunities in the area of Islamic finance globally.

Turkey's population is almost entirely Muslim and there remains considerable untapped demand for sharia-compliant products even if the banking sector is competitive and traditionally dominated by conventional banks. Both official and popular attitudes toward Islamic finance have changed in a favourable direction after a long tradition of staunch secularism since the establishment of the republic. The sector has further benefited from a growing search for alternatives in response to the global economic crisis, a move that has generally benefited Islamic finance globally. Moreover, Turkey's increasingly important economic ties with the Middle East have stimulated Islamic finance, not least because many Gulf Cooperation Council (GCC) investors favour the asset class while Turkey's need for inward investment remains considerable in the face of rapid population growth. The progress of the sector has benefited from a growing number of regulatory initiatives as well as product innovation. For instance, the Istanbul Stock Exchange in January 2011 launched the first participation index for equities deemed sharia-compliant.



JARMO KOTILAINE

Chief Economist, Bahrain Economic Development Board

Jarmo Kotilaine joined the Bahrain Economic Development Board as Chief Economist in September 2012. He previously served as Chief Economist for Saudi Arabia's National Commercial Bank (NCB) from 2010, and Chief Economist of NCB Capital, the investment arm of the NCB Group, from 2008. Dr Kotilaine previously worked for a number of years as an economic and financial consultant with a primary focus on emerging markets. He advised the Spanish stock exchange, Bolsas y Mercados Españoles (BME), headed the financial services consultancy of Oxford Analytica, a global strategic consultancy firm, and subsequently of Control Risks Group (CRG), a London-based international business risk consultancy. During this time, Dr Kotilaine's main clientele consisted of banks, stock exchanges and financial regulators, some of which he has continued to serve as an external advisor.

Dr Kotilaine studied economics and economic history at Oxford, Cambridge, and Harvard. He subsequently joined the faculty at Harvard where his primary research focus was the long-term economic and institutional development of Eurasia as well as on international trade and finance.

### Sukuk to meet needs of growing participation banking sector

The initial development of Turkish sukuk has been closely linked to the growth of the country's participation banks. The sector began to emerge in the second half of the 1980s thanks to the arrival of Islamic institutions from the GCC. These were followed by a handful of local institutions in the 1990s. However, the formal regulatory basis for the growth of the sector only took shape with the Banking Law of 2005. Since then, the growth of the sector has far outpaced conventional banks with an annual growth rate of 33.5% between 2005 and 2012, in contrast with an overall rate of 20.5% for the banking sector as a whole. Participation banks nonetheless still only account for 5.1% of total banking sector assets as at the end of 2012.

Sukuk hold considerable potential for Turkish participation banks for a number of reasons. These lenders have historically depended on retail deposits and syndicated short-term murabaha loan facilities for their funding. This narrow funding base has created challenges in terms of mismatches between assets and liabilities as well as in terms of cost – especially the cost of murabaha facilities. The growth of the banks' asset portfolios has made sukuk issuance an increasingly realistic prospect of late. This opportunity, importantly, offers longer maturities and lower costs.

### Sukuk to boost CAR and fund international expansion

But sukuk issuance also holds appeal because of regulatory pressures. Turkish participation banks have historically had lower capital adequacy ratios (CAR) than their conventional counterparts – however their CAR remains well above the set statutory minimum of 8%. In November 2012, for example, the averages for the two groups were 13.68% for participation banks and a higher 17.39% for conventional banks. Importantly, subordinated sukuk can be counted toward Tier 2 capital in Turkey. For instance, Bank Asya's March 2013 sukuk raised the CAR for the bank from 13% to 16%. This is likely to remain an important driver of sukuk issuance by banks in the near term, not least because Basel III standards will begin to be phased in this year, prompting banks to increase their capital adequacy ratios.



Sukuk issuance should also benefit from the growth ambitions of the Turkish participation banks. Bank Asya is building a presence in Africa and apparently has ambitions for India. Kuveyt Türk is planning to increase its capital by TRY960million to TRY2.06billion and establish an international presence through branches in Iraq and Qatar. It is also applying for a license in Germany. There is a plan to add another TRY360million over the next year and a half. A number of banks are working on expanding their product range.

Beyond this, the number of participation banks is set to grow. Deputy Prime Minister Ali Babacan said in March 2013 that the government would grant participation banking licenses to state-owned lenders. Overall, assets of Turkish participation banks are expected to triple over the coming decade to \$100bn in 2023, according to an Ernst & Young estimate.

### National needs

The Turkish authorities have also recognized the need for sukuk issuance. A number of factors account for this interest. As reflected by the support shown by the authorities for the country's participation banks, there is a strong will to develop financial services through the diversification of both providers and products. Turkey's 2007-2013 economic development plan highlighted the need to develop asset-based and interest-free financial instruments as an effort to boost the financial sector in the country.

Sovereign sukuk issuance is critical in terms of creating a benchmark for corporate issuance. Turkish authorities are committed to developing the national bond and sukuk markets so as to more effectively channel capital into economic development. In countries such as Bahrain where there has been a long-term commitment to regular short-term sovereign sukuk issuance alongside longer-dated paper, corporate issuances have seen to benefit as a result.

But Turkey is nonetheless also a capital importer and faces substantial funding needs for its ambitious infrastructure investments and growing population.

Sukuk offer a way of appealing especially to GCC investors who already have a presence in Turkey through their investments in the participation banking sector. The role of Middle Eastern investors has increased due to the endemic difficulties faced by the traditionally important partner countries in the West. The current Turkish government has for years worked on systematically developing the country's relations with the Middle East and there appears to be considerable untapped growth potential in the areas of investment and trade alike in spite of impressive growth of late. Turkish trade with the GCC rose by an estimated 60% last year to \$22 billion. More than a third of Turkish exports are already going to the Middle East and North African region which historically was of fairly marginal significance for Turkish trade.

### Creating the regulatory framework

The growth of sukuk in Turkey was held back for a long time by the absence of a comprehensive

regulatory framework and significant cost disadvantages created by this. The situation has begun to improve significantly in recent years.

The regulatory basis for sukuk issuance was created by the Capital Markets Board of Turkey's (CMB) Sukuk Communiqué on the principles of ijara certificates and asset leasing companies which came into effect in April 2010. The necessary supporting framework was created by the enactment of Law No 6111 (known as "Tax Amnesty Law") in February 2011. This regulation exempts sukuk-related transactions from value added tax, stamp duties, corporate tax, title deed registration fees, and notary public fees. The withholding tax on sukuk was reduced to 10%. Further measures exempted sukuk with tenors in excess of five years from taxes on revenue.

In spite of the significant progress seen in recent years, there are expectations of further significant steps. While the Turkish government currently exempts sukuk al-ijara from double taxation, this is not typically the case with other structures, which is limiting the growth of the market. Similarly, the application of revenue taxes of 3% to 10% to short-term sukuk remains a constraint on the growth of that market segment. Under current regulations, special purpose vehicles (SPVs) cannot issue a second sukuk before the redemption of the sukuk in circulation.

The CMB has completed the regulatory framework for new types of sharia-compliant instruments – this came into force on June 7, 2013. These should allow for the issuance of *istisna'*, *murabaha*, *mudaraba*, *musharaka*, and *wakala* sukuk. The constraints applied to SPVs are also expected to be relaxed.

### Pioneering initiatives

Sukuk issuance in Turkey began with a \$100 million 3-year offering by Kuveyt Türk participation bank in August 2010 which was arranged by Citigroup and Liquidity Management House. The issue was a success as demand exceeded supply by one and a half times. Kuveyt Türk returned to the market a year later, in October 2011, with a \$350 million 5-year sukuk. Highlighting the strong investor appetite for the asset class, the sukuk was priced at 5.875%, which was more competitive than that for bonds issued by leading Turkish conventional banks. In recent years, sukuk, especially in the Middle East, have tended to benefit from lower risk perceptions as the industry has matured and yields have increasingly tended to be below conventional issuance, partly in reflection of significant pent-up demand. The Kuveyt Türk issues are listed on the London Stock Exchange.

The Turkish Treasury pioneered sovereign sukuk issuance with a landmark offering in September 2012. The US\$1.5 billion offering was almost five times oversubscribed with bids worth \$7.5 billion in reflection of strong investor interest in the Turkish growth story. The sukuk was rated BB by Standard & Poor's. Approximately 58% of the offering was taken up by Middle Eastern investors while 13% went to Europe, and 12% to Asia. 9% was taken up by Turkish investors and 8% was sold to the United States.

The government announced its intention to use sovereign issuances as a way of creating a benchmark. The government returned to the market in October 2012 with its maiden Lira-denominated sukuk. The TRY1.6 billion issue attracted orders of just under TRY3.3 billion. A February 2013 TRY1.52 billion offering attracted bids worth TRY1.72 billion. Lira-denominated issuance has to date totaled TRY4.96 billion.

Although a number of planned issues by Turkish participation banks were cancelled or put on hold in recent years, the situation began to change dramatically this year with two offerings by Bank Asya and one each by AlBaraka and Türkiye Finans. Bank Asya placed a pioneering one-year Lira issue worth TRY 125 million in February. The banks returned a month later with a ten-year US Dollar offering. The \$250 million sukuk was priced at 7.5%. 52% of the investors were from Europe, 35% from the Middle East, and 13% from Asia.

Türkiye Finans placed a highly successful five-year offering worth \$500 million in April. This was the second largest sukuk issue in the country to date and attracted orders of just under \$2 billion in spite of very competitive pricing – yield of 3.95%. Fitch rated the issue BBB. 51% of the offering was taken up by Middle Eastern investors, 17% by Europeans, 17% by Asians, and 15% by UK buyers. Türkiye Finans is planning a further TRY 100 million issue this year.

AlBaraka Türk came to the market with its delayed \$200 million 10-year sukuk in late April 2013. The offering had a profit rate of 7.75%. 56% of the issue was sold to the Middle East, 26% to Europe, 10% to the UK, and 5% to Asia.

### A favourable outlook

Not surprisingly in view of the recent market momentum, the outlook for sukuk issuance in Turkey is deemed very favorable. In May 2013, HSBC estimated that Turkish sukuk issuance might double this year to \$3 billion. The Treasury has announced plans to issue Lira-denominated sukuk twice a year. Similarly, a number of Turkish companies are understood to be interested in sukuk issuance, especially in the domestic context. In many cases, the lack of credit ratings is a limitation for international issuance.

A number of sukuk applications are currently pending with the Capital Markets Board. The CMB has approved an Aktif Bank sukuk with a nominal value of up to TRY 200 million. The Yüksel İnşaat construction group has applied for an ijara sukuk worth approximately TRY 35 million.

Both Kuveyt Türk and Türkiye Finans intend to tap the market through Lira-denominated sukuk this year. Both offerings are expected to total approximately TRY 100 million. The CMB has approved a TRY 100 million issue by Türkiye Finans which is expected after June 2013.

While sukuk issuance continues to be potentially complicated due to Turkey's recent track record of volatile inflation, price pressures look likely to diminish. At the same time, the appetite for Turkish paper is growing. Many GCC investors see Turkey as an opportunity to achieve higher returns than those available in their home markets where the US Dollar peg has kept the interest rate environment at record low levels. Domestically, the increasingly important Turkish pension funds are likely to be interested in sukuk issues.

This article was written in early September 2013, and was first published in Thomson Reuters Zawya "Turkey Islamic Finance Report 2014: Fundamentals and the Promise of Growth", available for download from <http://www.zawya.com/middle-east/landinglead/turkey/>

**Table 1: Turkish sukuk issued as at end August 2013**

Sukuk name	Kuveyt Türk Katılım Bankası	Kuveyt Türk Katılım Bankası	Turkey sovereign sukuk	Turkey sovereign sukuk	Bank Asya Katılım Bankası	Bank Asya Katılım Bankası	Türkiye Finans Katılım Bankası	Albaraka Türk Katılım Bankası	Turkey sovereign sukuk
Structure	wakala	İjara-wakala	İjara	İjara	İjara	murabaha	murabaha	murabaha	İjara
Currency	USD	USD	USD	TRY	TRY	USD	USD	USD	TRY
Tenor (years)	3	5	5.5	2	1	10	5	10	2
Closing date	24 Aug 2010	30 Oct 2011	17 Sept 2012	20 Feb 2013	26 Feb 2013	21 Mar 2013	24 Apr 2013	30 Apr 2013	21 Aug 2013
Issue size	\$100mn	\$350mn	\$1.5bn	TRY1,520mn	TRY125mn	\$250mn	\$500mn	\$200mn	TRY1,82mn
Issuer name	KT SPV	KT SPV	Treasury SPV	Republic of Turkey	Asya SPV	Asya SPV	TF SPV	ABT Sukuk	Republic of Turkey

## Analysis: Turkish Sukuk Law

By Nida Raza

Director, Islamic Financial Services, Ernst & Young

Sukuk regulations and legislation in Turkey have only very recently been developed, and the first ever sukuk in Turkey was issued in 2010 by Kuveyt Turk Participation Bank. This issuance came after the Capital Markets Board of Turkey (CMB) issued a Communiqué in April 2010 to allow “Lease Certificates” to be issued. At the time the only allowance was for the ijara (onshore) and the murabaha (international) structures. This only allowed those corporations with tangible assets to issue sukuk which would also be tradeable according to the sharia ruling of a majority of scholars around the world.

### 2010 and 2011 legislation facilitating ijara sukuk

All sukuk issuances in Turkey must be set up by special purpose vehicles (SPVs), known in Turkey as “Asset Leasing Company” (ALC). ALCs are established by the originator of the assets which would be used for the sukuk transaction. The ALC comes under the purview of the Capital Markets Board of Turkey (CMB) for regulatory and supervisory purposes. As Turkey has tax implications for sale of assets the Tax Amnesty Law of 2011 provided a waiver of sales tax and stamp duty on transfer of assets between the Originator and the ALC if the transaction was effected for the purposes of issuing Lease Certificates. The CMB also provides a graduated withholding tax bracket (7-10%) for the distribution to be made from the ALC based on the maturity of the transaction. The withholding tax is exempted for longer-term tenors of at least 5 years.

### Latest 2013 regulations allowing other sukuk structures

The CMB released a new Communiqué known as “Communiqué on Lease Certificates (III-61.1) on June 7, 2013. This new regulation allows for Lease Certificates to be based on ownership (ijara), management agreement (mudaraba), purchase and sale (murabaha), partnership (musharaka) and construction contract (istisna’). This has paved the way for all corporations in Turkey to be able to issue Lease Certificates even if they do not have tangible assets for structuring purposes.



**NIDA RAZA**

Director, Islamic Financial Services, Ernst & Young – Bahrain

Nida is a Director at the Islamic Finance Center of Excellence at Ernst & Young and is based in Bahrain. She has 13 years of professional experience, Nida brings global investment banking experience having worked in the UK, USA and Middle East for international investment banks. Her expertise lie in fixed income products both Islamic and conventional. During her career she has led and successfully completed over 75 transactions raising \$100bn+ of fixed income capital for her clients. Nida holds a first class BSc(Hons) in Physics & Space Science from UCL, and has obtained an MSc in International Securities Investment & Banking from ICMA Center in the UK.

### Risks following change in regulations for ALCs

In order to protect investor interests and manage the regulations of ALCs, the June 7, 2013 Communiqué further noted conditions on the establishment and ownership of ALCs.

It was no longer sufficient for the Originator to set up and own the ALC, it is now a requirement to be a regulated financial institution (e.g. banks, brokerages, security agent), an exchange traded real property trust, a corporation that has obtained a local investment grade rating in Turkey or a company that is at least 51% owned by the Undersecretariat of Turkey.

This now means that most private and public non-financial institutions will have to “rent” ALCs from those that are able to establish their own or who already have an existing ALC. It must be noted that the law clearly states that it is the responsibility of the ALC and its Board to ensure that all profit distribution and principal repayment are effected in a timely manner. Since the ALC can be owned by a bank or other financial institution this can pose a headline risk if there is any issue surrounding the non-payment by the Originator of the Certificates. It is also interesting that the Certificate issuer will be the ALC whose name would be different to the underlying credit of the transaction.

Whilst the ALC setup is an attractive option from an investor viewpoint for protection of assets and in cases of default (allowing investors to oblige the trustee to execute the liquidation of assets without obtaining court approval), the concern for the financial institutions is the headline risk of non-payment throughout the life of the Certificates. One option is to contractually transfer the obligation of payment and principal to the Originator. The other option is to require the Originator to post a credit note or bank guarantee. In the case of the latter it would make the issuance of these sukuk more expensive and may deter some from issuing them altogether.

In the case where the corporation is investment grade rated, the ALC is established and owned by the Originator but it is a requirement for at least one independent Board member to be CMB-licensed. This is done to ensure that the regulations for the CMB are adhered to and to bring some continued regulatory oversight to these Originator-owned ALCs.

### Limit on maximum issuance to asset value

The 2013 Communiqué further imposes restrictions on the maximum issuance amount to asset value of 90% for ijara, musharaka and istisna' contracts. Valuation must be done pursuant to international standards and in accordance with the relevant regulations of the CMB.

We have yet to see issuance under these new regulations, especially from non-financial institutions. It will be interesting to see how these new regulations affect the pace of issuance in Turkey, which continues to attract liquidity for Islamic assets and global investor demand.

This article was written in early September 2013, and was first published in Thomson Reuters Zawya "Turkey Islamic Finance Report 2014: Fundamentals and the Promise of Growth", available for download from <http://www.zawya.com/middle-east/landinglead/turkey/>



## Towards a bigger Turkey sukuk pot: Potential Issuers

By Redha Al Ansari

Sukuk Analyst –Islamic Finance- Thomson Reuters

The Thomson Reuters Zawya sukuk pipeline reveals that a number of institutions are due to issue sukuk this year. These institutions come from across different sectors that are seeking to capitalize on the lower funding cost compared to conventional bonds.

The aviation industry is one sector (other than financial institutions) to use sukuk as a way of raising funds to finance new fleet acquisitions and expansion. Sukuk, without a doubt, are optimal for the airline and aviation sector given the excellent match between the long-term nature of the assets with a regular income stream from passenger traffic, in addition to the structure and tenor of the paper.

Historically, Emirates Airlines and Malaysia Airlines (MAS) have tapped the sukuk market to finance their aircrafts. Emirates issued the world's first airline sukuk in 2005. The 7-year paper was for US\$550 million. Since then Emirates has issued more sukuk. The airline's latest issuance came in March 2013, and amounted to \$1 billion with a 10-year maturity, carrying an average weighted

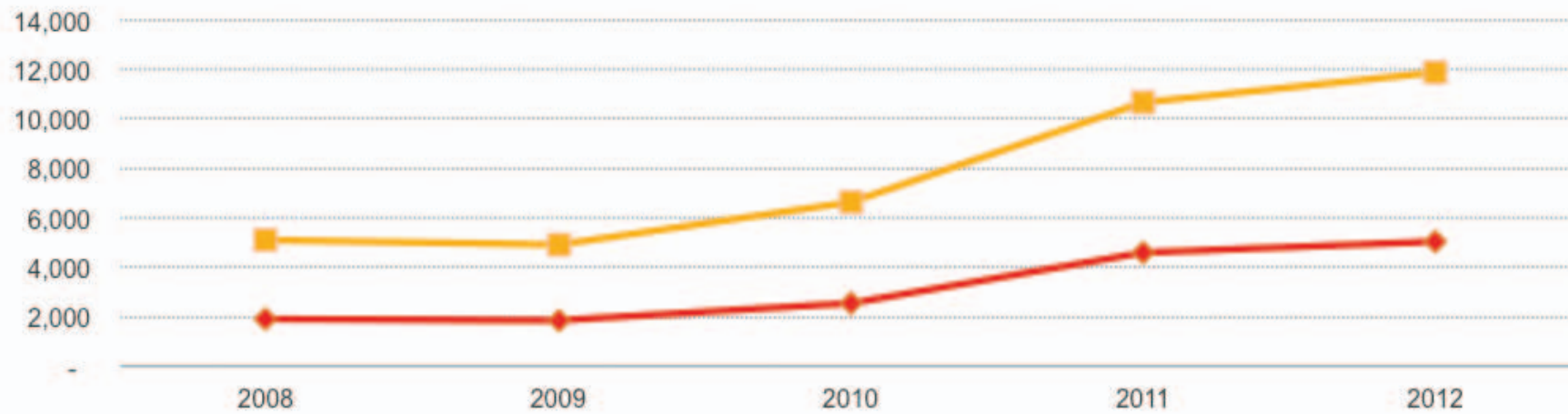
life of five years and priced tight at 300 bps over 5-year midswaps. Malaysia Airlines used the proceeds of its 20-year RM5.3 billion sukuk using the bai bithaman ajil structure, issued in late 2012, to finance its last Airbus A380 aircraft out of a total order of eight Airbus aircraft.

This paves the way for other airlines to benefit from what sukuk can offer. Turkey's national airline said in Q4 of 2012 that it was planning to use sukuk to help finance aircraft purchases. The company is considering buying at least six super jumbos, Chairman Hamdi Topcu said in an interview at an airshow in Istanbul on Sept. 6. Looking further into the deal, the airline may well consider issuing in USD to attract investors from the Gulf Corporation Council (GCC) countries.

The currency risk will be eliminated given that the majority of the GCC countries' currencies are pegged to the dollar. The optimal structure for the airlines to exploit is ijara, as it is ideal for the nature of their business. Profit distributed to investors on the sukuk is actually rent. Effectively, the issuer purchases the assets with the funds raised by investors, and the "borrower" becomes the tenant of the investors for the duration of the sukuk.

Turkish Airlines, also known as Turk Hava Yollari (THY), which is 49% owned by the government, has been unaffected by the global credit crisis in 2008 and the current recession in Europe and is increasing frequency or adding routes where other carriers are holding back.

### Turkish Airline Debt To Equity



Source: Turkish Airline Annual Report

—◆— TOTAL DEBT    —■— EQUITY

Other sectors such as construction also witnessed interest in using sukuk to raise funds. Agaoglu Group, one of Turkey’s largest construction and real estate companies, announced plans to issue a US\$2 billion sukuk program, to help with the financing of Istanbul’s international Financial Centre, according to the company’s website. The company is advised by Aktiv Bank and technical details are being finalized. The sukuk will be divided into tranches, with an initial one for \$250 million.

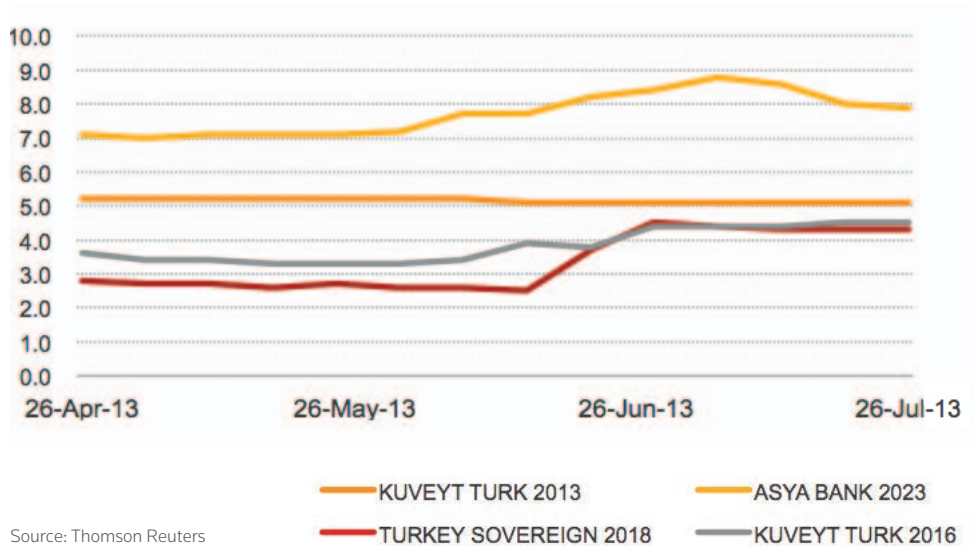
While Agaoglu Group has yet to announce the structure of the sukuk, the structures that are typically suitable for construction companies are istisna’ and forward ijara. Forward ijara is potentially a better option as it enables investors to undertake payment during the construction period, while the obligor payments will start within a specific period after completion. This could benefit the issuer till the project is completed. Although forward sales are impermissible under sharia, forward contracting through ijara is permissible provided that the rent amount will be paid only after delivery of the underlying asset.

Agaoglu Group President, Ali Agaoglu, has emphasized that the Group will seek GCC investors for the paper. “The Arabs in the Gulf countries have high interest in Turkey;” said Agaoglu. “We share the same culture, same cuisine, same entertainment culture. Most importantly we share the same religion.”

This is an opportune time for Agaoglu to issue sukuk, following its investment grade rating from Japanese credit rating agency JCR which arrived with Turkey’s sovereign investment grade. Outlook is favorable, and yields are expected to be tighter. The cost of insuring Turkey’s debt (5-year CDS) against default has been fluctuating since July 2012, ranging from 110 bps to 241bps for 5 year CDS. Turkey’s central bank increased its overnight lending rate by 75 basis points on July 23, 2013, pushing the CDS further down. The decision came after the drop in the Lira. It is anticipated that the central bank could be forced to tighten rates further with investors increasingly nervous about Turkey’s widening current account deficit and rising inflation. Other countries such as Brazil, India and Indonesia all tightened policy in July to shore up investor confidence after broad-based market declines.

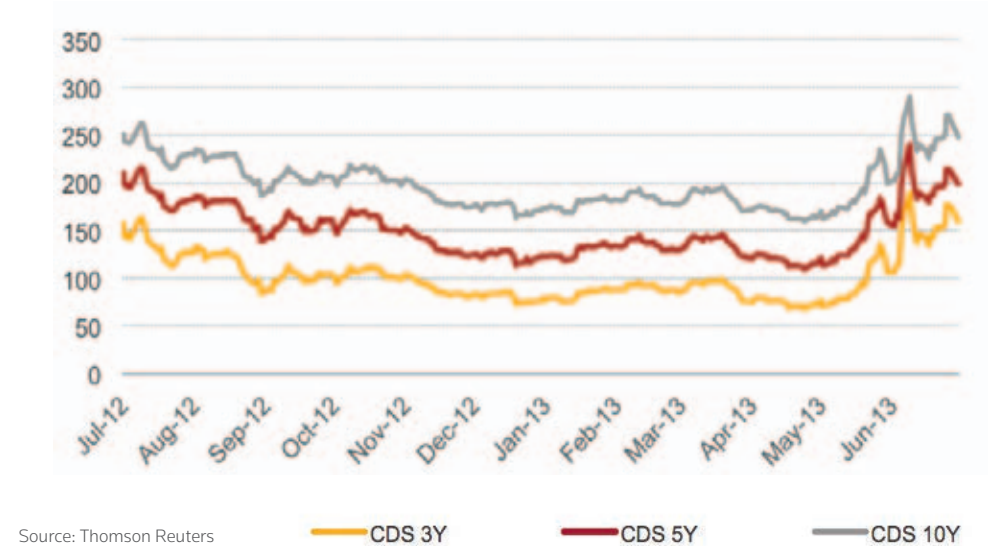
Shahine, A. (March 4,2013) “Billionaire seeks sukuk for Istanbul finance hub: Turkey credit. Bloomberg.

Comparison of Turkish Sukuk



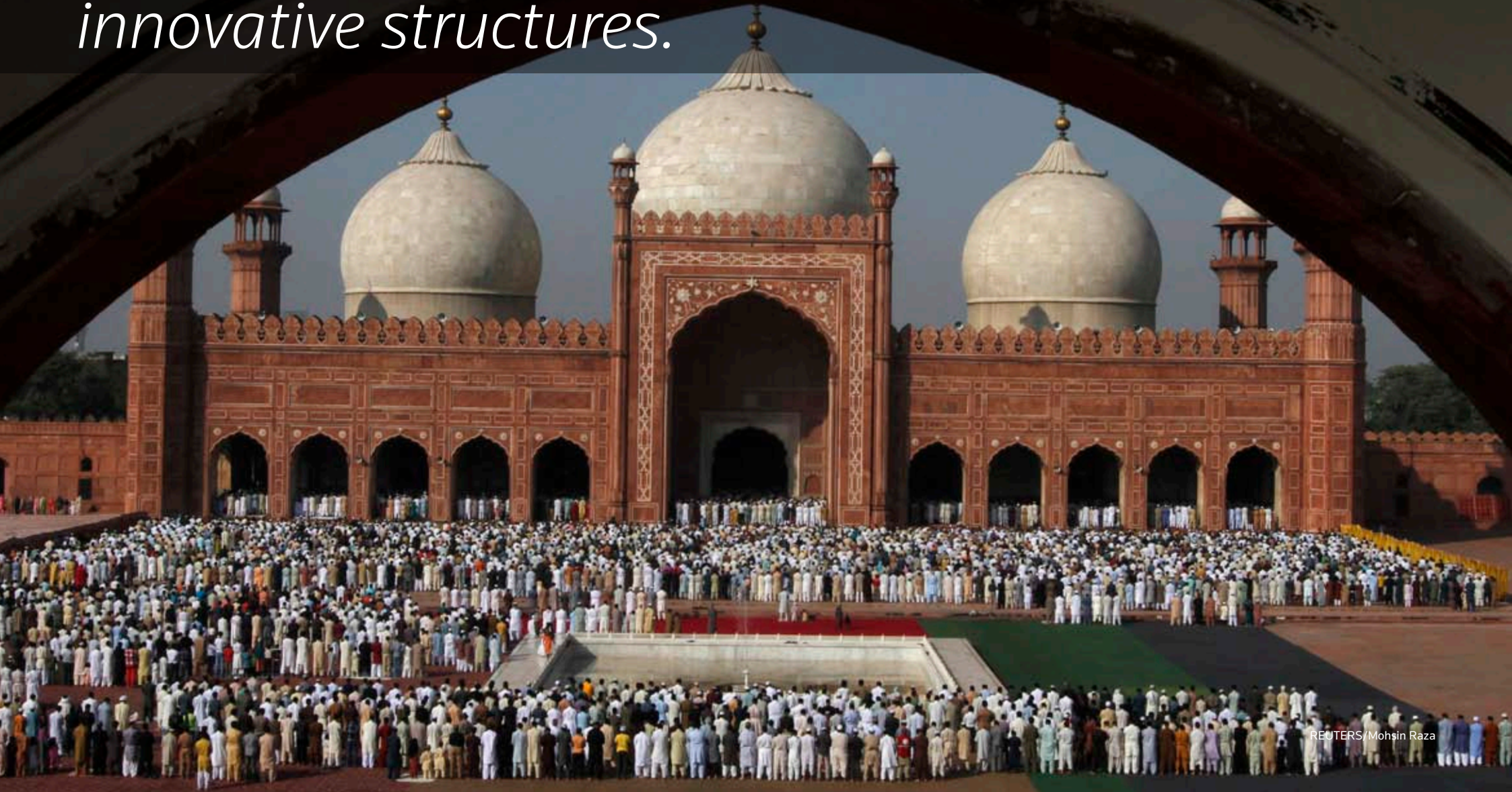
Source: Thomson Reuters

Turkey's 3, 5 and 10 Year CDS



Source: Thomson Reuters

*Pakistan is adding more depth to the sukuk market by introducing innovative structures.*



## Pakistan Sukuk Overview: Innovation driven by sharia requirements

By Suleman Muhammad Ali

Manager- Product Structuring & Research – Meezan Bank Limited

Pakistan entered the sukuk market in 2005 when the government reached out to foreign markets to supplement dwindling foreign reserves with the issuance of a \$600 million ijara sukuk listed on the Luxembourg Stock Exchange. The total sukuk issued as of September 2013 has reached approximately PKR 670 billion (US\$7 billion as per current market rates), according to data from the Securities and Exchange Commission of Pakistan and Meezan Bank calculations. 80% of the total value of Pakistani sukuk have been sovereign issues, issued by the two government-owned SPVs – the Pakistan Domestic Sukuk Company and Pakistan International Sukuk Company.

The total value of corporate sukuk issued is approximately PKR 132.5 billion as of September 2013, with the bulk of issues – 42% - coming from the power sector. This is mainly because the government has consistently pushed for investments in this sector in order to meet the needs of the country as it continues to face severe power shortages. Other major sukuk-issuing sectors are Utilities (including gas and power supply) with 9 percent of the total issue size, Cement 8 percent, Chemical & Pharma 7 percent and Fertilizer 5 percent. Financial institutions only account for 2% of all corporate sukuk issues, in stark contrast to other countries like UAE, Turkey and Malaysia where Islamic banks are active issuers. In fact no Islamic bank in Pakistan has as yet issued any sukuk to raise capital; the 2 percent share represents sukuk issuances by leasing companies and mudaraba companies.

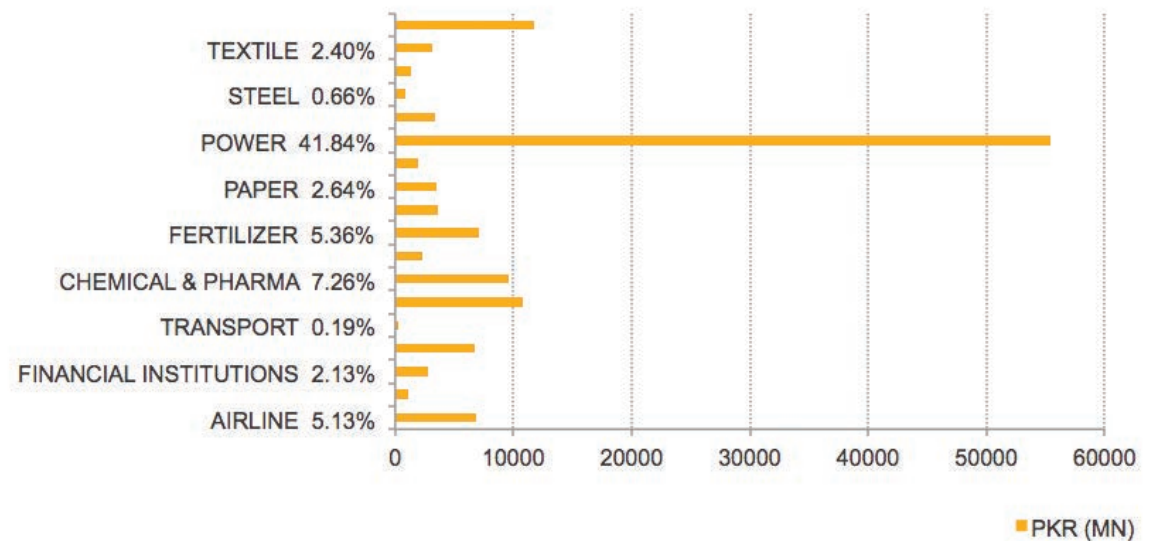


**SULEMAN MUHAMMAD ALI**

Manager – Product Structuring & Research at Meezan Bank Limited

Suleman Muhammad Ali is Manager – Product Structuring & Research at Meezan Bank Limited leading the product development and sharia-compliance function related to Islamic Structured finance, Sukuk Issues, Treasury and Corporate Finance. Mr. Ali is a reputed Islamic banking trainer, has conducted various corporate workshops/seminars and is a regular speaker on the subject at NIBAF – a training arm of State Bank of Pakistan (SBP). He was involved in the structuring of Pakistan’s first ever short term KAPCO Sukuk and the development/presentation of proposal regarding the launch of Islamic Interbank Offered Rate – Karachi (IIBOR - K) in Pakistan to SBP.

**FIGURE 1: SECTOR-WISE DISTRIBUTION OF PAKISTANI CORPORATE SUKUK BY ISSUE SIZE, AS OF SEPTEMBER 2013**





### Pakistan's innovative sukuk structures

In terms of sharia structures the Pakistani sukuk market appears to be more innovative compared to its peers, largely due to sharia and regulatory restrictions on the use of commodity murabaha. While murabaha has been the predominantly-used structure for domestic sukuk issues across the globe, diminishing musharaka and musharaka shirkatul aqd have been the most favoured modes in Pakistan.

As of this writing, the market is awaiting the launch of Pakistan's first airtime-based sukuk. Compared to other airtime-based sukuk in other jurisdictions that are based on murabaha, the structure of Pakistan's first airtime-based sukuk is backed by the ownership in underlying airtime prepaid cards, the sale of which will determine the return for the sukukholders.

Under the structure sukukholders purchase airtime from a major telecommunications company during the availability period. For quantification purposes the delivery of the airtime will be made by identification of the serial numbers of prepaid airtime cards of specific denominations. These prepaid cards can be purchased at a discount from the face value price normally sold in the

market. Subsequent to the purchase of the airtime the Issuer telco will be made an Agent to Sell through the Agency Agreement to sell the airtime in the market at face value through its franchises and retail outlets. Upon sale of airtime periodic payments will be made to sukukholders.

The specification and identification of serial numbers of the prepaid cards has been made a requirement to ensure that sukukholders take actual ownership of the airtime whose sale can also be tracked and identified rather than merely using the airtime service as a device for justifying financing.

Another crucial differentiating characteristic of the structure is that there is no undertaking or wa'd by the Issuer telco to purchase back the unsold airtime in case of its failure to sell the airtime in the market. This is to avoid the wakil being the kafil (the guarantor), or in other words, Agent Guaranteeing the Sale and the Sale Price; a practice criticized by certain sharia scholars. To ensure tradability at least 33 percent of the outstanding value of the sukuk will represent the unsold prepaid cards at all times.

FIGURE 2: STRUCTURE OF PAKISTAN'S FIRST AIRTIME-BASED SUKUK

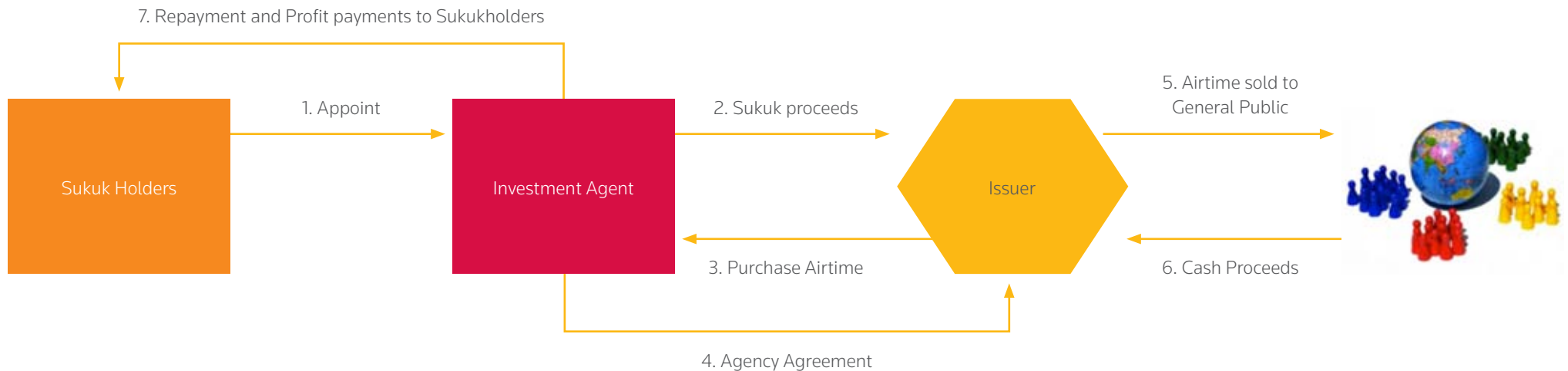
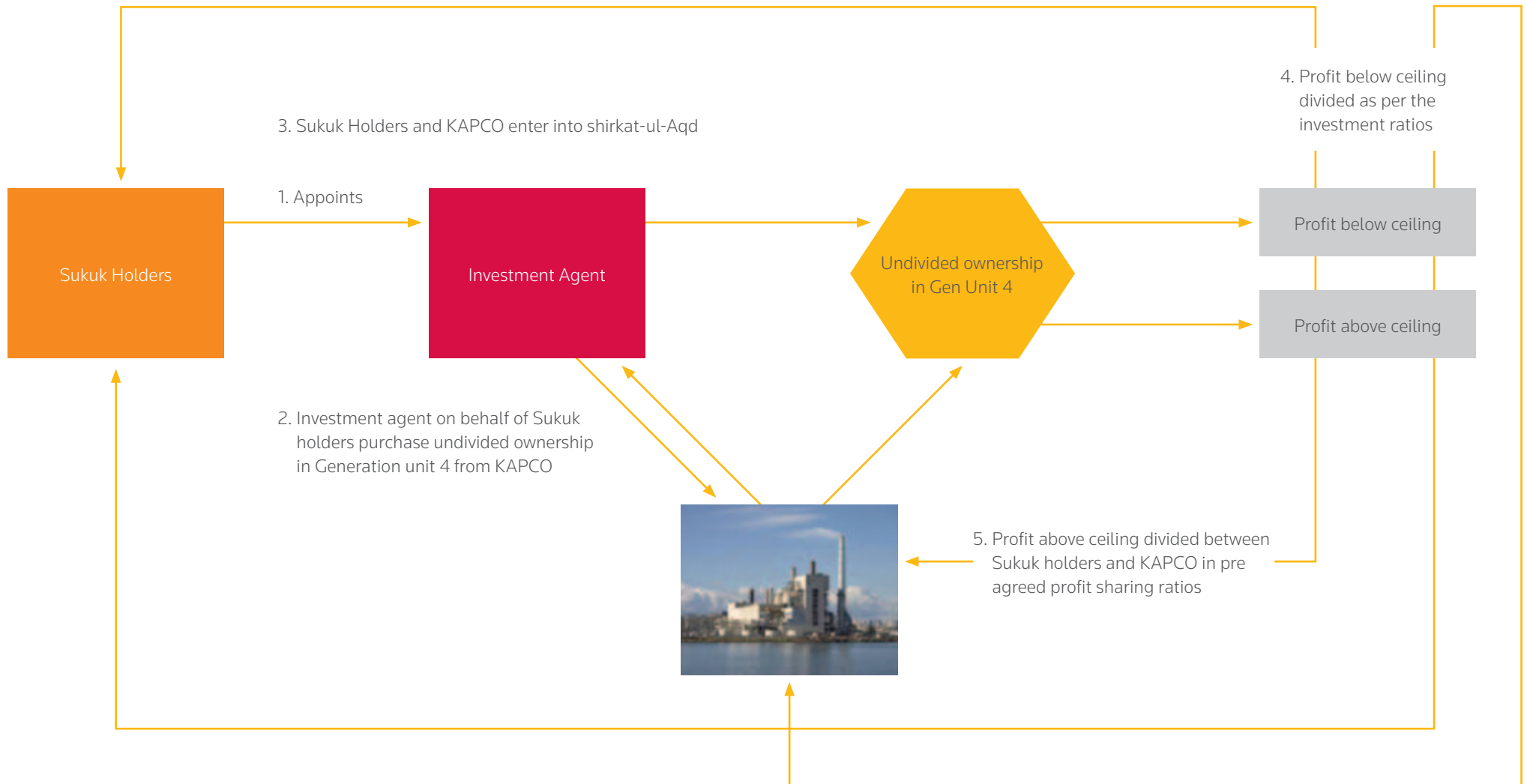


FIGURE 3: STRUCTURE OF KAPCO SUKUK



Another important innovative structure which has redefined the Pakistani sukuk landscape is the short-term sukuk based on shirkatul aqd (partnership based on profit and loss sharing) for power producing companies. The sukuk was initially structured for Kot Addu Power Company (KAPCO) by Meezan Bank Limited (MBL) in 2011 and since then it has been a favourite among liquidity-strapped power companies.

KAPCO's six-month tenured sukuk was issued to meet the company's short-term working capital requirements for purchasing fuel for power generation. Under the structure the sukukholders, through an investment agent, purchased an undivided share in the ownership of an identified Generation Unit (that produces power) from KAPCO for a purchase price equivalent to the issue amount. This created a shirkatul milk (joint ownership in property) between KAPCO and the sukukholders in the underlying generation unit. Subsequently the sukukholders and KAPCO contributed in kind their share in the Gen Unit towards shirkatul aqd (or business partnership) by executing a musharaka agreement to share profits and losses from the power generated and sold from the underlying Gen Unit.

The musharaka was limited to the underlying Gen Unit and did not extend to other Gen Units or business of the company. KAPCO acted as the managing partner under the musharaka. The profit sharing was based on two tiers wherein a profit ceiling was agreed in the musharaka agreement which if achieved was to be shared between the parties based on an agreed profit sharing ratio; bearing in mind the expected return for the sukukholders. For any profits above the ceiling another profit sharing ratio was applied in which a major ratio was agreed in favor of KAPCO.

#### Underlying factors driving the Pakistani sukuk market

Pakistan's value and volume of sukuk issues have seen an increasing trend on a year-to-year basis. However since last year sukuk issuances have seen a slowdown in activity. In the current year sukuk activity has not reached even half of 2012's value. However, at least three major corporate issues are expected for the last quarter of 2013, along with the usual year-end flurry of issuances.

#### TOTAL SUKUK ISSUED BY ISSUE SIZE

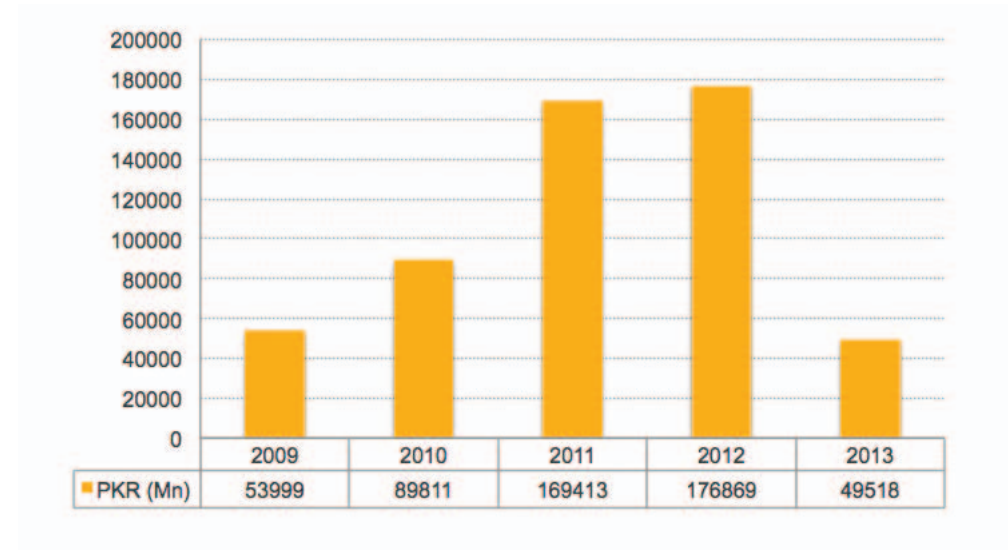


FIGURE 4: TOTAL VALUE OF PAKISTANI SUKUK ISSUED 2009 – 2013

Even with the slowing growth rate of Pakistani sukuk issues, sovereign issues have been consistent in terms of value and volume; it is the corporate sector that has been sluggish. (Note: Pakistani government fiscal year is July to June and for FY2013-2014 the PKR90 billion target for sovereign issues are on track albeit delayed due to the new government coming to office mid-2013. Figure 4 sukuk values are for calendar years 2009-2013.) Pakistani corporates are increasingly moving away from sukuk to rely on funding raised through syndicate transactions.

There are four major reasons for this trend:

- Firstly, almost all of the sukuk issued as of this writing have been privately placed, with financial institutions and mutual funds being major participants
- Secondly, with low sharia-compliant investment opportunities and an Islamic banking sector that is growing, Islamic banks have been able to attract high levels of deposits from the general public, resulting in high levels of excess liquidity whereby any funding requirements can be sufficiently fulfilled by a syndicate of Islamic banks crowding out mutual and pension funds

- Thirdly, issuing publicly listed sukuk involves lengthy procedural and information disclosure requirements. The country's listed debt market is under-developed with very low numbers of issues, even of conventional bonds. This makes the public listing of sukuk untested waters for corporate issuers
- Lastly, the sukuk issuance process involves higher documentation requirements with no added economic incentives for the corporates. Even for Islamic banks with excess liquidity the strategy for investments in sukuk has been to hold to maturity; characterizing low levels of trading in the sukuk market. Hence it is a position which encourages neither the issuers nor the investors to opt for the sukuk option. The option of corporate sukuk only tends to be explored when funding requirements cannot be fulfilled through syndicate arrangements either due to high funding requirements of the issuer, hitting the regulatory ceiling by Islamic banks in terms of sector and per party limits; high credit risk of the customer and uncertainty about future profit rates

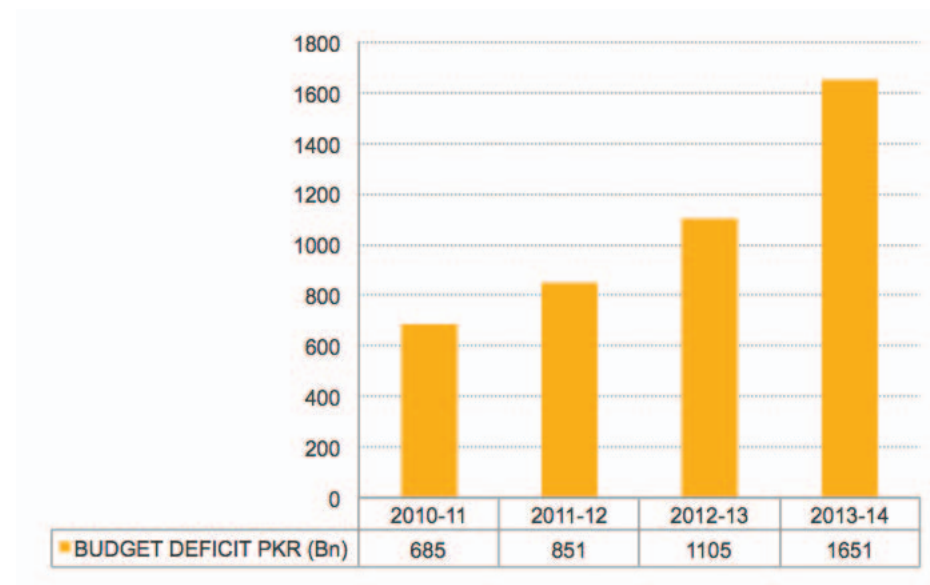
#### Future direction of the Pakistani sukuk market – 2014 and beyond: Sukuk to finance infrastructure projects

Going forward in 2014 corporate sukuk issuances are expected to see the same pattern of sluggishness. However, short-term corporate sukuk issuances in the power sector are expected to increase. This is because most of the independent power producers (IPP) operate on imported oil. With increasing oil prices, a weak Pakistani rupee and liquidity mismatches due to circular debt will constantly create a burgeoning requirement of short-term working capital. The power sector has an already high exposure to Islamic banks, and so the issuance of short-term sukuk will remain a viable alternative to tap the liquidity of Islamic mutual, pension and other funds. The shirkatul aqd-based musharaka sukuk for KAPCO, Pakistan's first ever short-term sukuk issued in 2011, has made the issuance of such sukuk a regular feature with a growing number of issuers and issue size every year. HUB Power has also been a regular issuer of sukuk since 2011, while other power companies like Lalpir Power came to the market in late 2013.

The Pakistani government's increasing budget deficit is also expected to drive sovereign sukuk issuances, as has been the case for the past five years. The budget deficit for the fiscal year 2013 – 2014 as per the country's federal budget is approximately PKR 1,651 billion, according to the Ministry of Finance's Budget in Brief; this is 49% higher than the budget deficit for the fiscal year 2012 – 2013. Figure 5 shows the annual position of Pakistan's budget deficit for the past five fiscal years.

FIGURE 5: PAKISTAN BUDGET DEFICIT FOR FISCAL YEARS 2010-2014 (E)

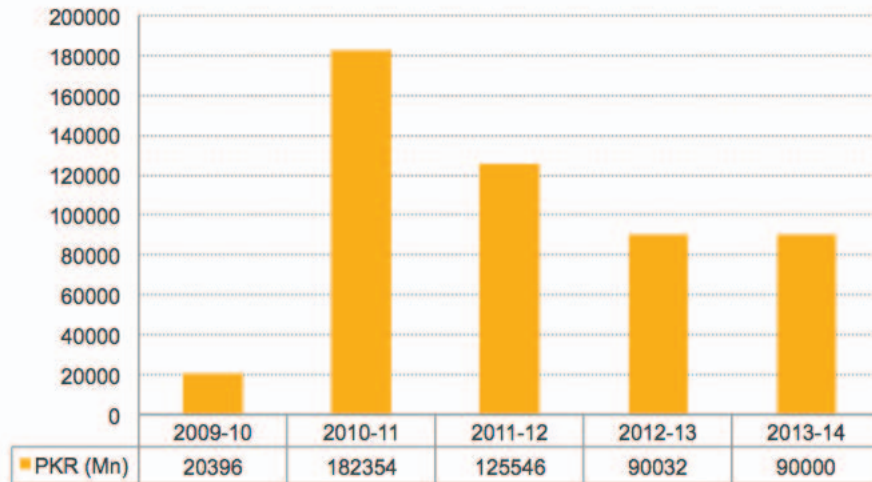
#### BUDGET DEFICIT By Year



To fund this gap the fiscal budget 2013 – 2014 has planned to target the issuance of sukuk to the tune of PKR 90 billion through the Government of Pakistan (GOP) Ijarah Sukuk series. This targeted issuance is exactly equal in size to the budgeted issuance in the fiscal budget 2012 – 2013, which saw PKR32 million extra issued over the planned PKR90 million. Hence going forward in the year 2014 it can safely be stated that the budgeted issuances are expected to be met. Figure 6 shows the Government of Pakistan (GOP) Ijarah Sukuk Issuances per fiscal year.

**FIGURE 6: IJARA SUKUK ISSUED BY PAKISTANI GOVERNMENT FISCAL YEARS 2009-2014 (E)**

**IJARAH SUKUK ISSUED BY GOP**



Source: Budget in Brief – [www.finance.gov.pk](http://www.finance.gov.pk)

Based on public statements and press reports, the new government in Islamabad is keen to promote Islamic finance and eliminate riba from the economy. Hence the actual sukuk issuances may well exceed this budgeted target, as was the case for the fiscal year 2010-2011. Apart from the federal government the provincial governments of Punjab and Khyber Pakhtun Khuwa have also shown keen interest in using Islamic finance to fund their provincial expenditures. The provinces have requirements to fund their massive commodity buying operation (besides other development expenditures) and it will not be a surprise if we see inaugural sukuk issues in this area as well.

Because of power shortages the federal government has aggressive plans for spending in this area in the foreseeable future. These include power projects such as the 6600MW Pakistan Power Park housing 10 coal fired power plants at Gadani at an estimated cost of \$15 billion – out of which two power plants are to be established in the first phase on a fast track basis – and the 4500 Diemer Bahasha Dam for which PKR 25 billion have been allocated in the current budget. In addition, the government also has aggressive plans for the development of ports and motorways such as the Karachi–Lahore motorway. With the apparent interest of the government in Islamic finance; sukuk issuances for funding these projects is a possibility.

Another area that has caused much market chatter is sukuk issuance for the government to tap international markets by issuing USD denominated sukuk specifically to supplement the depleting foreign currency reserves and stem the devaluation of the local currency. However, no matter how attractive or interesting this may seem it is a remote possibility at this stage with Pakistan's 3-year credit default risk premium standing at 8.5% , according to Bloomberg's calculations as of October 11, 2013. The funding will be too expensive compared to other sources like the IMF's 3-year Extended Fund Facility (EFF) recently approved by the IMF's Executive Board to the tune of US\$6.8 billion for Pakistan at a floating interest which currently stands at 3 percent.

Suggestions have been floated to issue bonds targeting Non Resident Pakistanis (NRPs); a sukuk in this regard can easily be structured and will be more acceptable in terms of sharia-compliance. However given the country risk premium such a sukuk would also need to be issued at rates which will make it an impractical proposition. Conversely, the government can also look to avail the IMF's approved EFF under an Islamic structured sukuk, for with the type of innovation in sukuk the country has seen, such a facility can easily be structured by the country's Islamic finance fraternity, making it yet again the first ever sukuk of its kind which would not only be in line with local needs but also open a new chapter for internal funding institutions like the IMF.



*“Wherefore art thou?” says the young  
sukuk market to long(er)-term suitors.*



## New Horizon

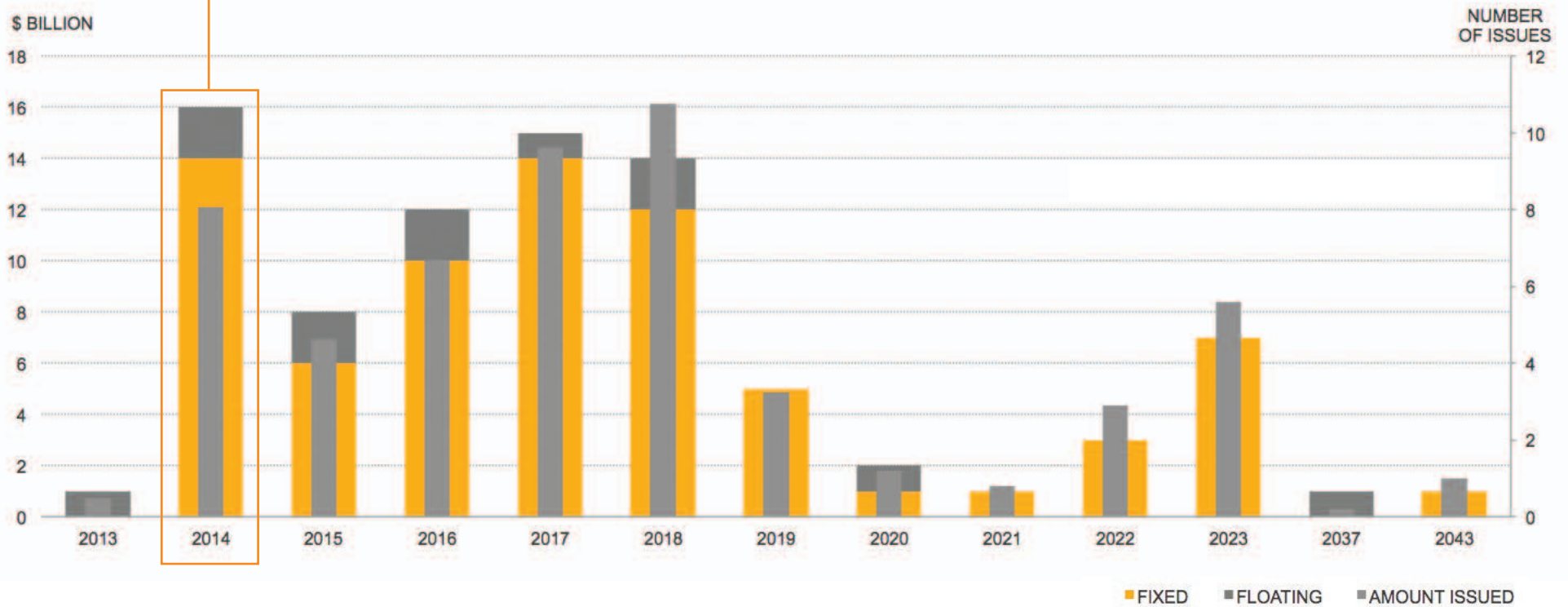
### Investors face reinvestment risks replacing high fixed coupon sukuk

*By Maturity Profile vs. Coupon Type*

Around \$8 billion of international sukuk will be maturing in 2014 (out of \$57 billion outstanding international sukuk); most of these are fixed.

This will leave investors with high reinvestment risk to substitute these high yields with strong credits and will create a gap in investors' balance sheets for profit from sukuk papers. Global investors still see more value in sukuk particularly in the Middle East compared to conventional bonds as yields tighten due to market recovery.

INTERNATIONAL SUKUK MATURITY PROFILE AS OF SEPTEMBER 30, 2013



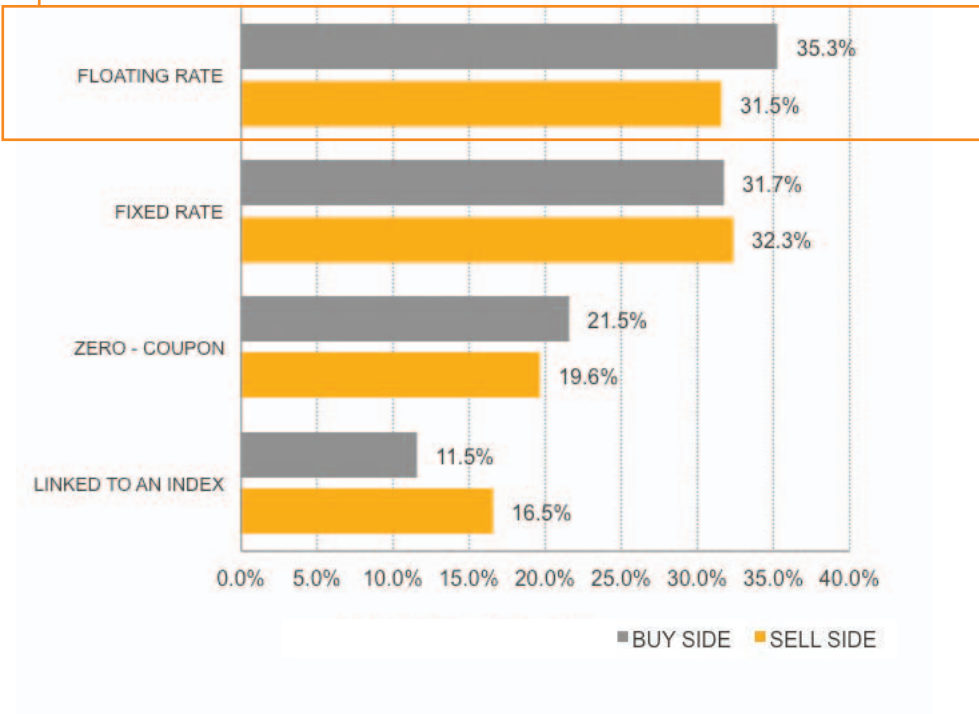


While **floating rate** coupons are most preferred for the buy side, it is the investors who more prefer it than the lead arrangers expect it. Lead arrangers equally expect floating and fixed rates at about 32%, with the fixed rate option marginally edging out floating rates.

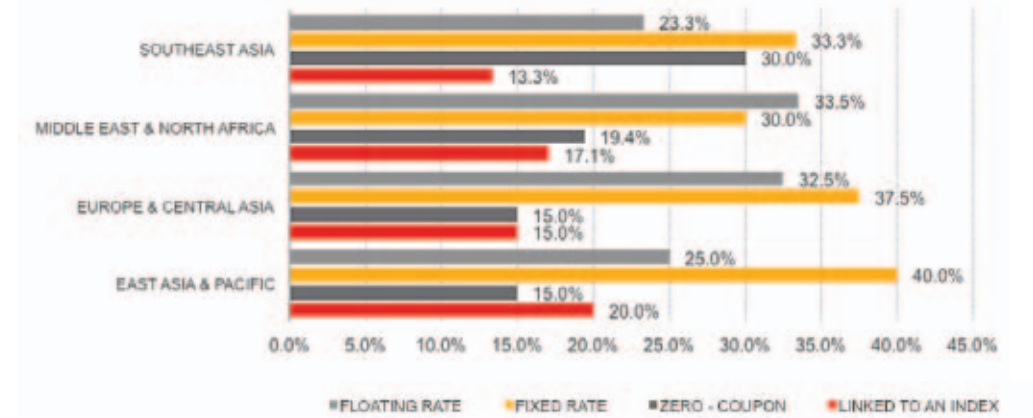
54.7% of buyers would still invest in sukuk regardless of the yield, followed by 35.8% if yield was 50 bps lower than a conventional bond.

	Respondants	Skipped
BUY SIDE	26	9
SELL SIDE	59	61

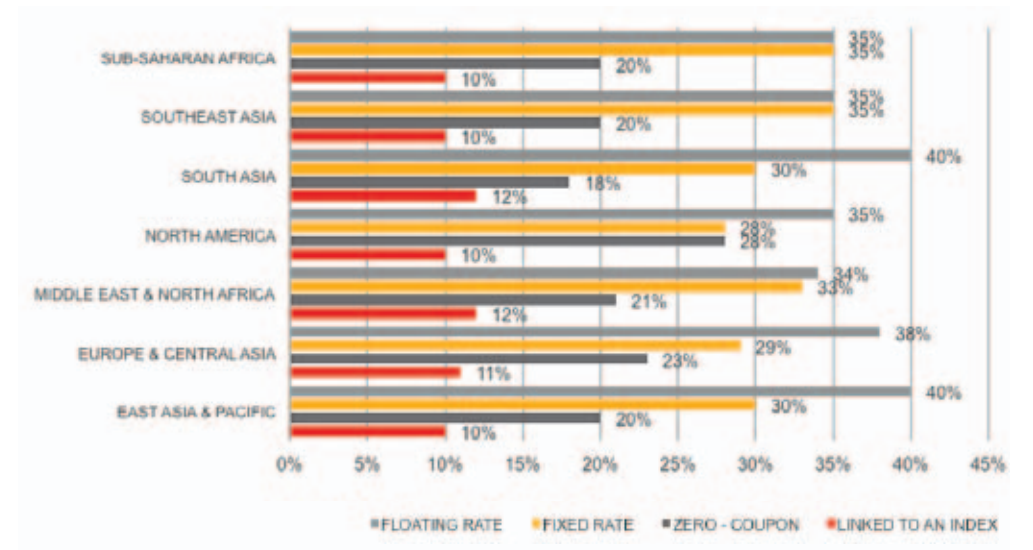
What is the most expected/preferred risk classification of sukuk issuance/ investment in 2013 and 2014?



**SELL SIDE: REGION BREAKDOWN**



**BUY SIDE: REGION BREAKDOWN**



## While Investors still seek secured debt, there is a growing appetite for riskier papers with attractive yields in the face of reinvestment risk

### By Type of Paper

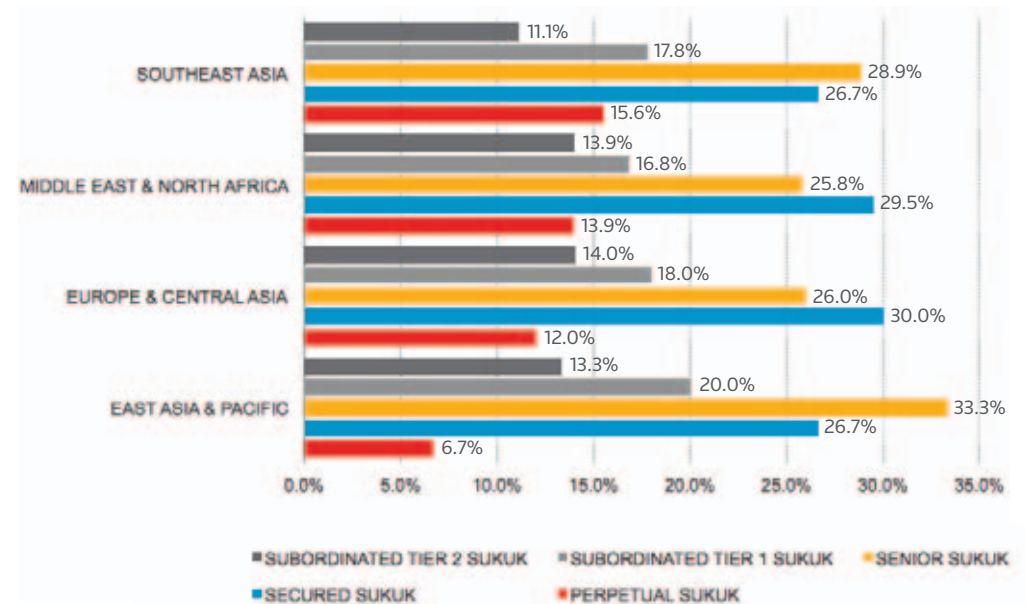
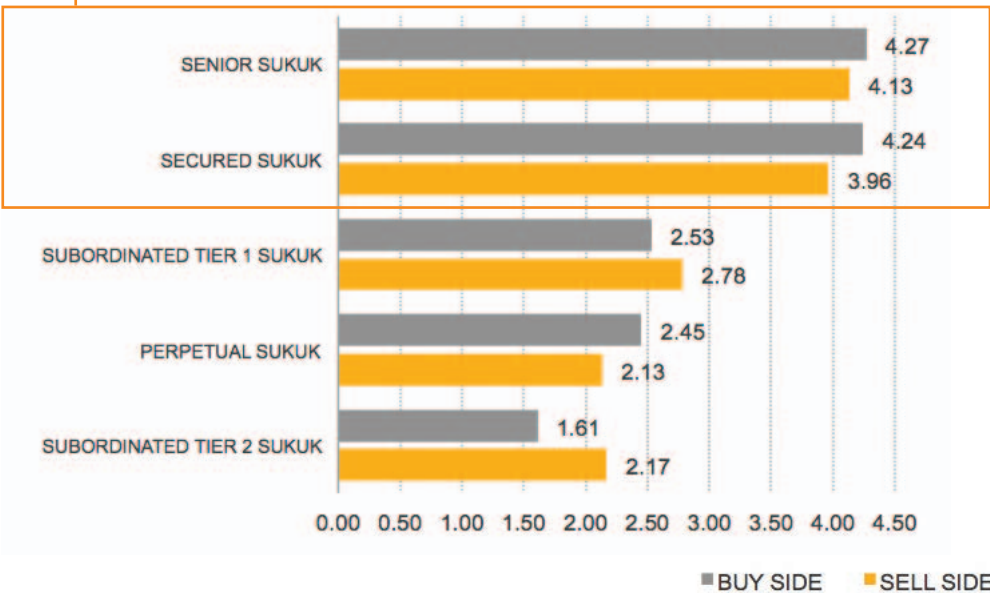
Lead arrangers and investors expect more senior sukuk issuances followed by secured sukuk. By region, Southeast Asia, East Asia & Pacific prefer senior sukuk while Europe, Central Asia, Middle East & North Africa prefer secured sukuk.

On the other hand, appetites have been whetted by riskier papers in the last couple of years, with the likes of several Tier I, Tier II and perpetual sukuk coming out of different regions (especially UAE and Turkey), which were met by oversubscribed books. This demand reflects new appetite towards riskier papers with strong credit and attractive yields.

	Respondants	Skipped
BUY SIDE	27	8
SELL SIDE	56	64

What is the most expected type of sukuk issuance/investment in 2013 and 2014?

SELL SIDE: REGION BREAKDOWN



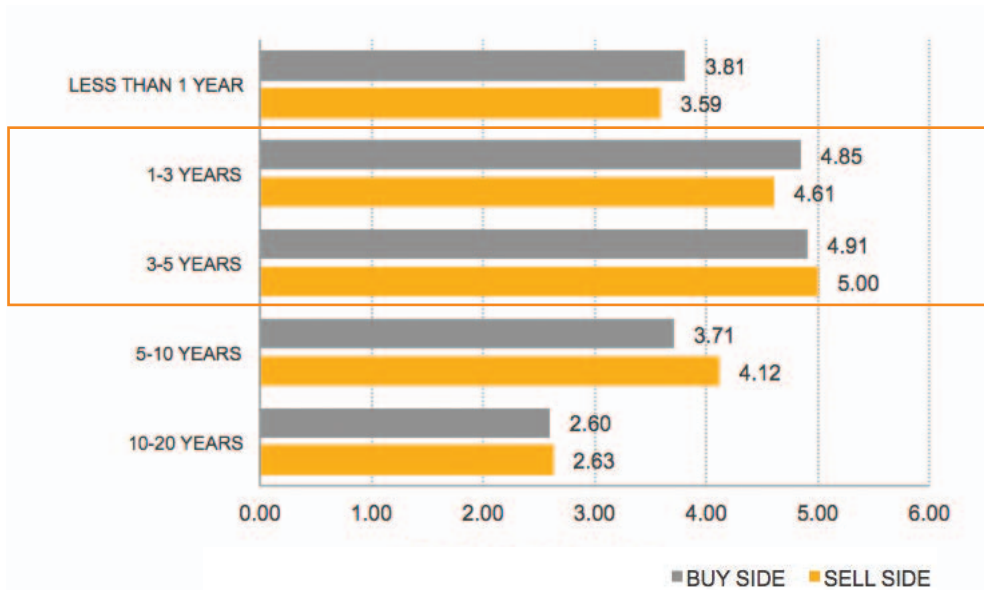
**In terms of tenors, investors are still keen on medium term sukuk**

In an expectation-preference match, the majority of lead arrangers and investors choose 3 to 5 year tenors as their preferred/expected sukuk. MENA countries prefer shorter terms of 1 to 3 years while Asian countries prefer the longer terms of 3 to 5 years.

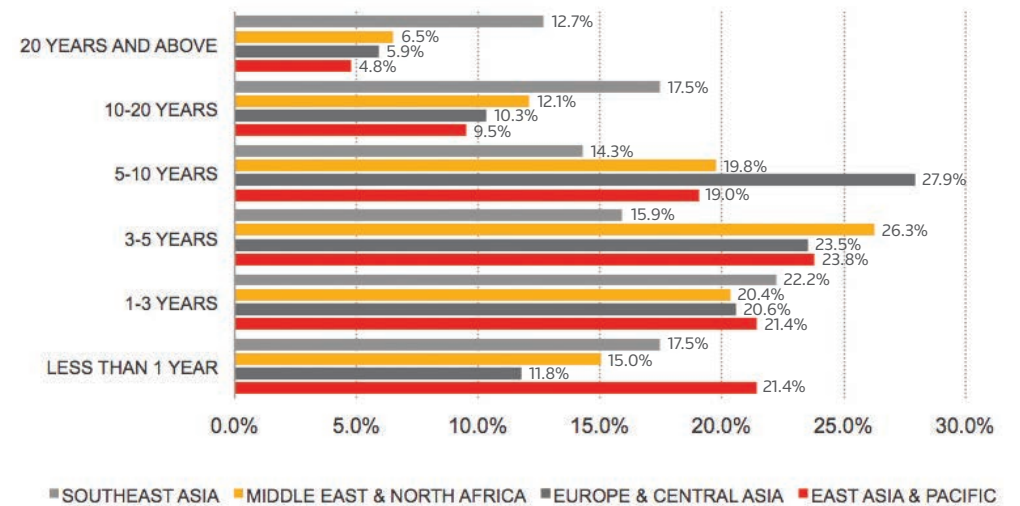
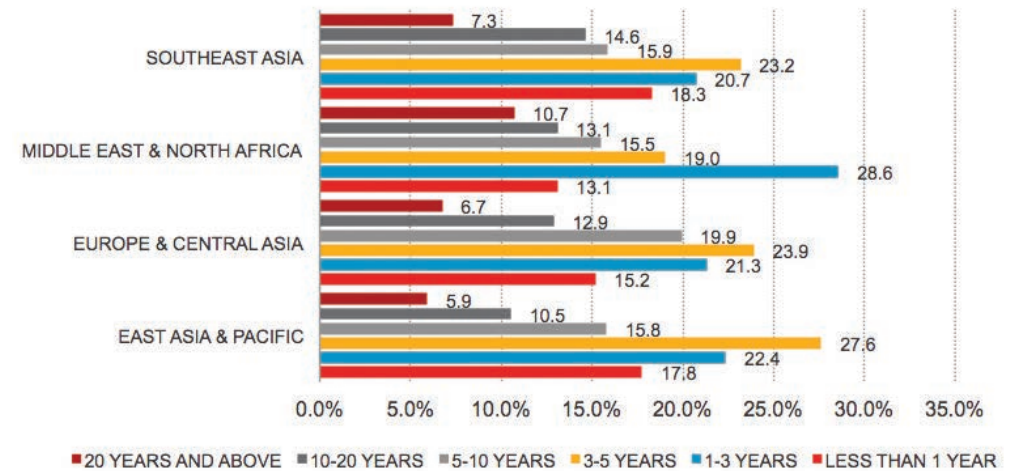
Long term tenors of 20 years and above are not expected on the sell side and not preferred on the buy side. However, an appetite for the longer end of the curve is slowly growing, proven by oversubscribed books in recent Tier I, Tier II and Perpetual deals from UAE and Turkey.

	Respondants	Skipped
BUY SIDE	27	8
SELL SIDE	59	61

**What is the most expected/preferred tenor of sukuk issuance/investment in 2013 and 2014?**



**BUY SIDE: REGION BREAKDOWN**



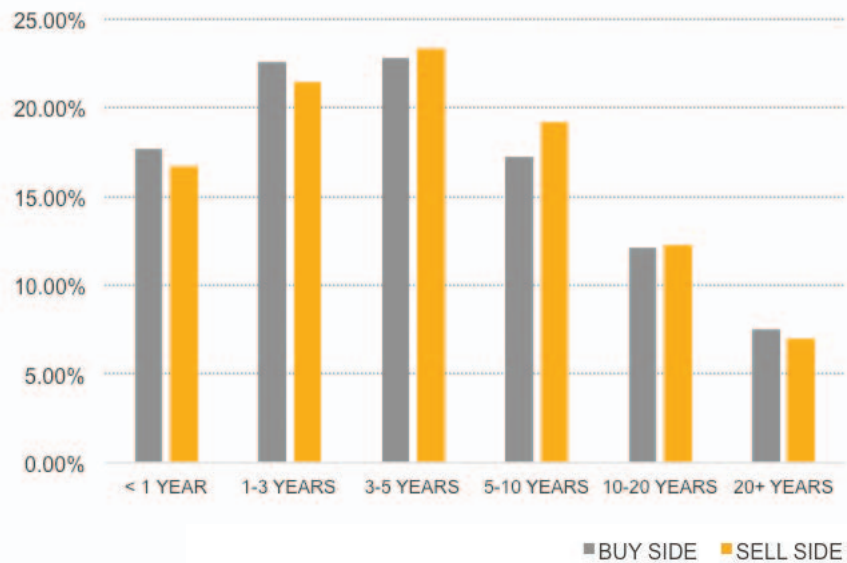
## Sukuk maturity profiles: Where will longer-term tenors come from?

By Blake Goud

Community Leader – Thomson Reuters Islamic Finance Gateway

The biggest shift from 2012 to 2013 in sukuk markets by many different metrics is the dramatic shortening of sukuk tenors. There are many ways to think of the shift in tenors, but one way is to think of the point where the preferences of the median investor meet the issuer's. In the survey findings of this Thomson Reuters Zawya Sukuk Perceptions and Forecast Study 2014, there was a noticeable discrepancy between issuers' and investors' demands and expectations for sukuk tenors.

### DISTRIBUTION OF INVESTOR/ISSUER EXPECTED TENOR



Investors (the buy side) favour shorter tenors (5 years and under) while issuers and the lead arrangers prefer longer tenors (more than 5 years). The most common tenor is 5 years and since the beginning of 2012, one in every six sukuk has a 5-year tenor. Despite having so many sukuk issued with a five-year tenor, it is also not the average tenor in the market; the average is longer at 8.9 years. The shift from year to year in the average tenor represents the impact of economic and financial market changes on investor and issuer preferences.

### Role of the perpetual sukuk

Given the limited use of callable sukuk in the markets, the contractual maturity date is likely to be the date at which the sukuk are actually repaid upon maturity, so the stated maturity of new issuance gives an accurate picture of changes in the demands of each side in response to changes in economic and financial conditions.

The one exception to this, which may begin to become more important in the future, is the issuance of perpetual sukuk like the Basel III compliant Tier 1 sukuk by Abu Dhabi Islamic Bank (issued Nov 2012) and Dubai Islamic Bank (issued Mar 2013). These have no contractual maturity, but do have a call feature that the issuer can use beginning after 6 years every time a periodic payment is due. In late Sep/early Oct this year, Almarai issued the first Gulf-based perpetual sukuk from a non-financial issuer.

With a large step-up at the call date (5 years after issuance), it makes it more likely that this sukuk will be called regardless of interest rate dynamics in the intervening years. This is in contrast with the ADIB and DIB sukuk, which in order to comply with Basel III requirements do not have step-up features if they are not called on the first call date.

Each of these structures (Basel III compliant with no step up and non-financial perpetual with step up) distinguish themselves from the majority of sukuk because they allow the issuers to delay periodic payment and push some of the underlying (principal) risk onto the sukuk holders. This is a far cry from the types of sukuk that attracted AAOIFI's ire in 2008 for not having any risk sharing features.

### Issuers look to lock in financing before Fed tapers

The impact of the Federal Reserve changing policy in a way that is perceived to signal nearer term rises in interest rates is likely to be increased issuer interest in locking in current rates while making investors more cautious and fearful of the losses they will suffer in response to a rise in interest rates. This will cause a rise in yield demanded by investors with a larger increase for longer tenor sukuk. The impact of this shift will also be reflected in the market prices of sukuk as a rise in the yield in the future will lead to lower investor demand for the sukuk relative to new (higher yielding) issues.

Another shift will occur with respect to changes in risk attitude among investors since most sukuk issuers are from emerging markets. This is likely to shift tenors in the opposite direction as a normalization of Federal Reserve policy will signal a strengthening US and global economy that will, over the longer-term, lead to higher global growth which will support investors moving into more risky investments, which in the fixed income sector, means emerging market bonds and sukuk.

#### Issuer hesitation leads to shorter hard currency denominated sukuk

In the first nine months of 2013, there has been a noticeable shift in the average tenor with the average tenor (weighted by size) falling to 8.3 years from 9.4 years in the same period in 2012. There is furthermore a discrepancy between the currencies used for issuance where local currency sukuk have longer maturity than hard currency sukuk. The former also account for the great majority of overall sukuk issuance given the dominance of Malaysian issuers in the market, which are nearly all denominated in Ringgit with the exception of a few global sukuk from the government and related issuers.

There is a good reason for issuers to prefer their sukuk is denominated in their local currency. Most businesses generate profits in the currency of the country where they are headquartered and they have to use those to pay profits and redemption amounts on the sukuk. If they are issuing hard currency sukuk, they have an opportunity to hedge the currency fluctuations but it is more expensive than for conventional debt, as well as being more expensive for longer tenor sukuk when compared to short- or intermediate-tenor sukuk.

#### GCC currency peg supports USD issuance

There is a notable exception to the requirement to hedge for hard currency sukuk (with an asterisk): the GCC. Since the GCC currencies are tied to hard currencies (the USD for all but Kuwait which is tied to a basket of currencies), issuers can generally accept that the currencies will remain tied and so hedging will be protection against a tail risk, rather an ongoing protection for the company's profits and ability to service the debt.

The asterisk mentioned above relates to the permanence of the currency peg. Occasionally, there is speculation in the market that the dollar peg will be abandoned and the currencies re-pegged to another currency or allowed to float. In the short run, this policy change is extremely unlikely, but both non-sovereign issuers and investors have to factor in this risk for longer-tenor USD sukuk, which will raise costs relative to local currency sukuk and limit supply.

Of the 46 sukuk issued in hard currencies, 35 were in the GCC, accounting for 76%. During the sample period (Jan 2012 to Sep 2013), the GCC sukuk issuance accounted for just 10% of the total sukuk issued and 35% of the total volume. Out of these 35 sukuk, 14 were issued with tenor of more than 10 years. Of the issuers who issued longer sukuk, most had sovereign or multilateral linkages.

#### Sukuk market development needs more investors with long term horizons

Looking forward, there are a number of factors that can affect the tenor of sukuk being issued besides the normal push and pull between investors and issuers that is in many cases driven more by the macroeconomy and global financial market developments than anything specific to sukuk. For sukuk specifically, longer tenors are less common in emerging markets than in developed markets because there is a higher potential for more dramatic changes and hence volatility, whether driven by economic or political and geopolitical changes.

The uncertainty from the potential for dramatic changes that affect emerging market fixed income investors' returns is reflected in less demand for longer-tenor sukuk. It is offset to some degrees by domestic or regional investors, particularly from pension funds or takaful funds who have a much longer-time horizon (and longer-dated liabilities for which they must match their assets). These areas of the market are not well developed in the GCC region in particular apart from the sovereign wealth funds which have not yet, by and large, taken an interest in sukuk.

Developing these types of investors is likely to require government action to establish pension funds and set mandatory contributions, as well as establish regulations on takaful operators that require certain allocations towards fixed income to protect the policyholders, particularly in family takaful. This work on the demand (buy) side is important to build a constituency among investors to demand longer dated sukuk. This demand will lead issuers and their advisers to determine whether the hard currency or local currency is the most appropriate as well as how to protect investors or issuers from adverse currency fluctuations using sharia-compliant swaps.



## GCC SUKUK WITH TENORS LONGER THAN FIVE YEARS

Sukuk Name	Structure	Country	Currency	Subscription Date		Yield	Tenor (Years)
Emirates Islamic Bank Sukuk(2018)	Musharaka	UAE	USD	7/4/2012	500.0	4.15%	6
Qatar Global Sukuk II(2018)	Ijarah	Qatar	USD	7/11/2012	2,000.0	2.10%	6
DIB Tier 1 Sukuk	Modarabah	UAE	USD	3/13/2013	1,000.0	6.25%	Perpetual non-call 6
Sharjah Islamic Bank Sukuk III	Wakala	UAE	USD	4/9/2013	500.0	2.95%	6
ADIB Tier 1 Sukuk	Modarabah	UAE	USD	11/8/2012	1,000.0	6.38%	Perpetual non-call 6
JAFZ Sukuk (2019)	Wakala	UAE	USD	6/12/2012	650.0	7%	7
Emaar Sukuk Limited(2019)	Ijarah	UAE	USD	7/12/2012	500.0	6.40%	7
Saudi Electricity Global Sukuk(Tranche 2)	Ijarah	Saudi Arabia	USD	3/28/2012	1,250.0	4.21%	10
Dubai DOF Sukuk(2022)	Ijarah	UAE	USD	4/25/2012	650.0	6.45%	10
Almarai Perpetual Senior Sukuk	Modarabah- Murabaha	Saudi Arabia	SAR	9/25/2013	453.3	3 m LIBOR + 200 bps	Peretual non-call 5
Saudi Electricity Global Sukuk(Tranche 2)	Ijarah	Saudi Arabia	USD	3/28/2012	1,250.0	4.21%	10
Dubai DOF Sukuk(2022)	Ijarah	UAE	USD	4/25/2012	650.0	6.45%	10
Dubai DOF Sukuk(2023)	Ijarah	UAE	USD	1/22/2013	750.0	3.88%	10
Emirates Airline Sukuk II	Wakala	UAE	USD	3/12/2013	1,000.0	3.88%	10
Saudi Electricity Global Sukuk II(Tranche 1)	Ijarah	Saudi Arabia	USD	4/8/2013	1,000.0	3.47%	10
Qatar Global Sukuk II(2023)	Ijarah	Qatar	USD	7/11/2012	2,000.0	3.24%	11
Saudi Electricity Global Sukuk II(Tranche 2)	Ijarah	Saudi Arabia	USD	4/8/2013	1,000.0	5.06%	30

Source: Zawya Sukuk Monitor and IFG Analysis

## Perpetual sukuk leading Islamic markets to greater risk sharing

By Blake Goud

Community Leader – Thomson Reuters Islamic Finance Gateway

More issuers are primed to tap investor demand for hybrid sukuk, as Dubai mall operator Majid Al Futtaim revived plans to tap sukuk markets and Malaysian consumer credit provider Aeon Credit is weighing either a perpetual notes or sukuk offering to boost capital. These sukuk in the pipeline are the latest in a string of issuance since markets came back to life when the US Federal Reserve decided to hold off on rumoured tapering of its asset purchases, following a selloff across emerging markets that largely froze sukuk primary markets.

The advent of the perpetual sukuk is a recent one and the structure is in the relatively early stages of development. However, that should not detract from the importance of perpetual sukuk – formally classified as hybrid securities that mix debt and equity into a unique security - that holds the promise of revolutionizing sukuk.

### GCC FINANCIAL INSTITUTION SUKUK ISSUANCE, BY STRUCTURE (%)



Source: Zawya Sukuk Monitor and IFG analysis. Data for 2013 goes through October 25, 2013

■ MODARABAMUSHARAKA

### Evolution of the perpetual sukuk

The origin of perpetual sukuk returns to the pre-crisis period where mudaraba sukuk were common instruments for Islamic banks to use as a way to expand their balance sheets. However, the pre-crisis mudaraba relied upon relatively crude redemption features that guaranteed par redemption of the sukuk on their maturity date. As a result, they received the condemnation of AAOIFI who prohibited the redemption feature that made these sukuk function in the same way as conventional bonds.

Following the AAOIFI decision, issuance dropped off significantly in part due to sharia concerns, but also as total issuance fell following the impact of the global financial crisis on the Islamic banking sector in the GCC. The drop-off in mudaraba sukuk began in 2008, the year of the AAOIFI decision (which was released in March that year following comments made in November 2007 by chairman of its sharia board Taqi Usmani). A tentative step back towards mudaraba sukuk came in late 2008 and again at the end of 2009 when Saudi Hollandi Bank issued mudaraba sukuk that addressed the new prohibitions contained in the AAOIFI guidance as released earlier in 2008.

### Rise of perpetual sukuk post-2012

However, these sukuk remained the exception for financial institutions until 2012 when the market for hybrid sukuk were thrown open in a surprisingly forceful way by the Abu Dhabi Islamic Bank Tier 1 sukuk which received \$15 billion in orders for the \$1 billion issued. Using a mudaraba structure, it provides ADIB with a subordinated source of financing that will also likely be Basel III compliant, though the final standards are yet to be released by the UAE Central Bank. The first interim liquidity requirements related to Basel III came into effect for UAE banks in January 2013 and full implementation of Basel III requirements will occur between 2015 and 2018.

The structures used by various issuers vary depending on the particularities of each market in which they are issued. For example, the Saudi Almarai perpetual issued in September this year (the first from a non-financial issuer in the GCC) uses the murabaha-mudaraba structure. Almarai was the first using this structure with a perpetual maturity. The mudaraba component (usually representing 51% of the issuance size for sharia compliance as a tradable instrument) provides the loss absorbance feature that is the equity component of the sukuk while the debt part is provided by the murabaha where the profit paid on the murabaha transaction is sufficient to generate the full coupon.

In the UAE, in contrast, the straight mudaraba is used where the full proceeds of the issue is invested into the originator's business and the sukuk assets are a pro rata share of the issuer's entire asset base. This structure provides for an anticipated level of coupon payment, but does not require that payments be made if there is not sufficient profits (after paying senior creditors) to pay the full amount, or if doing so would leave the bank insolvent. Any missed payments are non-cumulative, so investors are left bearing the losses (as well as losses should the sukuk be converted to equity or just left outstanding).

### Call feature of perpetual sukuk

A feature that is common across all of these structures is that they incorporate a call feature, which is uncommon in most sukuk. Typically sukuk have fixed redemption dates and the documentation provides explicitly for the redemption at par to maintain the debt qualities of the sukuk to attract investors. The callable sukuk, in contrast, do not provide investors with a fixed redemption date.



REUTERS/Jumana El-Heloueh

Each sukuk has different features depending on the market and the status and requirements (e.g. rules around call dates and terms under the Basel III standards). For example, the Almarai sukuk has the first call date 5-1/2 years following issuance and incorporates a hefty step-up in the yield if it is not called on that date. The ADIB (and Dubai Islamic Bank's March 2013 Tier 1 sukuk) are both designed to comply with Basel rules that require the first call date to be no earlier than 6 years following issuance and they do not allow a step-up feature as an incentive for the issuer to redeem when they are able to call. Instead these sukuk have repricing on the first call date and every 6 years thereafter.

The discrepancies between various forms of perpetual sukuk is understandable as a result of their newness. There is no standard for what type of perpetual sukuk structure functions the best for investors and for issuers. Nor is there likely to be complete standardization since financial issuers have different needs than non-financial issuers. However, the rapidity of expansion of geographical scope for the adoption of the perpetual sukuk (provided Aeon decides on a sukuk) is notable.

Besides the rapid adoption of a new structure, the combination of debt and equity features is important if the sukuk market hopes to gain some differentiation between itself and the conventional bond markets. Conventional bond markets are based on interest-bearing debt, and sukuk markets have copied this approach at least in substance if not in form. These perpetual sukuk still mimic conventional bonds in many ways, but the inclusion of equity features makes them include the type of risk sharing often promised but rarely delivered in Islamic finance. As these structures are refined, they should be made more standardized to lower issuer cost and make Islamic capital markets less debt based and more centred on hybrid solutions that better incorporate risk sharing than products in the industry's past.

This article was first published in IFG Weekly Issue No. 56 dated Sunday October 27, 2013.



## Investors are seeking investment-based instruments

### By Sukuk Structure

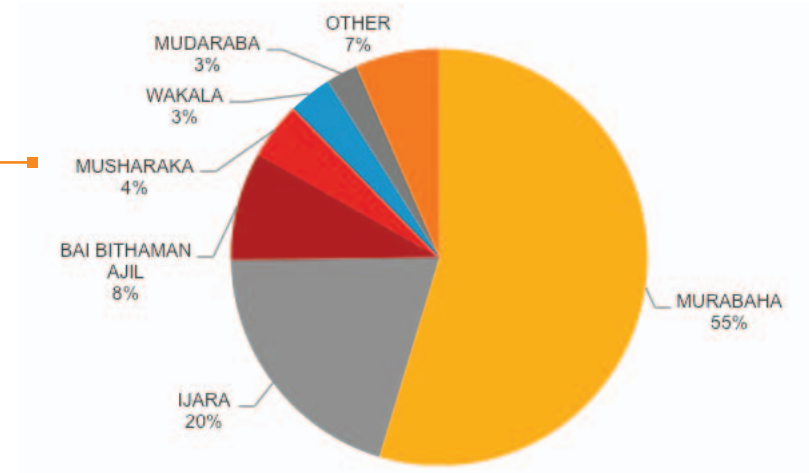
As at end Q3 2013, total sukuk issued using the murabaha structure amounted to \$43 billion compared to last year's \$69 billion. ijara follows with \$16 billion (2012: \$21 billion) and bai bithaman ajil with \$6.7 billion (2012:\$14 billion).

### TOP 5 GLOBAL SUKUK STRUCTURE HISTORICAL TREND (JAN 10 - SEP 13)

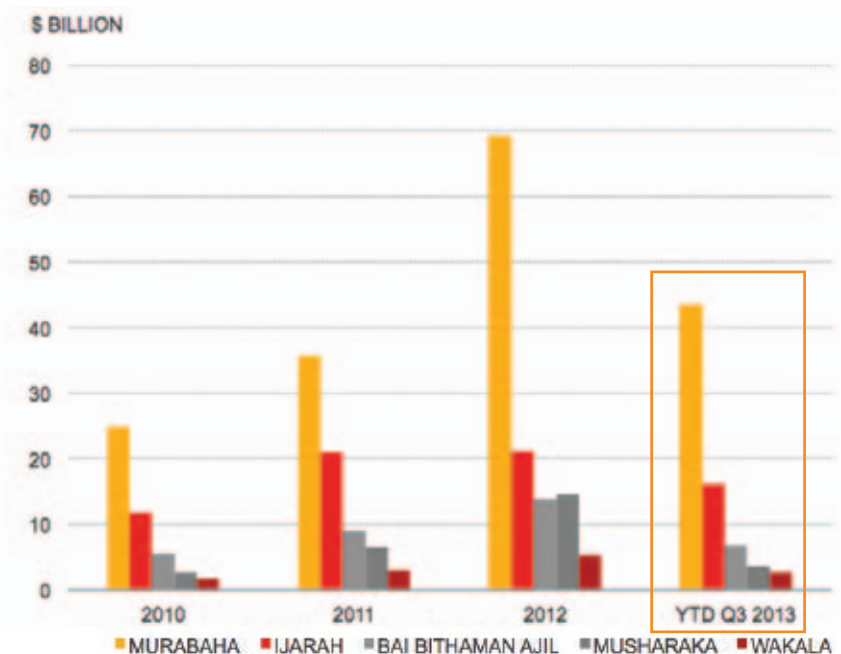
Structure	NUMBER of Issues	AMOUNT ISSUED (\$ Million)
Al Salaam	391	4,784.9
ALIm	1	305.3
Al-Istithmar	16	10,310.3
Al-Wakala Bel-Istithmar	26	7,461.8
Bai Bithaman Ajil	336	59,969.0
Bai Dayn	51	274.7
Bai Inah	7	519.4
Hybrid Sukuk	135	12,491.5
Ijara	816	109,639.2
Istisna	37	5,667.3
Manfa'a	1	650.0
Mudaraba	105	15,520.2
Murabaha	1048	188,475.5
Musharaka	533	59,321.3
Wakala	40	12,781.9
Grand Total	3,543	488,172

Source: Thomson Reuters Zawya

### GLOBAL SUKUK ISSUANCE BREAKDOWN BY STRUCTURE YTD Q3 2013



### TOP 5 GLOBAL SUKUK STRUCTURE HISTORICAL TREND (Jan 10 - Sep 13)

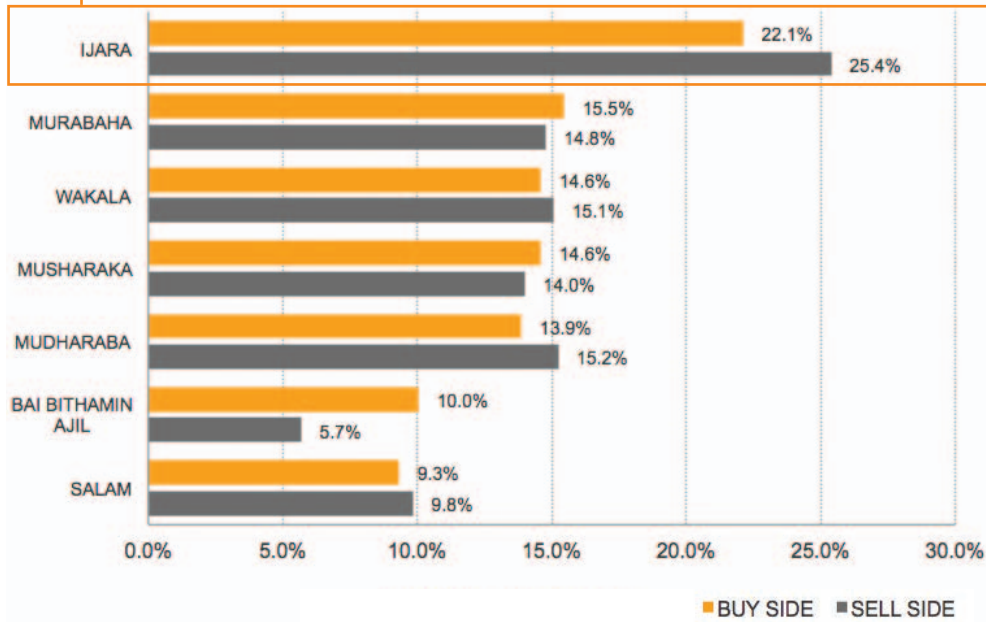


Source: Thomson Reuters Zawya

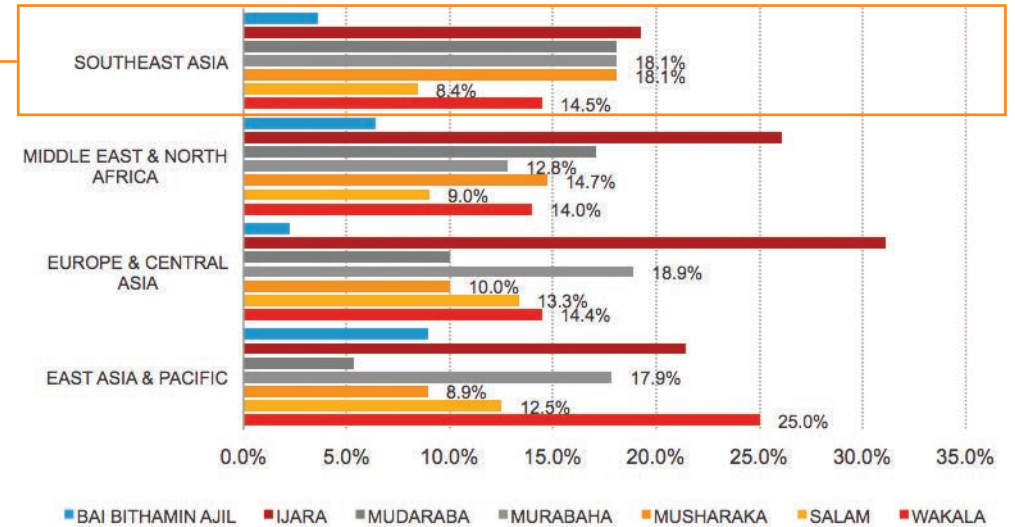
Overall, the ijara structure is favoured over other structures for both the buy and sell sides. However, interestingly, there is a growing appetite for wakala in Southeast Asia and East Asia & Pacific regions which reflect a shift in the market appetite from debt-based instruments to investment-based instruments.

	Respondants	Skipped
BUY SIDE	26	9
SELL SIDE	57	63

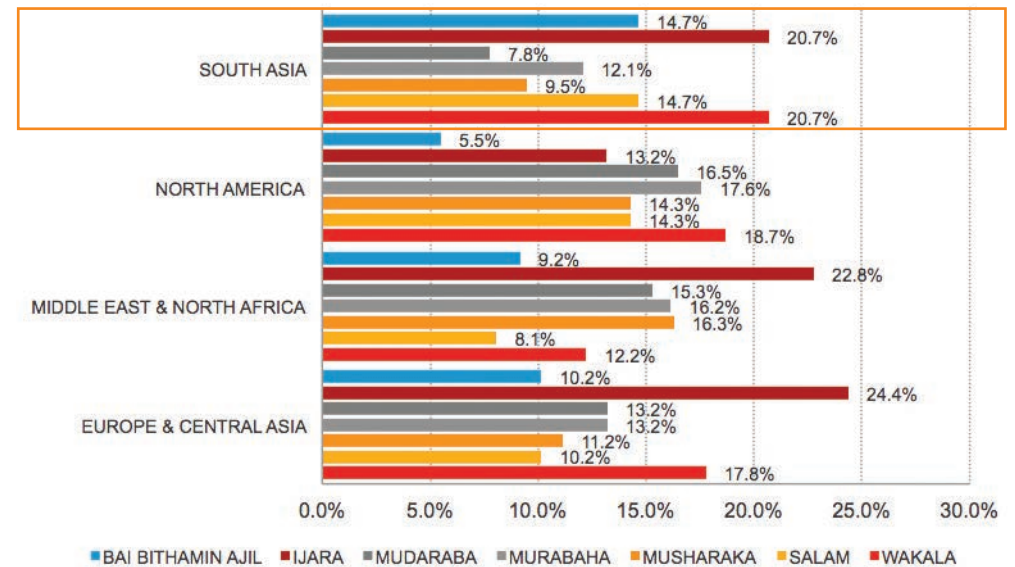
What is the most expected/preferred structure of sukuk issuance/ investment in 2013 and 2014



SELL SIDE: Region Breakdown



BUY SIDE: Region Breakdown

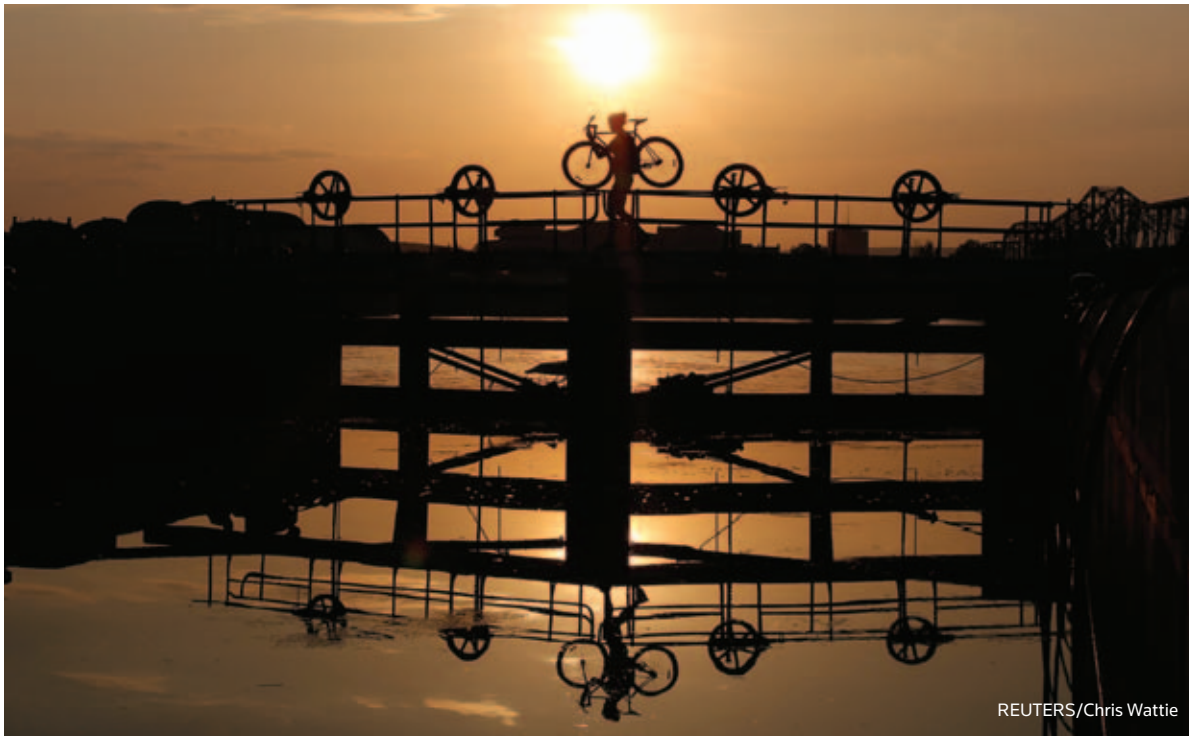


## 2013's innovative sukuk structures

By Hitesh Vithal Asarpota & Ryosuke Shimazu  
Investment Banking – Emirates NBD Capital

The sukuk market has historically been considered a niche market with various limitations in regard to currency types, coupon types, tenors, rating and structures. However, as the market continues to grow broader and deeper on the back of increasing liquidity in the Gulf Cooperation Council (GCC) banking sector, we have seen sukuk issuances in currencies other than USD and MYR, with maturities beyond 10 years and of sub-investment grade rating or no rating. The market has also witnessed a few innovative sukuk structures which allow for significantly more flexibility to issuers, and making the market more accessible.

Some of the most innovative sukuk coming out of the MENA region in 2013 include 1) Emirates Airlines US\$ 1 billion amortising sukuk, 2) Dubai Islamic Bank US\$ 1 billion Tier 1 sukuk and 3) Bank Asya US\$ 250 million Tier 2 sukuk. These were structured in line with globally accepted sharia standards and received substantial interest from Islamic investors in both the Middle East and Southeast Asia. Here are brief overviews of these notable sukuk structures.



REUTERS/Chris Wattie



### HITESH ASARPOTA

Director, Investment Banking at Emirates NBD Capital

Hitesh joined Emirates NBD Capital in 2008 and is responsible for the primary debt capital markets business of the ENBD Group. He has advised various government, blue chip and mid-cap clients on their Islamic and conventional financing strategies and access to debt capital markets and successfully raised over US\$ 20 billion for Middle East and Turkish issuers. Hitesh holds a BCom in Accounting and Economics from Sydenham College, India and a post graduation management degree from HEC Paris Grande École, France.



### RYOSUKE SHIMAZU

Associate, Investment Banking at Emirates NBD Capital

Ryosuke is an Associate in Debt Capital Markets based in Dubai, having arranged various international Sukuk issuances out of the region. Prior to joining Emirates NBD Capital, he was in Islamic Origination (Asia Pacific) at HSBC Amanah Malaysia and in Investment Banking Division at Citigroup Global Markets Japan. Ryosuke graduated with an economics degree from Bocconi University, Italy and holds a postgraduate degree in Islamic finance from INCEIF, Malaysia.

### CASE STUDY 1: EMIRATES AIRLINES US\$ 1 BILLION AMORTISING SUKUK

Emirates Airlines successfully priced a US\$ 1 billion 10 year amortising sukuk on March 19, 2013, attracting an order book exceeding US\$ 3.2 billion from over 130 accounts. Middle Eastern accounts took 85%, Europe 7%, Asia 5% and US offshore 3%. Banks bought 73%, funds 19%, private banks 5% and central banks 3%.

The sukuk is noteworthy for its unrated issue, amortising payment schedule with the average life of c. 4.9 years and innovative wakala structure and underlying assets. The structure, occasionally called voucher-based sukuk, is based on wakala whereby Emirates, on behalf of the sukuk trustee as its agent, sells certain rights and services (to be provided by Emirates itself) to third parties.

It is innovative in that this structure does not involve any physical assets which are typically required for tradable sukuk structures. Emirates' rights and services identified and used in this structure are non-physical assets, yet non-ribawi items; therefore, the sukuk based on such assets are deemed tradable at discount or premium. It is an ideal structure for airline operators who typically lack unencumbered physical assets sufficient for sukuk issuance. Further, Emirates was the first airline operator to adopt this asset type and structure in a sukuk format. The following is the simplified mechanism of the structure:

#### At issuance

The Trustee, on behalf of the sukuk investors, purchases from Emirates certain rights and services ("Rights to Travel") (measured in available tonne kilometers (ATKMs)) and pays the sukuk proceeds as the purchase price. Pursuant to a service agency agreement, the Trustee appoints Emirates as its agent to distribute and sell such Rights to Travel to third parties (e.g. Emirates' customers) according to a certain distribution schedule.

#### During the tenor

Emirates, as the agent of the Trustee, sells passenger tickets corresponding to the allotted Rights to Travel at an agreed minimum price and pays the sales proceeds to the Trustee, which are then paid through to the investors on the relevant periodic distribution dates. Any allotted but unsold Rights to Travel in any distribution period are sold to Emirates pursuant to a purchase undertaking to generate sale proceeds sufficient for the relevant periodic distribution amounts payable to the investors

#### At dissolution

The Trustee exercises its right to oblige Emirates to purchase the outstanding Rights to Travel from the Trustee for the exercise price pursuant to the purchase undertaking, which is to be used to redeem the outstanding sukuk.

Issuer	Medjool Limited	Rating	Not Rated
Obligor	Emirates	Status	Senior Unsecured
Tenor	10 years	Spread at Issue	5-yr USD MS + 300bp
Issue Date	March 19, 2013	Profit Rate	3.875%
Currency	USD	Re-Offer Yield	4.024%
Issue Amount	US\$ 1 billion	Listing	NASDAQ Dubai
Documentation	Reg S	Joint Lead Managers	Abu Dhabi Commercial Bank, Abu Dhabi Islamic Bank, Citigroup, Dubai Islamic Bank, Emirates NBD Capital and Standard Chartered Bank

## CASE STUDY 2: DUBAI ISLAMIC BANK US\$ 1 BILLION TIER 1 SUKUK

On March 13, 2013, Dubai Islamic Bank (DIB) issued a US\$ 1 billion Perpetual Tier 1 Sukuk after generating an order book in excess of US\$ 14 billion from over 360 accounts. Middle Eastern accounts took 38%, Europe 29%, Asia 29% and US offshore 4%. Banks bought 33%, private banks 32%, fund managers 29%, hedge funds 5% and others 1%.

The sukuk issue was aimed at further strengthening DIB's Tier 1 capital base, in anticipation of strong growth opportunities going forward. The structure was based on mudaraba, similar to the Tier 1 Sukuk issued by Abu Dhabi Islamic Bank in November 2012, whereby the Trustee (as rab-al-Mmaal) and DIB (as mudarib) constitute a mudaraba to invest in DIB's general business activities. Periodic distributions are at DIB's sole discretion unless certain restricted events occur and any unpaid periodic distributions are not cumulated. This structure involves no purchase undertaking or sale undertaking with respect to the mudaraba, which is generally regarded as constituting a guarantee of mudaraba capital by the mudarib. The following is the simplified mechanism of the structure:

### At issuance

The Trustee (as rab-al-maal) acting on behalf of the Sukuk investors enters into a Mudaraba agreement with DIB (as mudarib) to invest the sukuk proceeds in DIB's general business activities as mudaraba capital.

### During the tenor

Unless a non-payment event or a non-payment election occurs, DIB distributes the mudaraba profit generated by the mudaraba to both the Trustee and DIB at a pre-agreed profit sharing ratio of 99% to the Trustee and 1% to DIB. In the event that profits attributable to the Trustee is greater than the return expected under the mudaraba agreement, the amount of any surplus is retained by DIB and credited to a reserve. Distribution of mudaraba profits to the Trustee is at DIB's sole discretion subject to certain conditions, and any profits attributable but unpaid to the Trustee is credited to the reserve.

At dissolution: DIB may, at its discretion, liquidate the mudaraba in whole subject to certain conditions set out in the agreement (e.g. on the date falling 6 years from the issuance). If the capital to be returned to the Trustee from liquidation is less than the outstanding mudaraba capital, DIB either i) continues investing the mudaraba capital in and forgoes the final liquidation or ii) proceeds with the final liquidation and indemnifies the Trustee in respect of the shortfall. Since the discretion to liquidate the mudaraba rests solely with DIB, who is not obliged to liquidate if there is a shortfall, the covering of the shortfall by DIB is not deemed to be a capital guarantee by the relevant sharia committees.

Issuer	DIB Tier 1 Sukuk Ltd	Obligor Rating	A (Fitch), Baa1 (Moody's)
Obligor	Dubai Islamic Bank PJSC	Status	Subordinated Tier 1
Tenor	Perpetual, callable in year 6	Spread at Issue	6-yr USD MS + 495.4bp
Issue Date	March 13, 2013	Profit Rate	6.250%
Currency	USD	Listing	Irish Stock Exchange
Issue Amount	US\$ 1 billion	Joint Lead Managers	Dubai Islamic Bank, Emirates NBD Capital, HSBC, National Bank of Abu Dhabi and Standard Chartered Bank
Documentation	Reg S		

### CASE STUDY 3: BANK ASYA US\$ 250MN TIER 2 SUKUK

On March 28,, 2013, Asya Katılım Bankası A.S. (Bank Asya), the largest participation bank in Turkey by assets, successfully priced a US\$ 250 million debut Reg S Tier 2 Sukuk and attracted participation of over 80 accounts from Asia, Europe and the Middle East. Middle Eastern accounts took 35%, Europe 32%, UK 20% and Asia 13%. Funds bought 42%, private banks 30%, banks 25% and others 3%.

The sukuk was the first Tier 2 Sukuk out of Turkey, and the first international Tier 2 Sukuk issued in 2013. The payment obligations of Bank Asya are subordinated to all its senior unsecured obligations, and the tenor is 10 years callable in year 5. The structure is based on wakala whereby Bank Asya, as the Trustee's agent, manages the sukuk portfolio consisting of tangible assets and commodity murabaha receivables. Combining multiple underlying assets including Commodity Murabaha receivables, the structure helps reduce tangible asset requirements without compromising tradability. In addition, periodic distributions of Bank Asya's Sukuk are generated solely by the profit amount of the Commodity Murabaha transaction, which allows periodic profits to be fixed throughout the tenor and therefore requires no liquidity facility or reserve account to cater to any profit fluctuation. The following is the simplified mechanism of the structure:

#### At issuance

The Trustee, on behalf of the sukuk investors i) purchases from Bank Asya an asset portfolio comprising of non-real estate ijara assets and sukuk certificates backed by tangible assets pursuant to a purchase agreement and ii) sells certain sharia-compliant commodities to Bank Asya pursuant to a commodity murabaha agreement. The Trustee appoints Bank Asya as its agent to manage the asset portfolio and collect commodity murabaha payments on behalf of the Trustee, and provide certain services including maintaining the value of the asset portfolio at no less than 51% of the outstanding sukuk. The profit amount of the commodity murabaha is equal to the total periodic distribution amounts due under the sukuk until the issuer call date (year 5) and paid in equal installments to the Trustee until such issuer call date.

During the tenor: Bank Asya collects the income generated by the asset portfolio and the Commodity Murabaha contract and pays the periodic distribution amounts to the Trustee, which are then paid through to the investors on the relevant periodic distribution dates. Any excess is retained by Bank Asya as a reserve. If the Sukuk are not redeemed on the issuer call date (year 5), Bank Asya undertakes to enter into an additional Commodity Murabaha agreement for a reset deferred purchase price and continues to serve as the Trustee's agent until the scheduled dissolution date (year 10).

#### At dissolution

On the issuer call date (year 5), Bank Asya is entitled to oblige the Trustee to sell the asset portfolio to Bank Asya at the exercise price pursuant to a sale undertaking. In case the Sukuk are not redeemed on the issuer call date (year 5), the Trustee is entitled to oblige Bank Asya to purchase the asset portfolio from the Trustee at the exercise price pursuant to a purchase undertaking on the scheduled dissolution date (year 10). The exercise price and the outstanding deferred purchase price of the Commodity Murabaha are applied for the Sukuk redemption.

#### Conclusion

Due to the sharia requirement for financial transactions to be based on assets, it is hard to deny that Sukuk issuances are more challenging than comparable conventional bond issuances from a practitioner's perspective. Innovation in Sukuk structuring is underway, helping lower the hurdles for a variety of issuers to tap the liquid and resilient Sukuk market and offering more investment options to both Islamic and conventional investors. The structures presented above are only a few examples of innovative Sukuk issued out of the GCC and Turkey in 2013. It is expected that 2014 will see more innovative structures which facilitate Sukuk issues by issuers lacking required tangible assets and by issuers from new jurisdictions, which will potentially help bridge the demand-supply mismatch in the Sukuk industry.

Issuer	Asya Sukuk Company Limited	Status	Subordinated, lower Tier 2
Obligor	Bank Asya	Spread at Issue	5-yr USD MS + 652.5bps
Tenor	10 years (10NC5)	Profit Rate	7.50%
Issue Date	28th March, 2013	Listing	Irish Stock Exchange
Currency	USD	Joint Lead Managers	Emirates NBD Capital, HSBC, Merrill Lynch International and National Bank of Abu Dhabi
Issue Amount	US\$ 250 million		
Documentation	Reg S		
Issuer Rating	Ba3 (Moody's)		
Obligor Rating	Ba2 (Moody's)		



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*More cross border sukuk  
is coming our way*



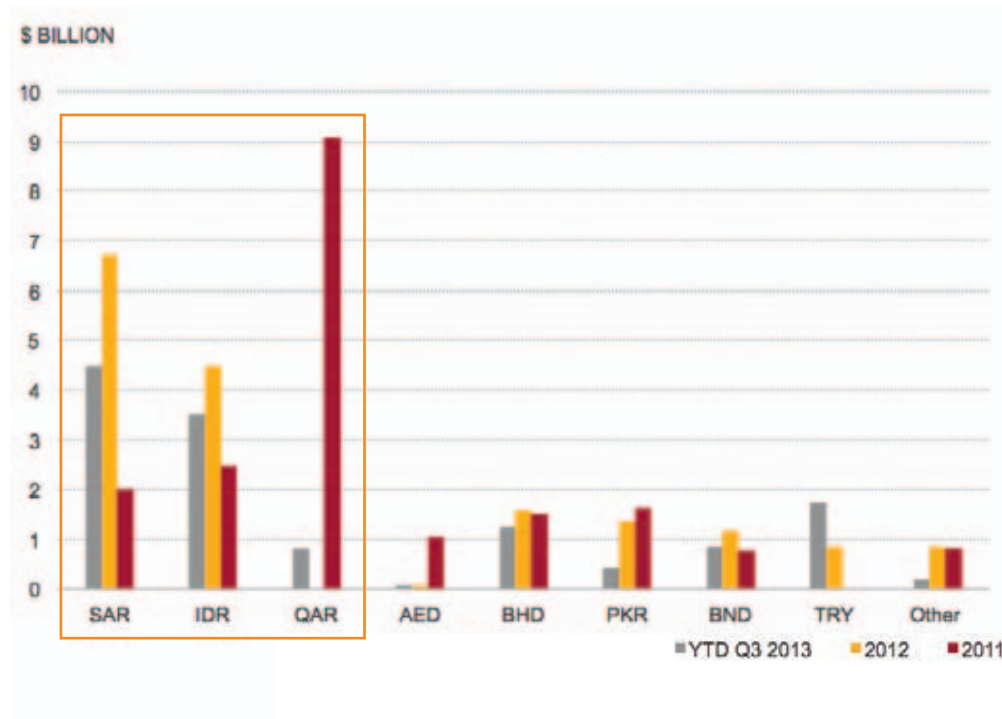
## GCC issuers are diversifying their funding through cross border sukuk issuance

### By Currency

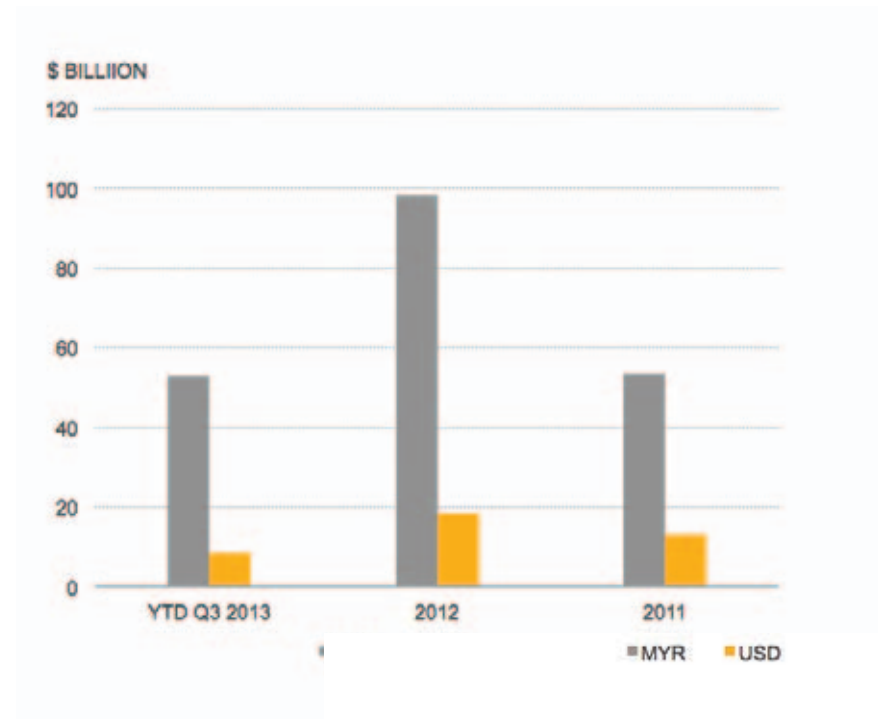
Malaysia is the most liquid market for sukuk and issuers will flock to a liquid market. Between the two sukuk powerhouses – Southeast Asia and the GCC - the trend for cross-border sukuk issuances has been one-way – Middle Eastern issuers selling in Malaysia. Investor and currency diversification will also encourage issuers to tap other markets other than their home market to reduce the concentration of both investors and currencies. Additionally, there is the attraction of the availability of a variety of structures that are popular in Malaysia but not elsewhere. Abu Dhabi National Energy Company's (TAQA) sukuk programme (first issue February 2012) in Malaysia is a prime example of an issuer seeking financing and geographical diversification. The sukuk is based on the commodity murabaha (commodity-linked) structure that is not as favoured by the GCC countries. In the first nine months of 2013, almost \$53 billion was raised in Malaysian Ringgit and only \$8.4 billion were issued in US dollars. This is a clear sign that issuers are confident tapping the Malaysian market.

Apart from the preferred MYR & USD currencies used for the cross border issuances, \$4.5 billion were issued in SAR and \$3.5 billion in IDR in the first nine months of 2013.

GLOBAL SUKUK CURRENCY COMPARISON EXCLUDING MYR & USD (JAN 11 - SEP 13)



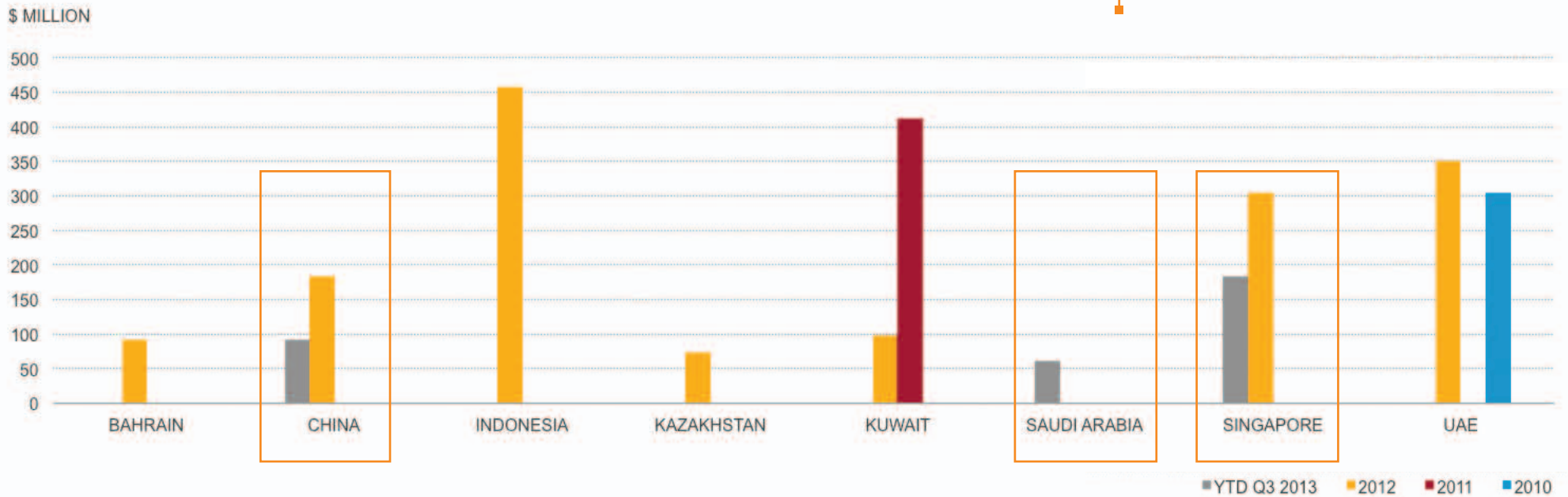
GLOBAL SUKUK CURRENCY COMPARISON MYR VS USD (JAN 11 - SEP 13)



More cross-border issuances have acclimatised Malaysian investors to GCC sukuk issuers. The returns on GCC sukuk are attractive to Asian investors mainly because of the political risk which adds a premium to yields. Most GCC sovereigns also have higher ratings than Malaysia's. Diversification also applies to investors, as they will be able to reduce concentration risk by distributing their eggs in different baskets.

In 2012, Malaysia had 11 cross border sukuk issued totalling \$1.56 billion (Bahrain, China, Indonesia, Kazakhstan, Kuwait, Singapore and UAE). In a drastic drop, only three countries issued cross border sukuk in Malaysia in the first nine months of 2013 - China, Saudi Arabia and Singapore, for a total volume of \$335.78 million.

CROSS BORDER SUKUK ISSUANCE IN MALAYSIA BY FOREIGN INVESTORS HISTORICAL TREND (JAN 10 - SEP 13)



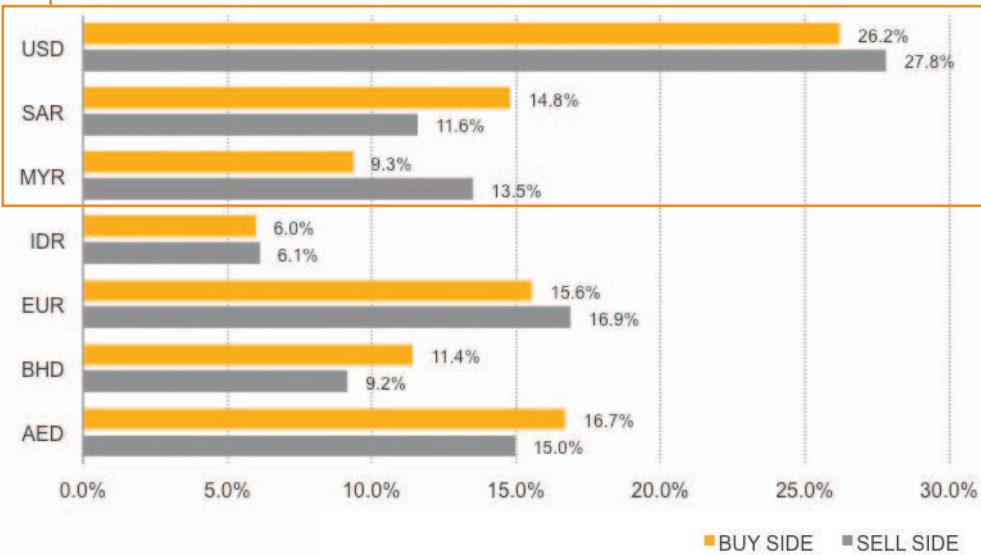
Both lead arrangers and investors choose USD as their first choice for cross-border sukuk issues, with the Euro and Emirati Dirham trailing.

Investors prefer AED as their second preferred cross-border currency, while lead arrangers expect EUR as their second option.

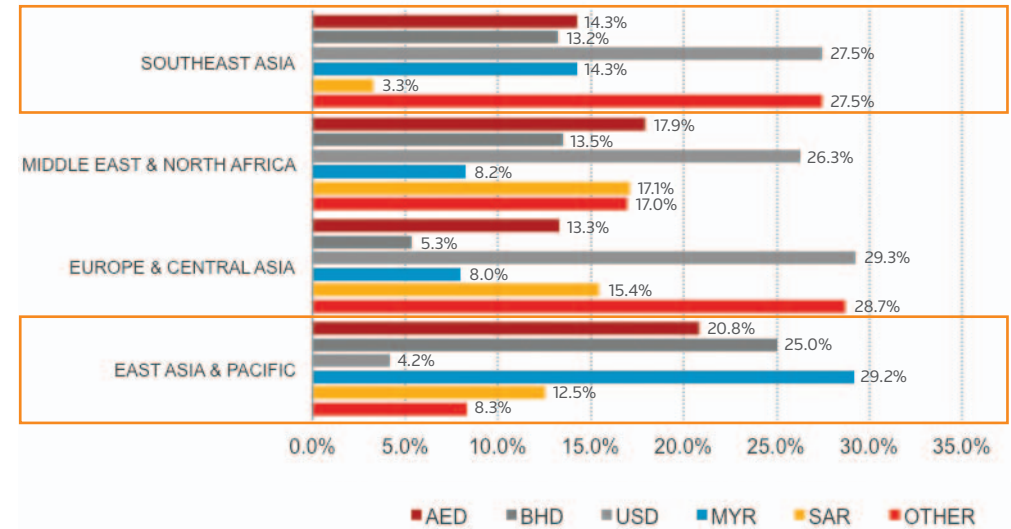
Interestingly, Southeast Asian investors prefer USD as a second currency as they can enter into currency swaps to manage currency risk. East Asia & Pacific are in favour of MYR as a second option for sukuk investment mostly due to their familiarity to the market and MYR's high liquidity and attractive pricing (most evident in 2012).

	Respondants	Skipped
SELL SIDE	27	8
BUY SIDE	57	63

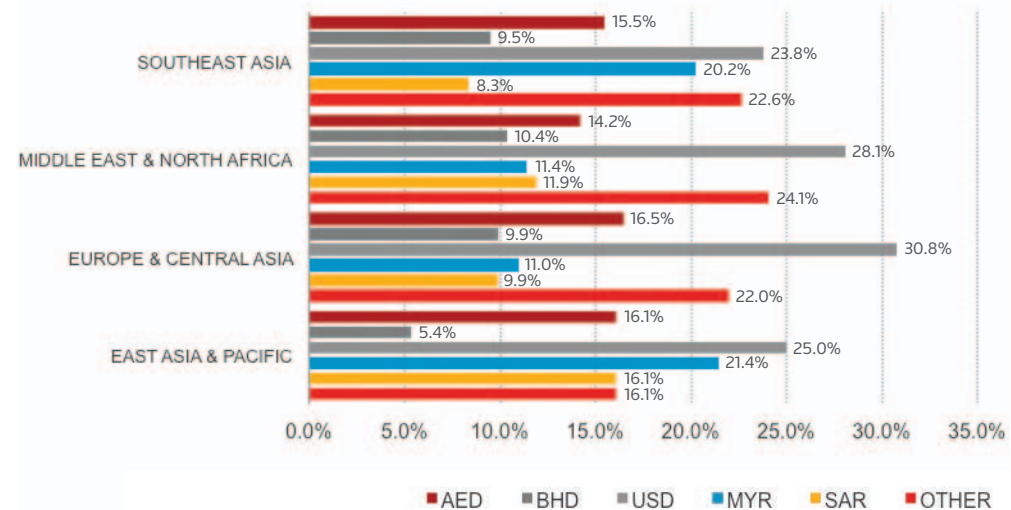
What is the most expected/preferred cross-boarder currency of sukuk (besides local currency) to issue/invest in 2013 and 2014



BUY SIDE: REGION BREAKDOWN



SELL SIDE: REGION BREAKDOWN



## International sukuk: a need for more disclosure and better transparency

By *Ahsan Raheem, CFA, FRM*  
Equity Analyst –Azzad Asset Management

Sukuk have developed to occupy a dynamic part of the Islamic financial system. A glance at the ratio of domestic versus international issues, however, reveals that there is some way to go before we can claim the sukuk market to be truly global. The value of global aggregate sukuk for the period January 1996 to September 2013 is \$488.17 billion, according to Thomson Reuters data. The sukuk market is dominated by domestic issues which represent 84% of the total market. International sukuk comprise only 16%. The issuance of international sukuk is a relatively new trend in Islamic debt markets. In 2002, the Malaysian government launched the first rated international sovereign sukuk. Since then, the value and volume of international sukuk have been on the rise. Cross-border sukuk is another consideration and a marker for the development of the global sukuk market. Cross-border issuances are few and far between although the number has been on the rise of late, with most activity coming from Gulf Cooperation Council (GCC) issuers tapping Malaysia's sukuk market.

According to Thomson Reuters Zawya's 2014 sukuk survey, 50.6% of investors prefer to invest in international sukuk, while 59.3% of lead arrangers believe that international sukuk will be the most expected type of issuance in coming years. This strong bias in favour of international sukuk is justifiable. Characteristics such as spread resilience, efficient distribution, tradability, and emerging market exposure have made them an attractive solution for Western institutional investors<sup>(1)</sup>. Large conventional players with global market reach have helped distribution and have added depth to the market through increased participation. However despite the increasing trend toward international sukuk issuance there are various challenges in need of attention from the Islamic finance industry.

From the perspective of the global sukuk investor, there are two main issues impeding demand for international sukuk. First, there is the issue of enforceability from a common law and sharia perspective. The second issue relates to the underlying assets that make sukuk unique. As either asset-backed or asset-based securities, sukuk are said to represent ownership. However, opaque reporting of underlying assets and often undisclosed or ill-defined ownership structures create challenges for international investors performing their required due diligence. This issue is evident with even a cursory examination of the information outlined in sukuk prospectuses. Both these issues, which are somewhat interrelated, remain hotly debated among many stakeholders in the Islamic finance industry.



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### Sharia enforceability

The distinction between sharia-incorporated jurisdictions and purely secular jurisdictions is important in addressing the issue of when, and under what circumstances, sharia is an enforceable element of a contract under the laws of a specific nation. Legal systems in many majority Muslim countries are still primarily secular.

Often, economic and legal structures are the product of legislation or royal decree, and some, if not most, of those structures remain unclear—or in conflict with, or contrary to sharia<sup>(2)</sup>.

Most legal systems have some provision incorporating sharia into the legal structure. However, the degree to which this incorporation occurs varies widely.<sup>(3)</sup> So, there remains some question of whether, in what circumstances, and to what extent sharia will be enforced even in jurisdictions within the Islamic economic sphere.

To highlight the issues pertaining to enforceability of sharia in different jurisdictions, consider a typical sukuk issue from Saudi Electricity (SE) Company. The SE Sukuk issuance is a securitization of assets located in Saudi Arabia, a sharia-incorporated jurisdiction. In this case, the asset originator is located in the same jurisdiction, while the Special Purpose Vehicle (SPV) Sukuk issuer is located in the Cayman Islands, a secular jurisdiction that allows for the choice of applicable law for financial transactions.

<sup>1</sup> Although the Sukuk market has improved in terms of liquidity and spread resilience over the past 24 months compared to conventional bonds, Sukuk issues usually trade with bigger spreads and sometimes offer low liquidity.

<sup>2</sup> "Contractual Enforceability Issues: Sukuk and Capital Markets Development" by Michael J.T. McMillen

<sup>3</sup> *Ibid*

SE Sukuk are sold to both Muslim and non-Muslim investors throughout the world. Applicable laws will include those of the sharia-incorporated jurisdiction (where the originator and the assets are located) and the Cayman Islands. In this case, sukuk certificates and the transaction documents are governed by English law. Furthermore, it is likely that securities laws in Saudi Arabia, as well as those of the various jurisdictions of the purchasers of the sukuk, will be applicable under certain circumstances.

Sukuk certificate holders share the added risk of courts not enforcing a foreign judgment in a country where sukuk assets are present. The legal system of the United Arab Emirates, for example, is unlikely to enforce a foreign judgment without re-examining the merits of the claim and may not recognize a foreign law as the governing law for a transaction. This is factored into sukuk prospectuses, for example in the Abu Dhabi Commercial Bank Islamic Finance (Cayman) Limited issue of 2011 due 2016, according to UAE commercial bank Abu Dhabi Commercial Bank (ADCB):

The UAE is a civil law jurisdiction, and judicial precedents in the UAE have no binding effect on subsequent decisions. In addition, court decisions in the UAE are generally not recorded. These factors create greater judicial uncertainty.<sup>(4)</sup>

Many of the countries where sukuk originators are domiciled allow arbitration under various international laws. However, investors are warned that there is no assurance that local courts will recognize and enforce any arbitral award. Moreover, the arbitration process can be costly and time consuming, as described in the SE Sukuk 2013 prospectus:

The Kingdom of Saudi Arabia is a signatory to the New York Convention on Recognition and Enforcement of Arbitral Awards (1958), and as such, any arbitral award could be enforceable in the Kingdom of Saudi Arabia but subject to filing a legal action for recognition and enforcement of foreign arbitral awards with the Board of Grievances, which can take considerable time.<sup>(5)</sup>

For sovereign sukuk, the country may unconditionally waive sovereign immunity, but it would still be difficult to enforce the waiver of immunity in a country's court against its own state. For instance, an Indonesian government November 21, 2012 sukuk prospectus explains that Indonesian law prohibits the seizure of property or assets owned by the republic:

The Republic is a sovereign nation. Consequently, it may be difficult for holders of the Certificates to obtain or enforce judgments against the Republic.<sup>(6)</sup>

4 Source: Sukuk Prospectus - ADCB Islamic Finance (Cayman) Limited due 2016 - Issue Date: November 22, 2011

5 Source: Sukuk Prospectus - Saudi Electricity Global Company 2 due 2023 & 2043- Issue Date: April 8, 2013

6 Source: Sukuk Prospectus - Republic of Indonesia Perusahaan Penerbit SBSN Indonesia II due 2018- Issue Date: November 21, 2012

7 "Contractual Enforceability Issues: Sukuk and Capital Markets Development" by Michael J.T. McMillen

8 Islamic Financial Services Industry Stability Report 2013

9 Ibid

In these examples, transactional and legal risks are significant, which can discourage global investors from entering the market. Transactional standardization is one of the methods of defining and reducing risk, reducing transaction costs, and preserving margins.<sup>(7)</sup> Equivalent conventional securitization transactions are, for the most part, quite standardized. For example, with conventional transactions, the same forms of financing documents are used with minimal change from one transaction to the next. These documents have been used successfully over a period of years and have been the subject of considerable interpretive litigation. Sharia-compliant transactions of this type have not yet obtained an equivalent degree of standardization or concomitant certainty, consistency, predictability, or transparency, especially as to enforcement of sharia.

Moreover, the legal framework in majority Muslim countries may need amendments to current laws or the issuance of new statutes with respect to securities, capital markets, taxation, and contract law.<sup>(8)</sup> It is a positive step that parliaments and supervisory authorities in a number of these jurisdictions have taken steps to issue or revise legislation and regulations for the issuance and trading of sukuk.

The Malaysian Securities Commission revised its Islamic Securities Guidelines, issued in July 2011, and issued its Guidelines on Sukuk in December 2012. The guidelines provide more comprehensive guidance on the subject, covering areas such as the approval process, applicable sharia rulings, and ratings and disclosure requirements. The Securities and Exchange Commission of Pakistan also issued draft rules for the issuance of sukuk in October 2012. Similarly, the Capital Market Authority of Oman issued its draft Sukuk Regulations in early 2013 to seek stakeholder feedback.<sup>(9)</sup>

Finally, the Turkish government passed legislation in February 2011 to facilitate the issuance of leasing certificates (Ijara Sukuk) that included tax neutrality measures consistent with equivalent conventional products.

### Underlying Sukuk Assets, Ownership, and Prospectus Disclosures

According to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), sukuk are defined as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct, and services, or (in the ownership of) the assets of particular projects or special investment activity."

Investors, in general, and socially responsible investors, in particular, are interested in understanding as much as possible about the underlying assets to which they have an ownership claim. They would like to understand where these assets are located, their value, purpose, and income generation ability. Most sukuk prospectuses, however, provide little information about the sukuk or trust assets. Offering documents from GCC bank sukuk provide limited information regarding underlying assets; in fact, they discourage prospective investors from gathering information or performing due diligence on assets. One such document states:

No investigation or enquiry will be made and no due diligence will be conducted in respect of any Wakala Assets comprised within a Wakala Portfolio.<sup>(10)</sup>

A determination as to whether the transaction constitutes a “true sale” has not been fully disclosed in certain sukuk issuances, a clear legal risk. There is often no assurance in the prospectus that legal ownership has been transferred to the SPV from the original owner, as stated in this recent sukuk prospectus from Malaysia’s Sime Darby:

No steps will be taken to perfect the legal transfer of the ownership interest (including registration if required as a matter of law) in the Lease Assets of any Series with any relevant regulatory authority in Malaysia and, therefore, in relation to any Assets or Lease Assets which require perfection in order to legally transfer any ownership interest; Sukukholders shall not have legal ownership in any such Asset or Lease Assets.<sup>(11)</sup>

There is, therefore, a need for more disclosure and better transparency to help investors make informed decisions. It is important to elaborate and more fully address sukuk assets and their legal ownership, while avoiding any conflicting clauses in order to comply with AAOIFI standard 5/1/8/3 on Investment Sukuk. That standard states:

The contract that forms the basis of the issue must be complete with respect to its elements and conditions and should not include conditions that conflict with its objectives and rules.

On the positive side, there has been noticeable progress with disclosure requirements in the industry. The Islamic Financial Services Board (IFSB) has proposed Guiding Principles on Investor Protection in Islamic Capital Markets as part of its Strategic Performance Plan 2012-2015. (12) On 18 September 2012, the IFSB, in collaboration with the International Organization of Securities Commissions (IOSCO) and the Malaysian Securities Commission, conducted a roundtable on disclosure requirements for Islamic capital market products. They discussed the importance of a strong disclosure regime in facilitating cross-border activity and the ways for collaboration between the IFSB and the IOSCO to address imminent issues concerning Islamic capital markets.

<sup>10</sup> Source: Sukuk Prospectus – ADCB Islamic Finance (Cayman) Limited due 2016 - Issue Date: November 22, 2011

<sup>11</sup> Source: Sukuk Prospectus – Sime Darby Global Berhad due 2023

<sup>12</sup> Islamic Financial Services Industry Stability Report 2013

## Conclusion

International and cross-border sukuk issuance is critical to strengthening the liquidity and price efficiency of Islamic financial markets. Global investors are looking for a more coherent understanding of contractual enforceability from both legal and sharia perspectives, and better disclosure with regard to a “true sale” and the underlying ownership of sukuk assets. There is a need for industry stakeholders, especially regulators and standard-setting institutions, to take more collaborative actions to standardize regulatory frameworks. This will provide the dual benefit of international confidence and strong legal backing to ensure investor protection.





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# Chapter Three Challenges



*2013: U.S. Fed threatens to sneeze  
and bond markets catch the sniffles.*



## Sukuk Price Dynamics

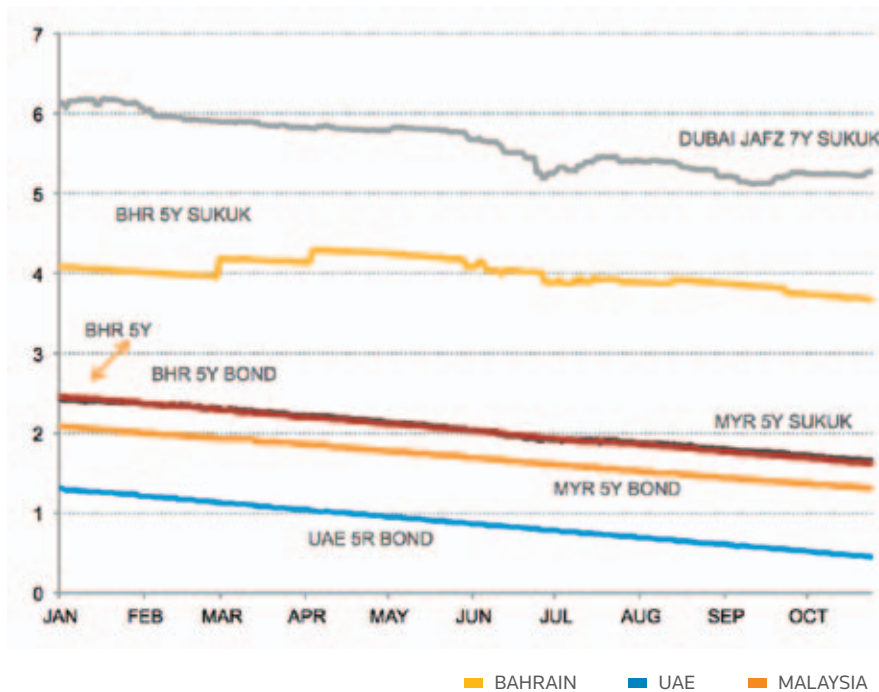
The U.S. Federal Reserve first floated the idea of tapering its stimulus package in May 2013 sending bond yields up around the world, and making it less attractive to issue debt

*Insights of international sukuk and bonds in the GCC and Malaysia in 2013*

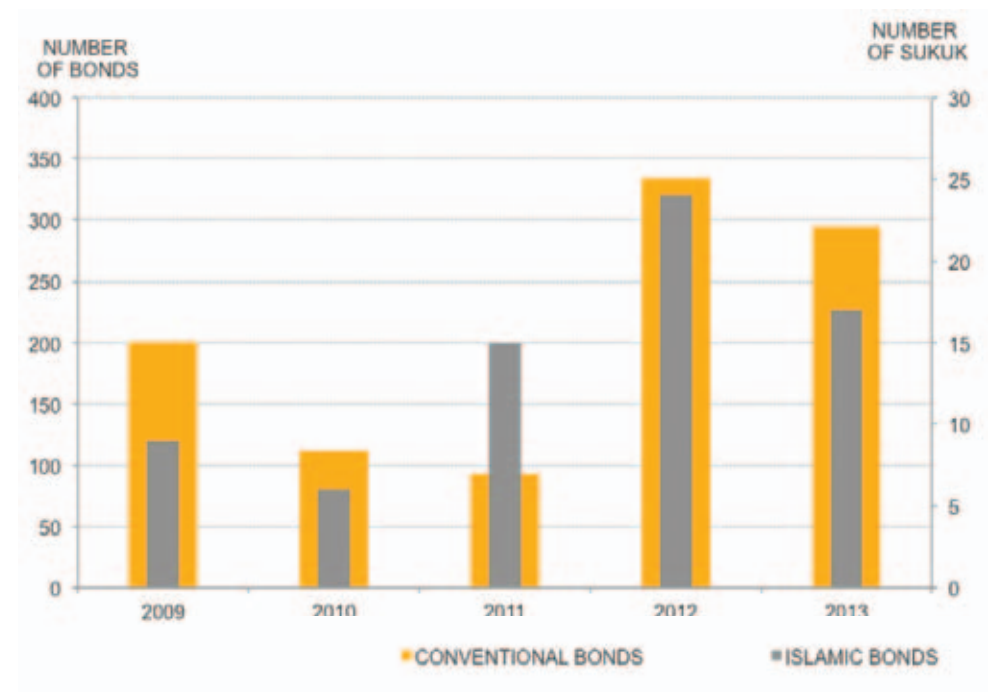
The volume of sukuk issuances plunged in the first half of 2013, but the second half picked up due to strong growth across regional capital markets. The announcement by U.S. Federal Reserve chairman Ben Bernanke to begin tapering quantitative easing (QE3) in 2013 should economic conditions allow for it have all but shut down any remaining hopes of international U.S. dollar bond issuances, making investors shift towards sukuk for its equity orientation. Talk of tapering QE3 has spiked investors’ fears of increased rates.

During the first half of 2013, conventional bond issuances out of the MENA region reached a new record. More than \$30 billion was raised by issuers from the MENA region in the first six months of the year. Tapping into excess global liquidity and investors seeking higher yielding assets, corporates in the region have been raising new debt or refinancing old ones. But signs are that such positive momentum may already have started winding down, with interest rates likely to rise when the Fed eventually cuts back QE3.

### SOVEREIGN YIELD COMPARISON (SUKUK AND CONVENTIONAL BONDS)



### NUMBER OF EUROBOND ISSUES PER YEAR FROM 2009 TO 2013



## But the Fed pointed to weaker US economic signals in September and again on October 30; this could all but rule out the potential of a slowdown in US quantitative easing before 2014

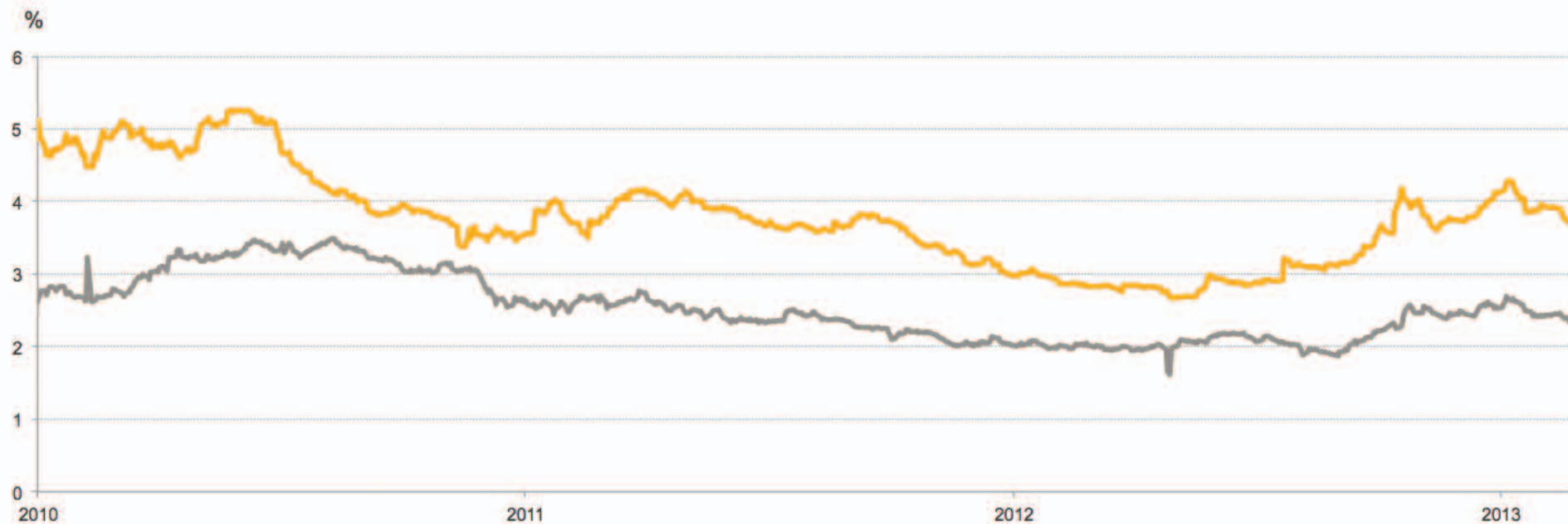
### *Danger lurking for bond and sukuk portfolio managers*

Rather than going to the market, potential bond and sukuk issuers waited to see how markets would react over the summer lull and autumn period. Emerging markets were victims of the hit on liquidity and they have suffered considerable capital outflows as investors reverted to safe havens. This increase in global rates has made several emerging economies vulnerable, since the value of their stock markets have declined and their currencies took a beating against the US dollar.

The Fed has stated it will only start taking the US economy off its fiscal incentive programme after U.S. job data shows evident improvement. Much will depend on how economic data, which has returned mixed signals for growth prospects, develops over the next few months and in 2014.

Investors have had to implement a more resilient and flexible approach in their fixed-income investing instead of avoiding bonds or sukuk altogether.

### JPMORGAN GLOBAL AGGREGATE BOND INDEX VS HSBC/NASDAQ DUBAI US DOLLAR SUKUK INDEX



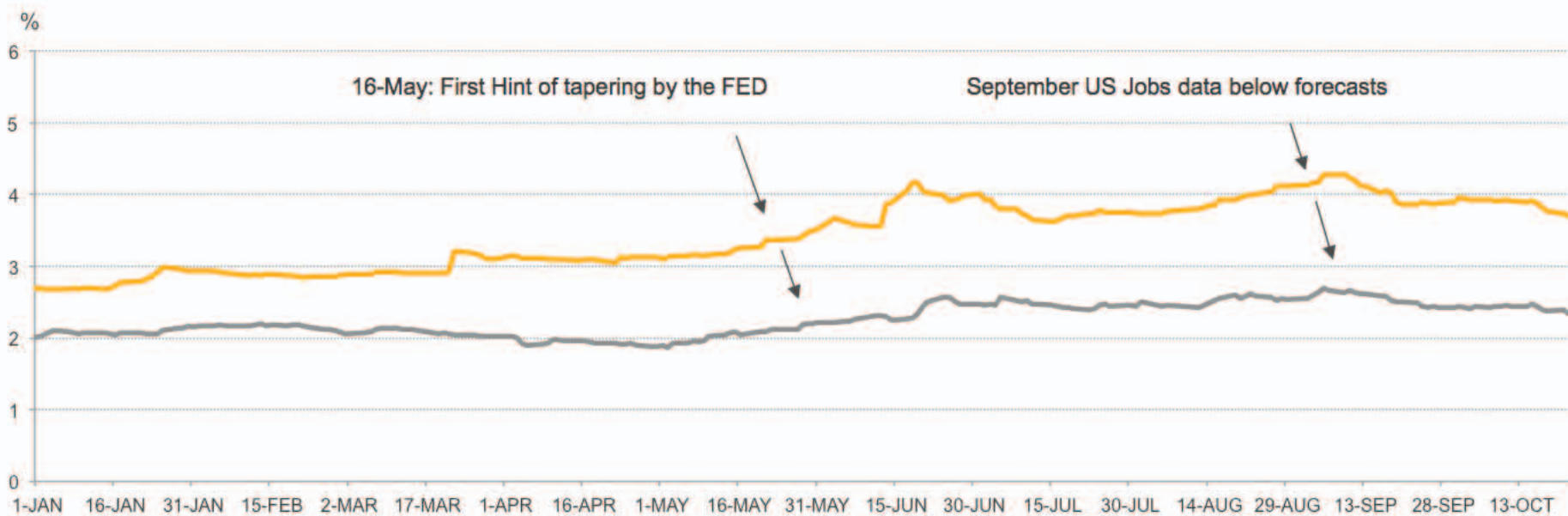
## Sukuk yields, however, have fallen below conventional bond yields, making it a cheaper option for corporates to raise financing

### Sukuk vs. bonds

Yields on sukuk fell below those of conventional bonds in October 2010, according to the HSBC/Nasdaq Dubai Sukuk Index. The spread between the two widened until about June 2012. Since then it has shrunk, but sukuk still remain the cheaper option.

In the first half of 2013, there were \$11.5 billion of sukuk issues from the MENA region. This was slightly less than the \$13.2 billion for the same period in 2012, which included the SR15 billion (\$4 billion) General Authority of Civil Aviation (GACA) sukuk from January 2012. (Qatar's \$4 billion dual-tranche sukuk was issued in July 2012, which is after the period under consideration here).

### YTD (OCT 2013) JPMORGAN GLOBAL AGGREGATE BOND INDEX VS HSBC/NASDAQ DUBAI US DOLLAR SUKUK INDEX



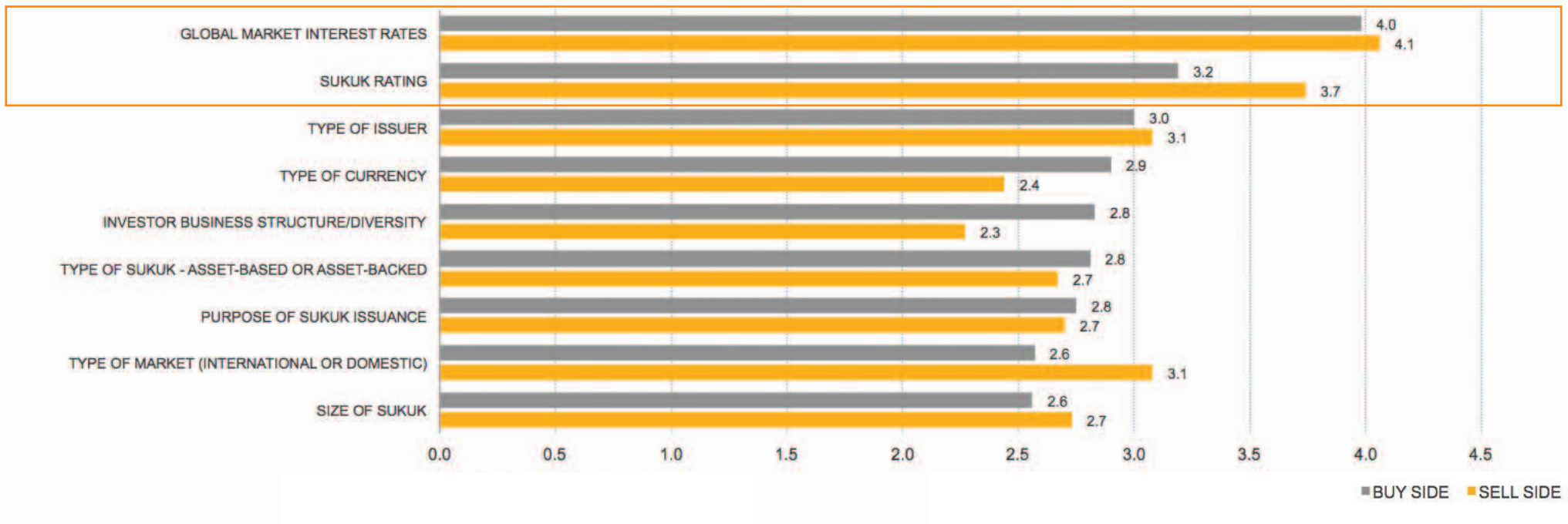
## Emerging market bonds and sukuk have been amongst the main beneficiaries of the Federal Reserve’s decision in September 2013 not to begin tapering its \$85 billion monthly bond-purchasing programme

### Sukuk pricing:

Lead arrangers and investors agree that global market interest rates are the most important factor affecting sukuk pricing. Markets have been put under pressure by the U.S. debt ceiling battle and the ongoing will-they-or-won’t-they cut back stimulus drama in 2013.

	Respondants	Skipped
SELL SIDE	25	10
BUY SIDE	56	64

The most important factors based on their significance to sukuk pricing.



## Investors are still confident that sukuk and bonds will generate positive returns in 2014, even in the face of a potential rise in long-dated US Treasury yields

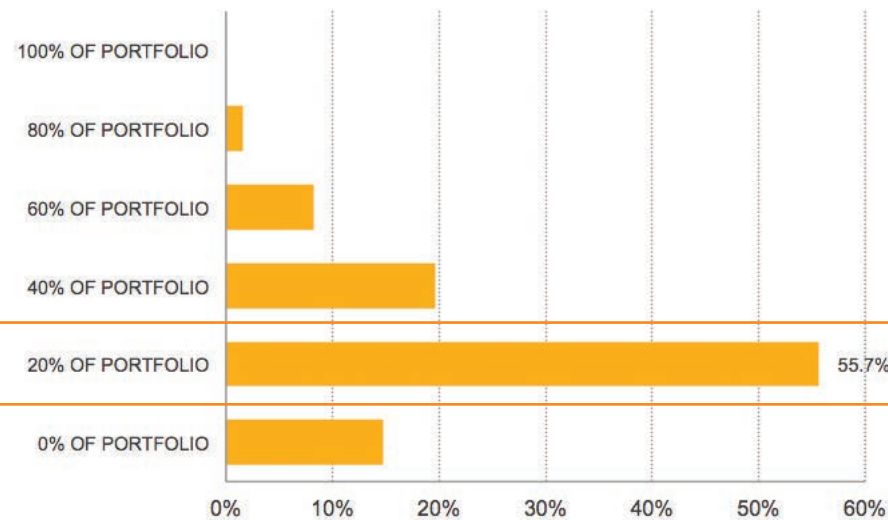
### Fixed Income vs. Equity

#### Fixed income vs. equity:

About 56% of investors say that 20% of their portfolio have been moved from fixed income to equities following the recovery in the equity market and the U.S. Fed’s tapering announcement.

	Respondants	Skipped
BUY SIDE	61	59

**BUY SIDE:** For 2013 and 2014, what is the total proportion of investors’ portfolio that have moved and are moving from fixed income (bonds and sukuk) to equities given the equity market recovery?



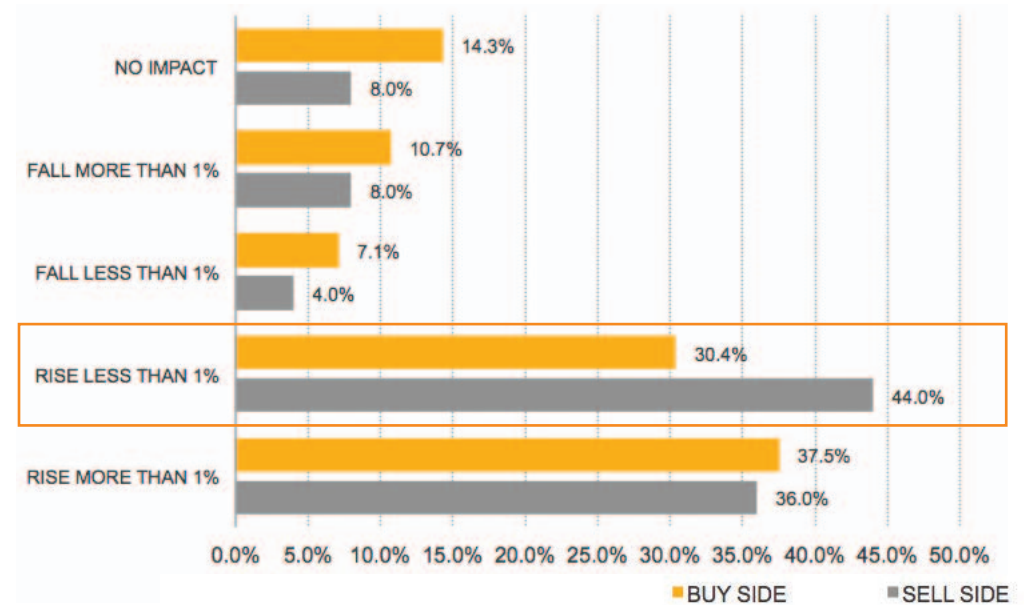
#### Interest Rate:

Lead arrangers believe that the yield on sukuk would rise less than 1% if there were a 1% rise in global interest rates;

While investors believe that the yield on sukuk would rise more than 1% if there were a 1% rise in global interest rates.

	Respondants	Skipped
SELL SIDE	25	10
BUY SIDE	56	64

**SELL SIDE:** In your estimation, If there were a 1% point rise in global interest rates would the yield on sukuk:





## 2014 outlook for emerging market fixed-income investors is anticipated brighter than 2013, with many expecting the asset class to turn positive next year in spite of an expected spike in rates

### Cost of sukuk

#### Cost of issuance

More than two thirds of lead arrangers agree that the cost of issuing sukuk is either the same or more expensive than conventional bonds.

#### Cost of issuance

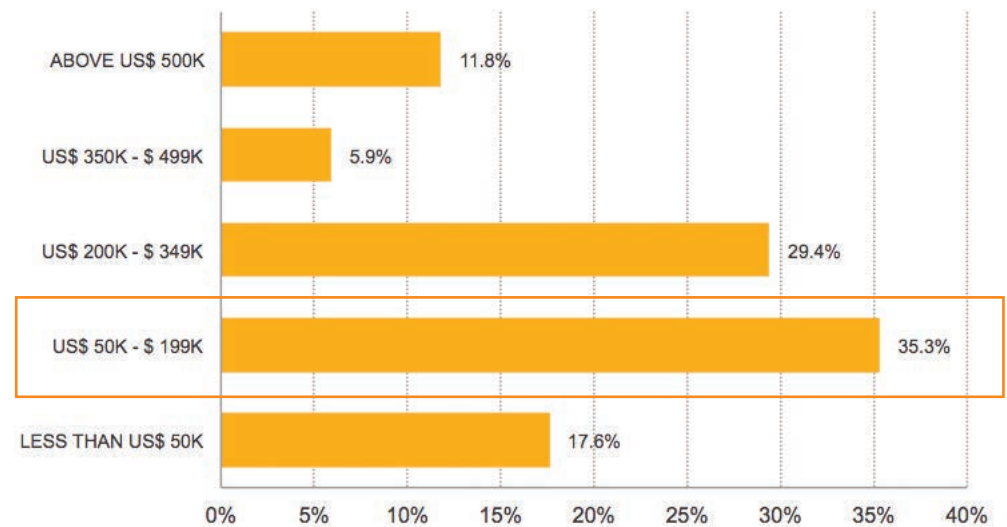
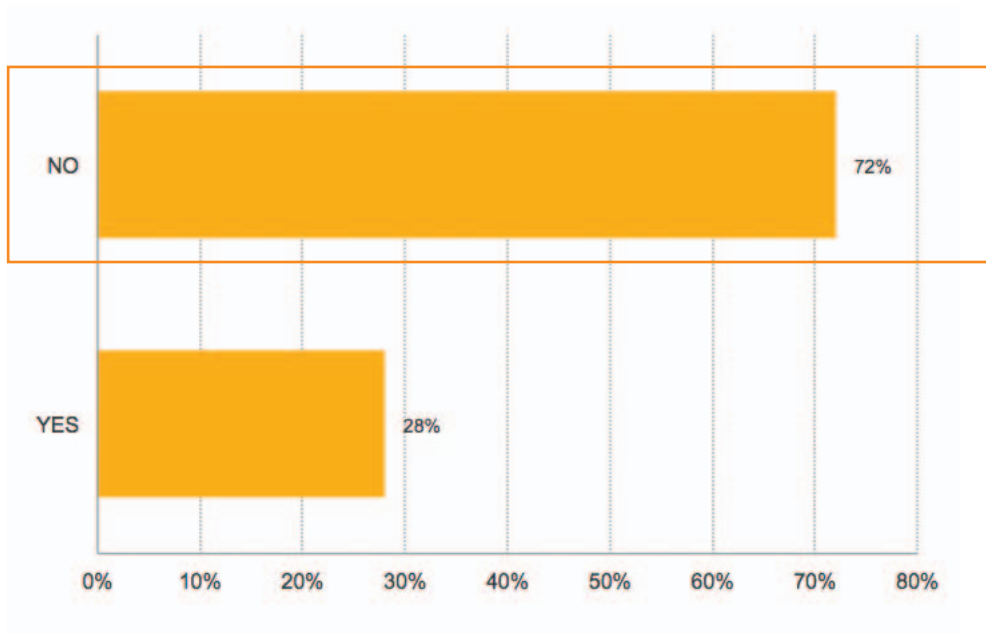
Most lead arrangers consider the additional cost of issuing sukuk over issuing conventional bonds to be between \$50k and \$199k.

	Respondants	Skipped
SELL SIDE	25	10

	Respondants	Skipped
SELL SIDE	17	18

SELL SIDE: Is the cost of issuing sukuk less than the cost of issuing conventional bonds?

SELL SIDE: If you answered No to the previous question, what is the average additional cost of issuing sukuk, for an issuer, compared to a conventional bond, in US dollar terms?



## Despite their higher issuing costs relative to bonds, sukuk have benefited from specialist investors who solely deal with sharia-compliant products

### Sukuk vs bonds

Majority of sellers would still issue sukuk if the yield was 50 bps higher than a conventional bond, followed by 26% who would issue sukuk regardless of the yield.

54.7% of buyers would still invest in sukuk regardless of the yield, followed by 35.8% if yield was 50 bps lower than a conventional bond.

### Cost of issuance

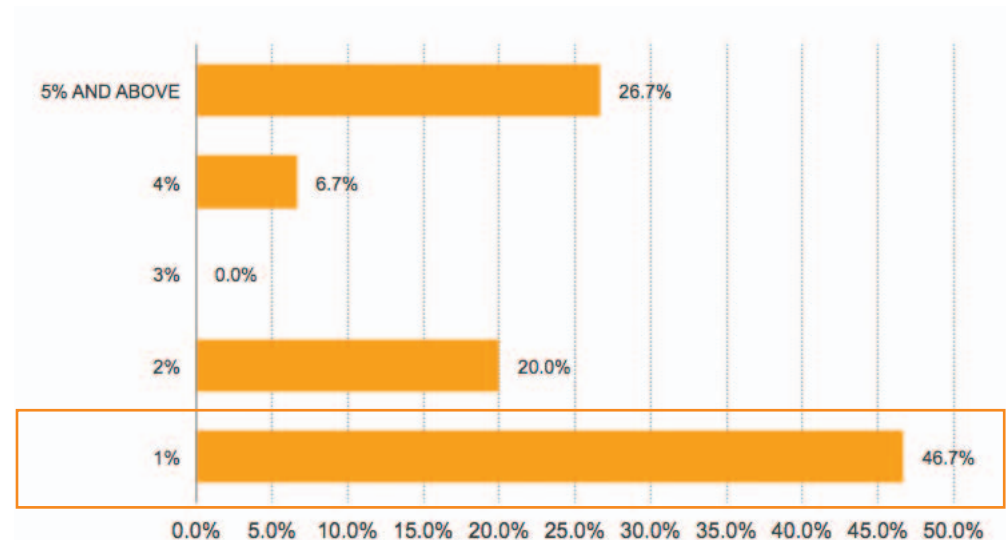
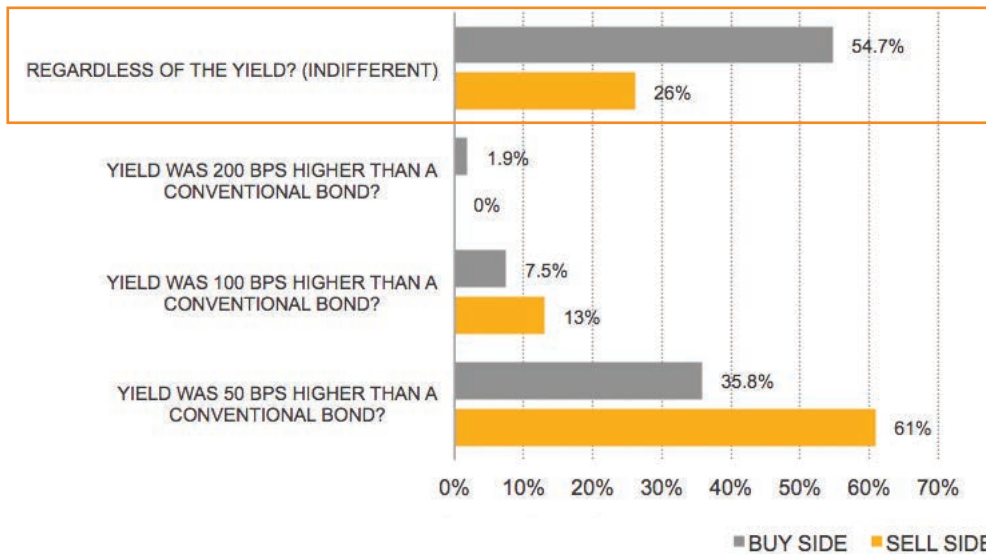
About 47% of lead arrangers believe that on average, the cost of a single sukuk issue is 1% of its total size.

	Respondants	Skipped
SELL SIDE	23	12
BUY SIDE	53	67

	Respondants	Skipped
SELL SIDE	16	19

### Would you still issue/invest in sukuk if?

SIDE: On average, what is the cost of a single sukuk issue expressed as a percentage of its total size?





*Despite the noticeable improvement, liquidity and tradability are still the main issues causing the price gap between sukuk and bonds.*

## Lack of tradability prices is one of the main issues facing sukuk liquidity

### Liquidity & Tradability Risk

Around 70% of lead arrangers believe that liquidity and tradability drives the price gap between sukuk and bonds.

The main reason behind the lack of liquidity and tradability is the relatively smaller size of the sukuk market compared to bonds. In addition, there is also the lack of shorter term sukuk for treasuries to reinvest their short term deposits to meet their short term obligations. The \$490 million IILM maiden sukuk issued on August 2, 2013 was structured to rectify this issue.

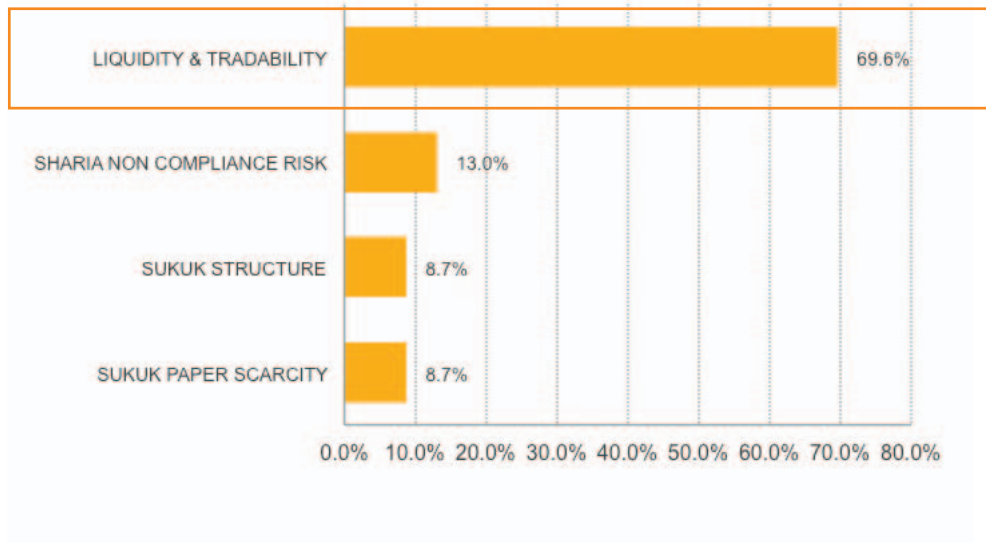
Most lead arrangers and investors believe that the lack of global international Islamic banks with wide networks, such as HSBC, JP Morgan, and Citi Bank, is the most significant setback for sukuk tradability and liquidity.

It is noticeable that in all international and big sukuk issuance, conventional banks are the main lead arrangers and book runners of sukuk while Islamic banks only play a secondary role by being a support to the issuance distribution limited to local markets. (Data for this can be found in the lead arranger league table in the appendices.)

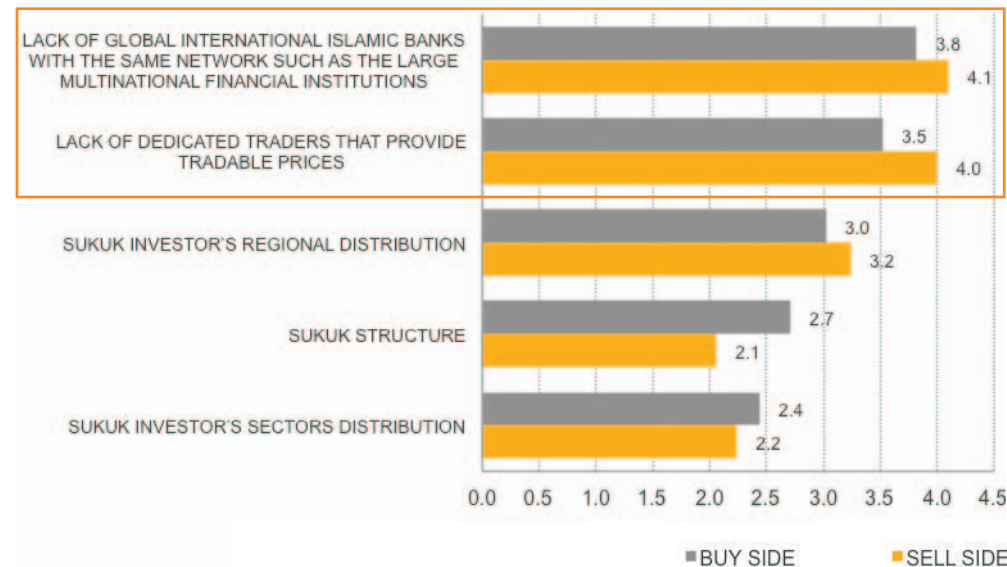
	Respondants	Skipped
SELL SIDE	23	12

	Respondants	Skipped
SELL SIDE	22	13
BUY SIDE	53	67

### SELL SIDE: What drives the price gap between sukuk and bond?



### What is the most significant sukuk tradability and liquidity setback?



## Regional distribution in the primary market drives sukuk movements

Almost all lead arrangers and investors believe that regional distribution in the sukuk primary market affects sukuk tradability and liquidity. Both lead arrangers and investors rank MENA as their first choice for regional distribution, followed by East Asia & Pacific and Europe & Central Asia.

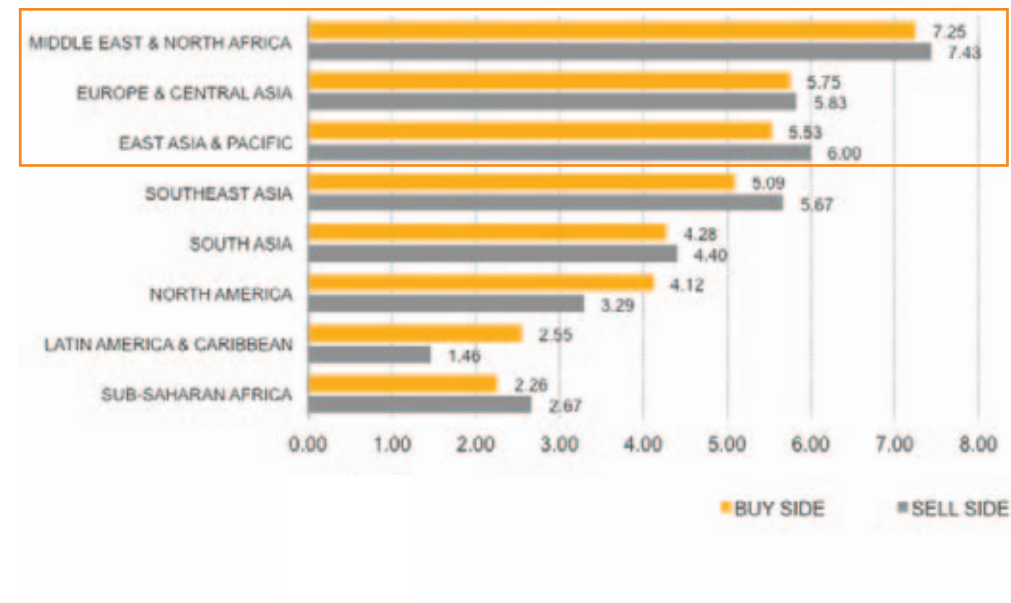
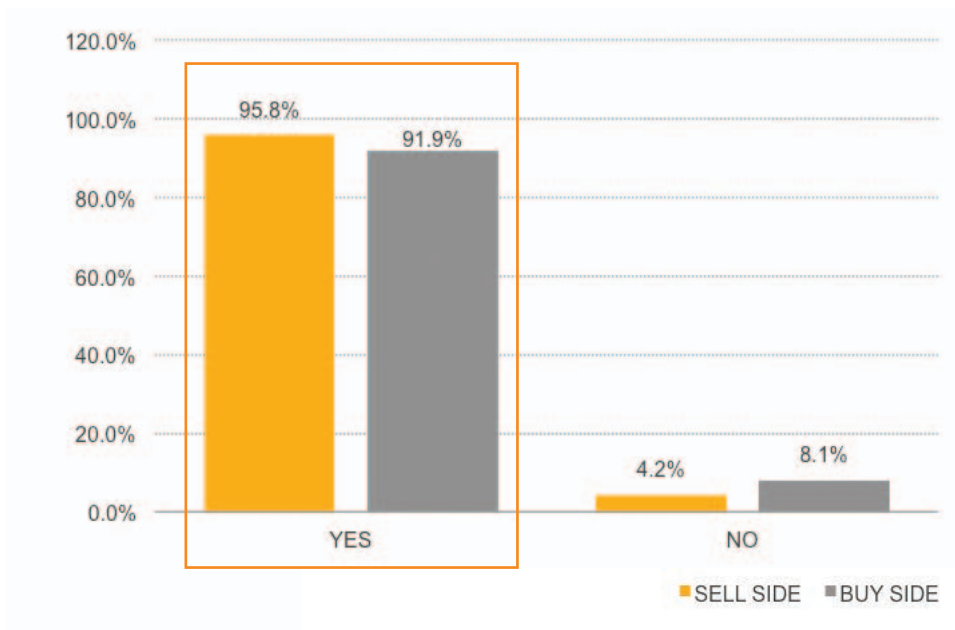
Lead arrangers and issuers usually believe that regional sukuk holders will hold on to the sukuk papers, given the scarcity of sukuk papers in the market to meet the high demand from both traders and investors which will assist in stabilising sukuk price. Investors and traders would also prefer regional distribution, as their well-established relationships and networks with Islamic banks better facilitate the exchange of papers.

	Respondants	Skipped
SELL SIDE	24	11
BUY SIDE	62	58

	Respondants	Skipped
SELL SIDE	21	14
BUY SIDE	51	69

Does the regional distribution in the sukuk primary market affect its tradability and liquidity?

If answered Yes to the previous question, Please rank the regions listed below as your expected/Preferred regional distribution for sukuk investors/holders.



## While the type of investor distribution drives the frequency of sukuk movement

91.7% of lead arrangers and 85% of investors say that distribution allocation in the primary market between the different types of investors (banks, government, funds. etc) affects tradability and liquidity.

The primary sukuk holders' intentions - whether to hold or trade sukuk - affects transactions in the secondary market and the number of available tradable sukuk.

Lead arrangers most rank banks as their first choice for sector distribution, followed by government and corporate. Investors also rank banks as the top sector, followed by government and corporate.

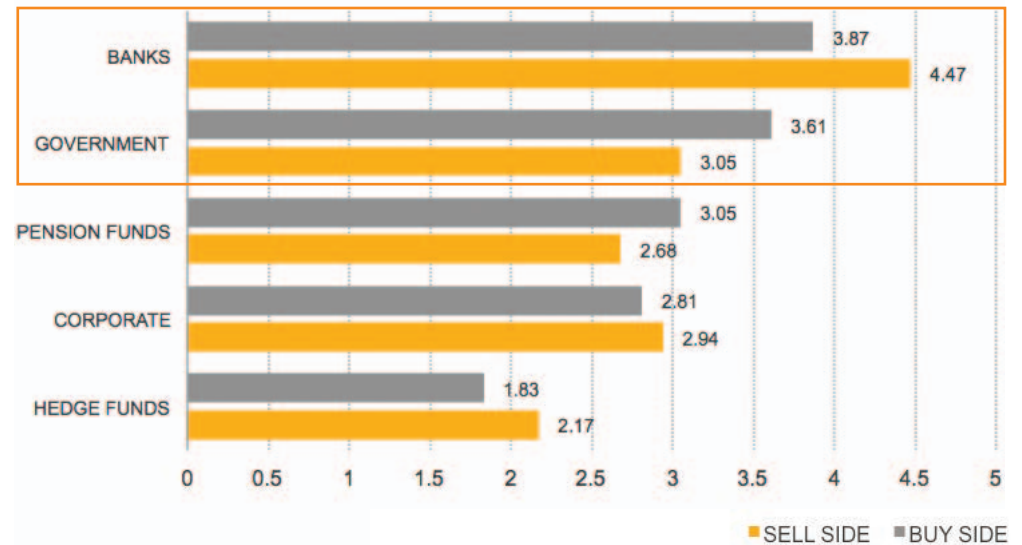
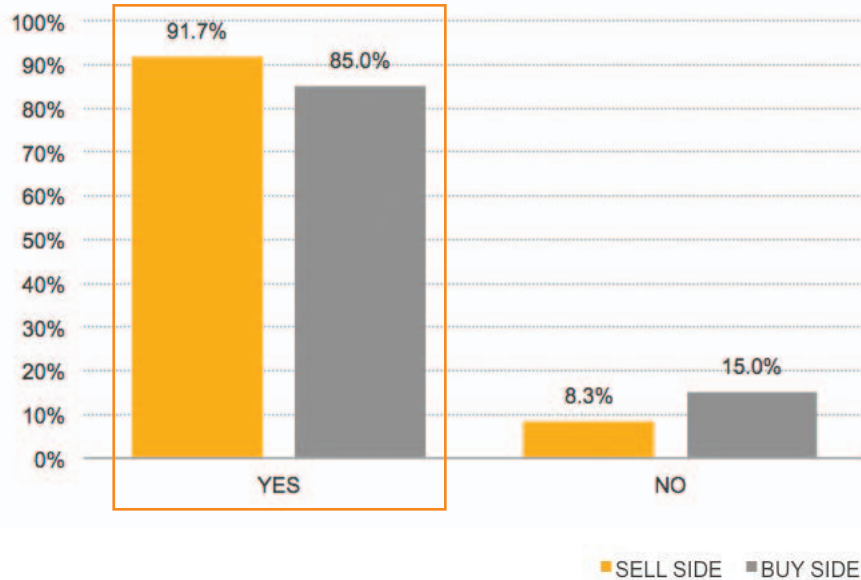
Buy-Sell sides believe that most banks and governments would trade sukuk to stimulate market tradability and gain short-term profit while pension & hedge funds would prefer to hold sukuk for longer periods to gain stable periodic income in the form of coupon payments.

	Respondants	Skipped
SELL SIDE	24	11
BUY SIDE	60	60

	Respondants	Skipped
SELL SIDE	20	15
BUY SIDE	49	71

Does the distribution allocation in the primary market between the different types of investors (banks, government, funds. etc) affect tradability and liquidity?

If answered Yes to the previous question, please rank the sectors listed below as your expected distribution allocation in the primary market among the different types of investors.



Note: Final quantitative findings for this question is based on the average scores of the ranking for each option

## More than 70 % of investors would like to liquidate their investment and book profits in less than 5 years

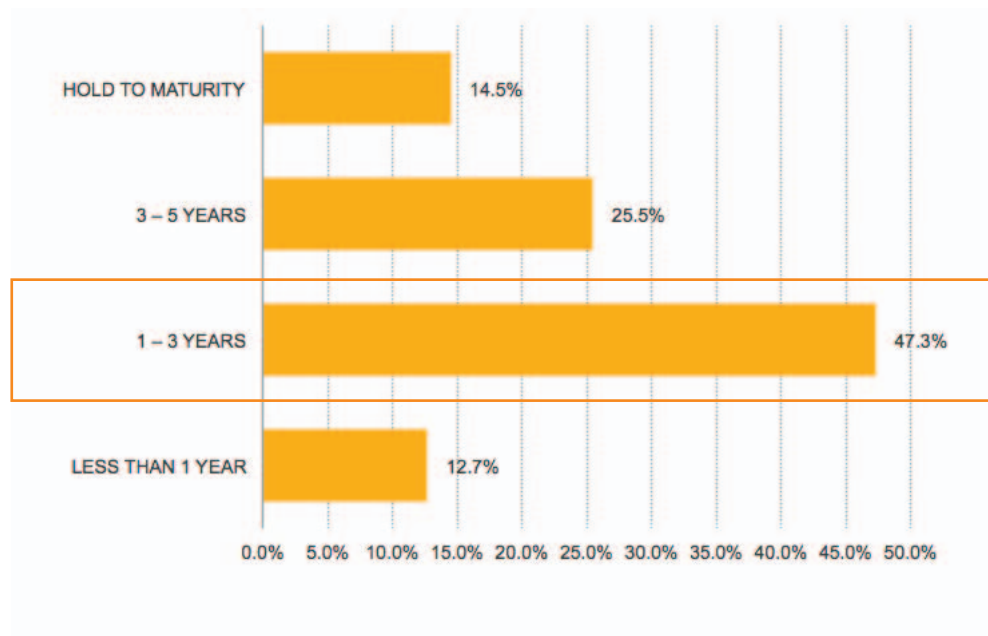
Most investors would hold their sukuk for 1 to 3 years, while a quarter of investors would hold their papers for 3 to 5 years. Most investors that prefer 1 to 3 years are from the financial and government sector while corporates prefer to hold for longer, up to 5 years.

Government would usually prefer to not hold papers and trade in order to stimulate tradability particularly in the local markets while banks would look to liquidate their investment once they view an opportunity to book early profits due to favourable market movements. On the other hand, corporates (which also includes pension & hedge funds) would prefer to hold on sukuk a bit longer to enjoy stable relatively high returns.

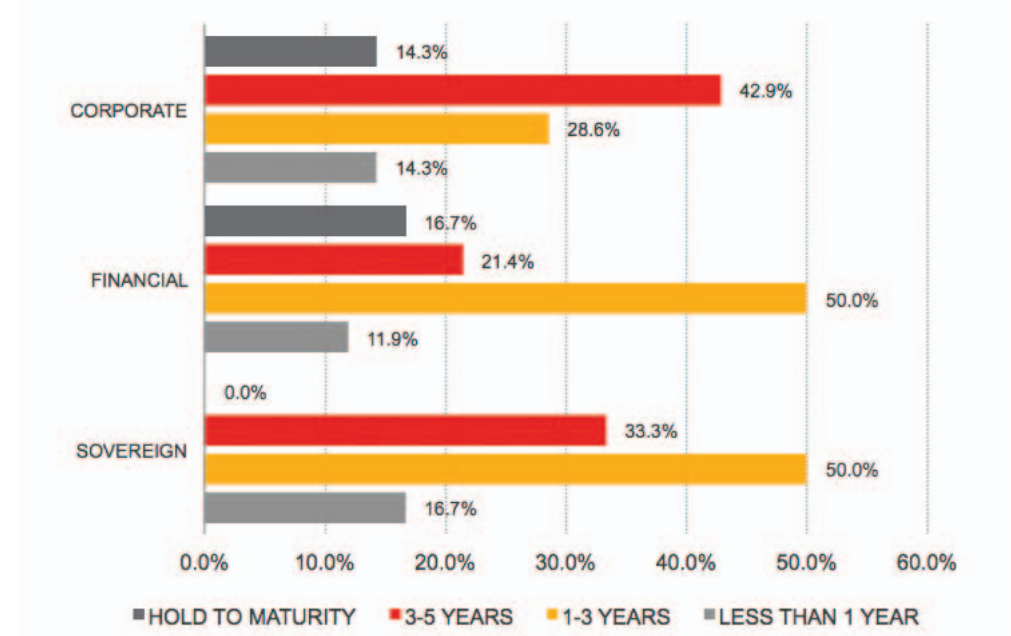
Noticeably, investors are not confident enough in the sukuk market to hold the sukuk until maturity (unless it is an Islamic bank whose sharia board forbids trading sukuk). They may also not see enough value to trade sukuk in the shorter term due to limited returns.

	Respondants	Skipped
BUY SIDE	55	65

BUY SIDE: If you invest in sukuk, what is your average hold period for the sukuk you buy?



BUY SIDE: Sector Breakdown



## Despite investors preferring to hold sukuk for 1 to 3 years, most of them categorize sukuk as HTM on their balance sheets. This weakens liquidity and tradability

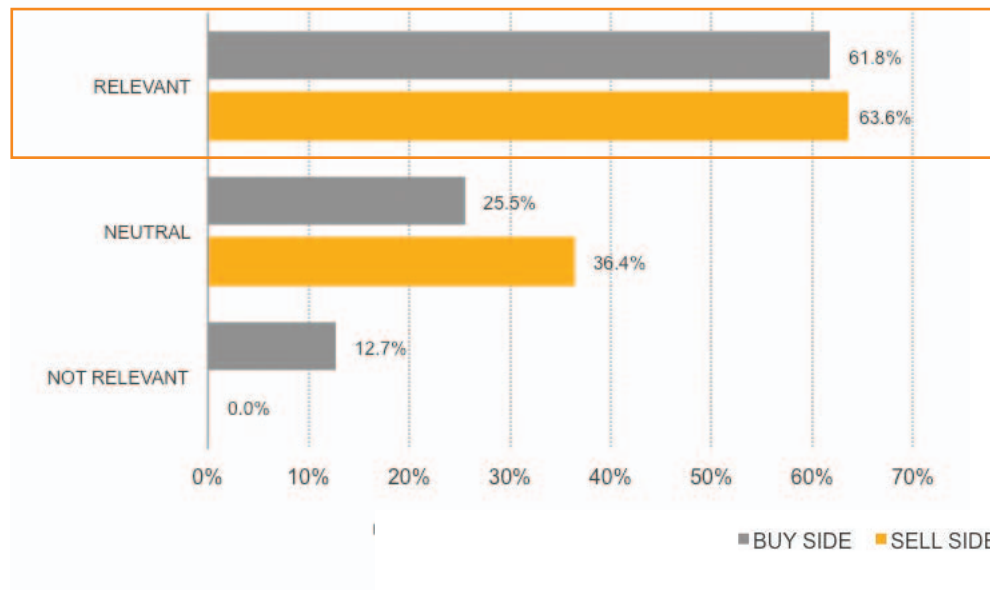
63.6% of lead arrangers believe sukuk categorization is relevant, and 36.4% remain neutral on the matter. Similarly, investors are also of the opinion that sukuk categorization is relevant, followed by 25.5% who do not categorise them either way.

Most investors classify their sukuk as HTM in their balance sheet, followed by AFS. HTM limits the ability of investors to trade sukuk due to accounting policies constraints or sharia restrictions in trading certain type of sukuk structures. On the other hand, having fewer papers to trade in the market will increase the bid-ask spread and lower the liquidity process.

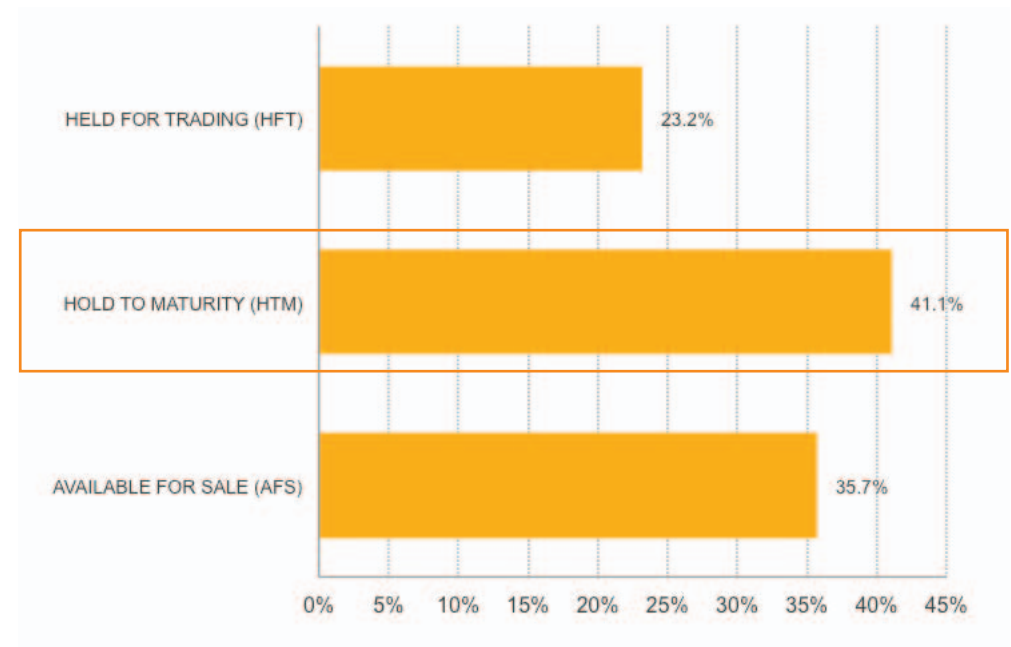
	Respondants	Skipped
SELL SIDE	22	13
BUY SIDE	55	65

	Respondants	Skipped
BUY SIDE	56	64

How relevant is sukuk categorization (Available for sale (AFS), Hold to maturity (HTM), Held for trading (HFT)) on the investor’s balance sheet for liquidity and tradability?



BUY SIDE: How do you categorize sukuk in your balance sheet?





## Sukuk Liquidity and Tradability Risks

*By Mohammad Ahsan, CFA  
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Liquidity is the lifeblood for any market and its importance increases exponentially in the global debt markets, which essentially trade over-the-counter. Bond trading is facilitated for potential buyers and sellers by banks acting as market-makers/dealers, providing bid-offer quotes, and committing their own balance sheet to hold or warehouse inventory. However, the shape of this activity is changing post-global financial crisis and we are slowly approaching a liquidity trap situation in global debt markets.

The 2008 crisis was sparked by sub-prime credit and later fire-balled into a global epidemic due to sudden flight of liquidity from debt markets. Post-crisis all major global banks, facing stringent capital requirements under Basel III and domestic regulatory changes such as the Dodd-Frank Act (the Volker Rule is a part of this Act and it basically restricts US banks from proprietary trading), are slowly retreating from the business of bond trading through inventory warehousing. Both the magnitude and timing of this development is alarming, to say the least. The following explain why.

### Global bond issuance: Going North

The past few years have seen a phenomenal rise in the global debt markets spurred by ultra-loose monetary policies (low or zero policy rates and asset purchases commonly referred to as quantitative easing) pursued by central banks in the major developed markets. Quantitative easing allowed borrowers across the world to tap the debt market and raise record sums of money. Cumulative global bond issuance reached almost US\$ 26.3 trillion between 2010 and September 2013.

### Dealer inventories – Going South

In boom times for global debt markets, according to U.S. Federal Reserve data, corporate-bond inventories among primary dealers in America have fallen by a staggering 78 percent to below US\$ 60 billion, from a peak of US\$ 235 billion in 2007.

The picture is not very different for European banks. The potential consequences are pretty severe – investors who have happily accumulated positions in fixed income may find it difficult to time their exit from the market and could end up holding the paper for a much longer period than anticipated.

Fortunately for the debt markets, record volumes of new deals (primary issuances) have provided liquidity to investors and hence the effects of lower dealer inventories are still not clearly visible. However, when interest rates do start to eventually rise, and bond investors decide to off-load their holdings, there will be a much lower appetite for the paper in the secondary market, as most banks will probably be focusing on pure “intermediation” – trying to match buyers and sellers, rather than risk warehousing.



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Ahsan has over 13 years of experience in Investment Banking, and Treasury and Capital Markets. He heads the Structured Solutions and Fixed Income Trading Desk at Mashreq, which is primarily responsible for developing structured asset & liability solutions, fixed income distribution and secondary market credit trading services for institutional, corporate and HNW/retail clients of the Bank. Ahsan also supervises the risk warehousing and market-making activities of the Bank in the fixed income markets. He manages the economic and market research function of Mashreq, and works with the trading team to regularly provide market comments/updates and trade ideas. He has worked on several local and international bond/sukuk transactions totaling over USD 1 billion.

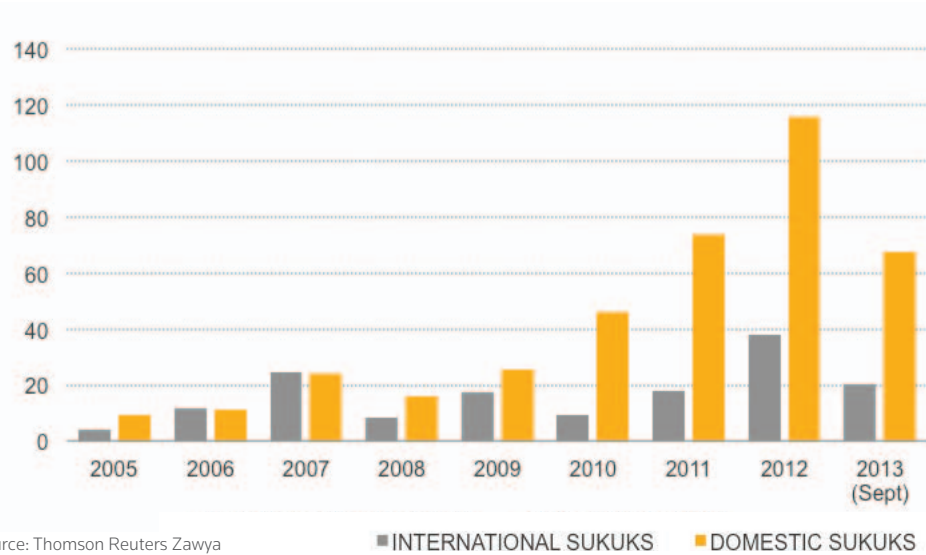
Ahsan completed his MBA from Institute of Business Administration Karachi in 1999 and holds CFA Charter awarded by the CFA Institute and FRM Charter awarded by Global Association of Risk Professionals (GARP).

### Does the global sukuk market face the same liquidity risk?

The development of the sukuk market is a fairly recent phenomenon. It was only in 2005 when sukuk issuance (both domestic and international) crossed the US\$ 10 billion mark. Although the sukuk market has grown at an impressive rate, its market size is still very small compared to the global conventional bond market. During the period 2005 to September 2013, total global sukuk issuance reached US\$ 540.3 billion; over 70 percent of deals were domestic issues. Domestic sukuk issuance steadily increased from US\$ 16 billion in 2008 to US\$ 116 billion in 2012. However, such sukuk are generally not tradable outside their domestic market and hence have limited foreign investor interest. Therefore, from the liquidity and trading perspective, our focus is only on international sukuk.

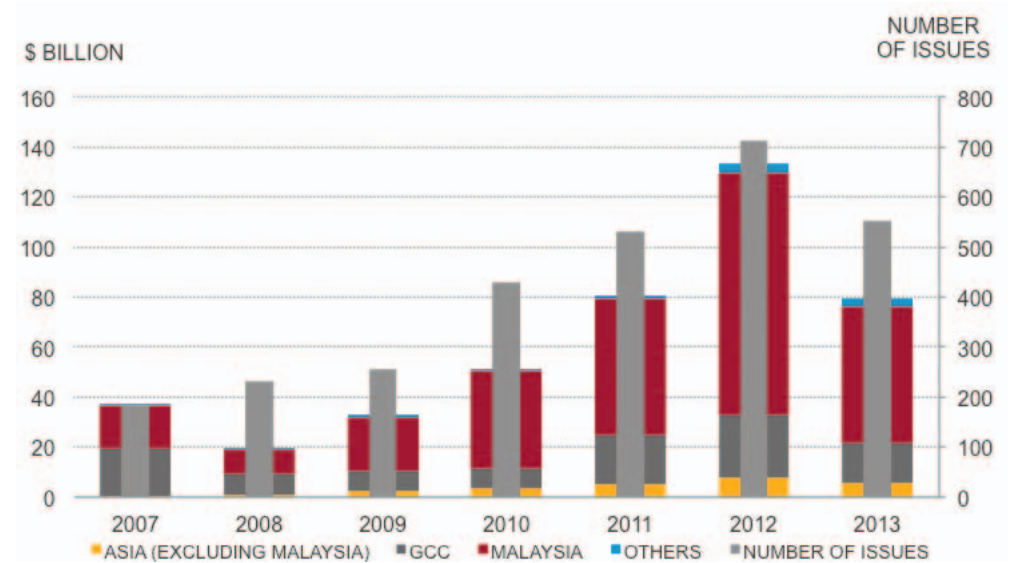
New issuance of international sukuk witnessed a precipitous drop in 2008 to US\$ 8.2 billion from US\$ 24.4 billion in 2007. Since then it has picked up speed and cumulative new issuance touched approximately US\$ 103 billion during the period 2009 to September 2013. However, it is pertinent to note that historically, international sukuk issuance has primarily come from the GCC region – 65 percent of new sukuk issues for the period under consideration were from GCC issuers. Indonesia, Malaysia and Turkey (from 2012) are the other countries with increasing international sukuk deals. Within the GCC, sovereigns and financials have been the major sukuk issuers.

FIGURE 1: TOTAL SUKUK ISSUANCE 2005 – SEPTEMBER 2013



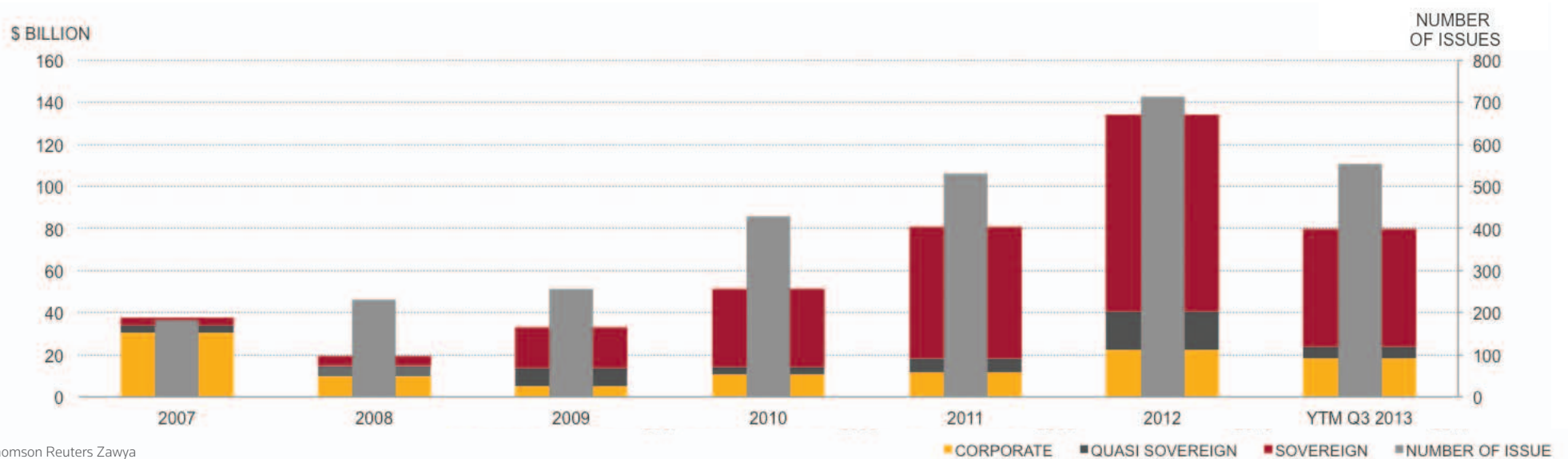
Source: Thomson Reuters Zawya

FIGURE 2: SUKUK ISSUANCE BY REGION 2007-SEPTEMBER 2013



Source: Thomson Reuters Zawya

FIGURE 3: SUKUK ISSUANCE BY BORROWER TYPE 2007-2013 YTD



Source: Thomson Reuters Zawya



Another important factor affecting tradability/liquidity is the geographical distribution of the investor base. Interestingly, participation of Middle East-based investors in the GCC region's sukuk deals has been increasing over time, an evidence of strong "local bid", as we say in our parlance.

Table 1 shows the allocation by region for some of the recent sukuk issues. We can see that Middle Eastern investors were apportioned the lion's share for most issues. Secondly, allocation of new sukuk issues in terms of investor type is primarily tilted to favour banks, asset and fund managers, and private banks.

**TABLE 1: ALLOCATION BY GEOGRAPHY FOR SELECTED SUKUK**

Issue	ME	Europe	Asia	USA
Qatar Islamic Bank 2017	48%	18%	30%	4%
Qatar International Islamic Bank 2017	50%	20%	30%	
Jabal Ali Free Zone 2019	65%	28%	7%	
Emirates Islamic Bank 2017	42%	28%	30%	
State of Qatar 2017	58%	20%	18%	4%
State of Qatar 2022	50%	23%	21%	6%
Republic of Turkey 2018	58%	22%	12%	8%
Abu Dhabi Islamic Bank Perpetual	32%	26%	38%	4%
Emaar Properties 2019	48%	38%	13%	1%
Dubai Water & Electricity Authority 2018	65%	23%	12%	
Emirates Airline 2023	85%	7%	5%	3%
Dubai Islamic Bank Perpetual	38%	29%	29%	4%
Saudi Electricity & Water Authority 2023	49%	21%	15%	15%
Saudi Electricity & Water Authority 2043	25%	33%	15%	27%
Sharjah Islamic Bank 2018	53%	17%	30%	
Dar Al Arkan 2018	76%	22%	2%	
Bank Al Hilal 2018	58%	17%	22%	3%
Republic of Turkey 2018	27%	42%	10%	11%
Emirate of Ras Al Khaimah 2018	56%	20%	23%	1%

Source: Mashreqbank

**TABLE 2: ALLOCATION BY INVESTOR TYPE FOR SELECTED SUKUK**

Issue	Banks	Fund Managers	Private Banks	Others
Qatar Islamic Bank 2017	42%	39%	6%	13%
Qatar International Islamic Bank 2017	44%	34%	4%	18%
Jabal Ali Free Zone 2019	64%	27%	9%	
Emirates Islamic Bank 2017	35%	40%	20%	5%
State of Qatar 2017	61%	24%	7%	8%
State of Qatar 2022	54%	33%	9%	4%
Republic of Turkey 2018	59%	26%	5%	10%
Abu Dhabi Islamic Bank Perpetual	11%	26%	60%	3%
Emaar Properties 2019	40%	47%	7%	6%
Dubai Water & Electricity Authority 2018	63%	24%		13%
Emirates Airline 2023	73%	19%	5%	3%
Dubai Islamic Bank Perpetual	33%	29%	32%	6%
Saudi Electricity & Water Authority 2023	32%	42%		26%
Saudi Electricity & Water Authority 2043	10%	64%		26%
Sharjah Islamic Bank 2018	12%	49%	24%	15%
Dar Al Arkan 2018	62%	34%		4%
Bank Al Hilal 2018	48%	31%	4%	17%
Republic of Turkey 2018	43%	36%	7%	14%
Emirate of Ras Al Khaimah 2018	46%	33%	3%	18%

Source: Mashreqbank

This tells us that most global sukuk are from Middle Eastern issuers – primarily sovereigns and financials, and are mostly held by regional investors – primarily banks and asset managers. So what does this tell us about liquidity?

Firstly, it is fair to say that the shrinking of dealers' inventories (international banks) is not a major concern for sukuk markets in the region. There are several major local/regional banks which are active in trading and making markets for sukuk and hold sizeable inventories to service the needs of their clients.

Secondly, the sukuk are primarily held by the investor segment – specifically Islamic banks – which are generally long term hold-to-maturity (HTM) players. As a credit trader I have observed that whenever the regional credit markets have seen significant selling pressure (Dubai World stand-still in 2009, European sovereign crisis in 2011 and Ben Bernanke’s tapering comment in May 2013), the “local bid” has absorbed most of the bonds/sukuk.

However, there is a flip side to this, which we encounter when the ticket size is fairly large. As mentioned earlier, the sukuk market is still small compared to the conventional market and the number of outstanding issues for investment/trading is still only in double digits. When one needs to buy in size, it is extremely difficult to source paper from HTM investors and efforts to do so invariably cause the price to rise. Similar difficulty is faced when the offer size is large and it becomes a challenge to sell without pushing the price down. The limited depth of the sukuk market boils down to the scarcity factor – there are not enough global sukuk issues to quench the appetite of investors, who are loaded with liquidity and are looking for deployment avenues. To put the above challenge in perspective, according to JP Morgan, the current outstanding size of the global sukuk market is approximately US\$ 46.6 billion. Out of this, 86% or US\$ 40.1 billion is from Middle Eastern issuers. We believe there is significant scope for new sukuk issues from other geographies. Secondly, within the Middle Eastern sukuk issues, 68% or US\$ 27.25 billion have come from the corporate and quasi-sovereign sectors. Sovereign sukuk issuance, though improving, has significantly lagged behind the corporate/quasi sovereign issuance. Dubai sovereign has been one of the most active sukuk issuers, followed by the Emirate of Ras Al Khaimah and Kingdom of Bahrain. The State of Qatar, which is a regular borrower in the debt markets, issued its maiden sukuk only last year. Lastly, and more importantly, even within the Middle East region, sukuk issues comprise only 20% of outstanding debt stock. This shows that although the region is like a “home market” for sukuk issues, the size of the conventional bond market is still far bigger than the sukuk market.

Another factor inhibiting liquidity from the demand side is non-inclusion of regional sukuk issues in any of the major emerging market bond indices such as JP Morgan’s EMBI Global Index and CEMBI Broad Index. This restricts global bond funds/asset managers, using such indices as benchmarks, from allocating a portion of the assets under management (AUM) to sukuk issues.

### What will improve sukuk liquidity?

We reiterate that sukuk market liquidity is a function of higher supply. Growth in total sukuk market size vis-à-vis the conventional bond markets will lead to improved liquidity. We believe the following will help:

- **GCC region will continue to be the main driver of growth in the sukuk market.**  
However, going forward, we need to see a larger proportion of sukuk issues in gross new issuance. Current proportion of 20% is low, to say the least. Sovereign issuers can take a lead by raising a higher portion of their debt funding through sukuk. Similarly, corporate issuers using both conventional and sharia-compliant financing can shift the balance in favor of sukuk issues.
- **Higher pace of international sukuk issuance from markets such as Turkey, Indonesia and Malaysia.**  
The sovereigns have issued sukuk in the past two years coupled with corporates and financials who have occasionally tapped the market. However, there is significant scope for growth. For example, Turkish conventional banks, which are regular issuers of debt, are currently not allowed to issue a sukuk. A favorable change in regulation by the Turkish central bank can open doors for new sukuk issues by Turkish banks.
- **Evolution and acceptance of sukuk financing across the capital structure will provide depth to the market.**  
Last year we saw the launch of the world’s first perpetual hybrid sukuk by Abu Dhabi Islamic Bank in the UAE, which was eligible for treatment as Tier 1 equity. The structure was replicated by Dubai Islamic Bank earlier this year and there are reports that some other regional Islamic banks will use the same structure to raise Tier 1 capital. Corporates are also increasingly looking at such perpetual sukuk structures to raise equity capital. Turkey’s participation banks (Islamic banks) have successfully raised subordinated Tier II capital through sukuk issues (for an example of this refer to Bank Asya Tier II sukuk in article on 2013’s Innovative Sukuk Structures in this report.). Expectations of strong performance by equity markets in the coming years can once again bring back to life once popular convertible sukuk issues. Overall, the signs are strong that in the near future we will see emergence of sukuk as a comprehensive capital structure solution and not just as a senior debt instrument.

The million dollar question is – Can the global sukuk market grow in size to become comparable to the conventional debt market? We hope it does one day. But that day is still very far away.

Disclaimer: the views and opinions expressed in this article are those of the author and do not necessarily reflect the view or position of Mashreqbank or any of its affiliates.

*Should sharia rulings loosen up,  
tighten up, or even standardise?*

## Asian countries go straight down the middle between asset-based sukuk and asset-backed sukuk

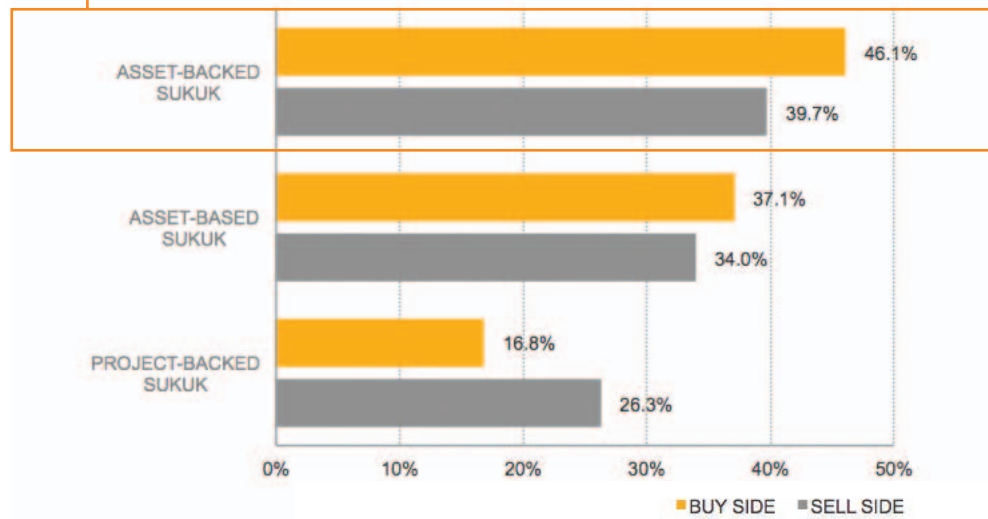
### By Risk Classification

As a whole, most investors prefer asset-backed sukuk (which is secured and gives investors recourse to both asset and obligor guarantee), with strong demand from MENA, Europe & Central Asia, and East Asia & Pacific. However, Sub Saharan Africa has a stronger appetite for asset-based sukuk (recourse to only the obligor’s credit quality) compared to other regions.

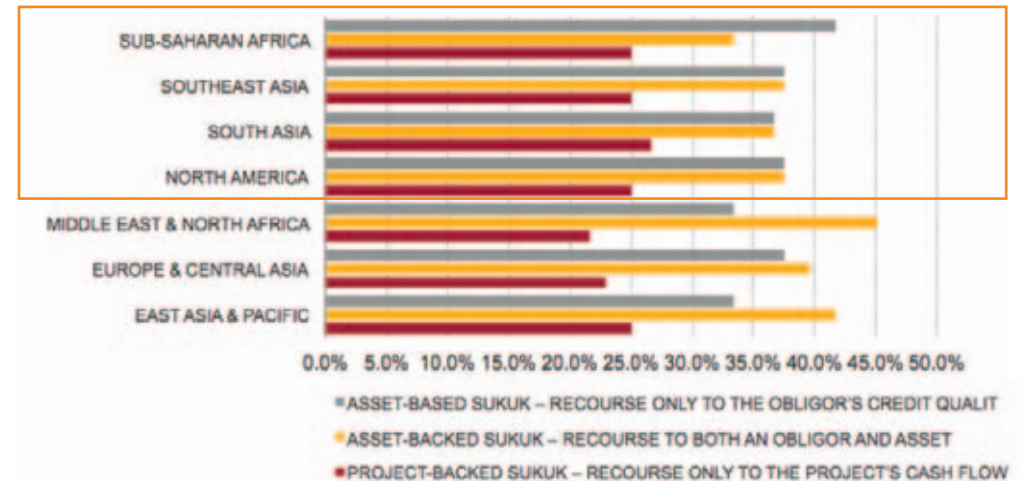
With the exception of Europe & Central Asia, more lead arrangers from other regions expect asset-backed (39.7%) over asset-based sukuk (34%). Project-backed sukuk is both least preferred by investors and least expected by lead arrangers in all regions. Project-based sukuk gives investor recourse only to the asset.

	Respondants	Skipped
SELL SIDE	26	9
BUY SIDE	59	61

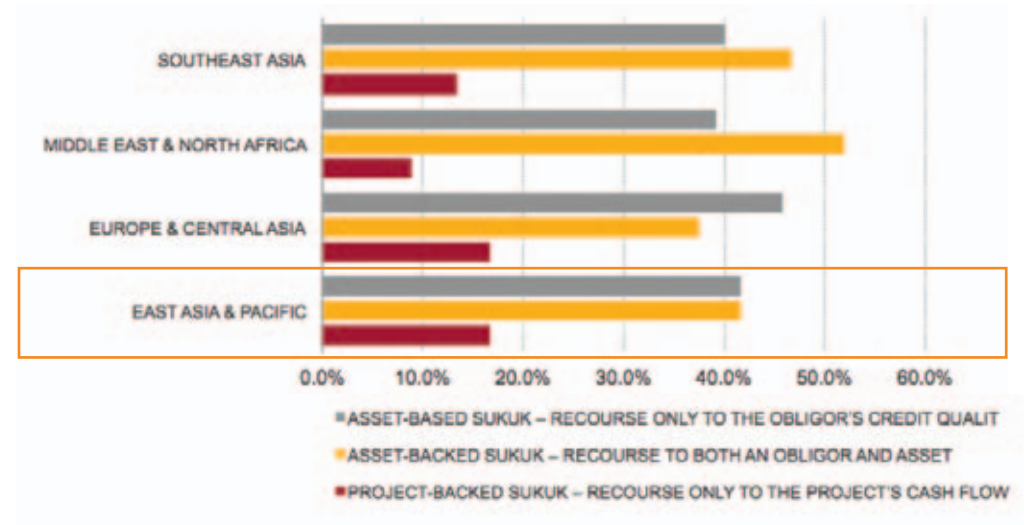
What is the most expected/preferred risk classification of sukuk issuance/investment in 2013 and 2014



### BUY SIDE: REGION BREAKDOWN



### SELL SIDE: REGION BREAKDOWN



## Sharia Criticisms against Sukuk

by Marjan Muhammad and Beebee Salma Sairally  
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Sukuk structures have evolved since the early days of the market, which emerged in the 1990s. If in the beginning sharia prescription for sukuk was to be based on 100% tangible assets, market needs have seen sukuk structures move from being asset-backed to asset-based to blended-assets to asset-light. In this article we chart sharia criticisms against sukuk, following a narrative based on the sukuk historical timeline, and consider if market practicalities and realities have indeed diluted sharia decisions on sukuk structures.

Sukuk were initially introduced as an alternative instrument which serves the same purpose of providing long-term financing as conventional bonds without compromising the requirements of sharia. The features of the early sukuk issuances thus mimicked those of fixed-income instruments. Over time the features of sukuk have evolved to include their own distinctiveness while at the same time maintaining some characteristics similar to bonds.

From plain vanilla sukuk which employ only one underlying sharia contract for its issuance, some sukuk structures have become more complex and involve a combination of at least two underlying sharia contracts. For instance, the sukuk al istithmar issued by the Islamic Development Bank's (IDB) Solidarity Trust Services Ltd in 2003 comprised ijara, murabaha and istisna contracts; Projek Lintasan Shah Alam Bhd in 2008 used ijara, mudaraba and ijara mawsufa fi thimma contracts for undertaking a toll-road project; the Government of Malaysia's \$2 billion dual-tranche wakala sukuk in 2011 combined the wakala structure with ijara assets, receivables from murabaha contracts and sharia-compliant shares; and the Malaysia Airlines Junior Sukuk 2012 used a combination of musharaka and musawama contracts to effect the perpetuity.

### Accommodating the market: From asset-backed to asset-based to blended-assets to asset-light sukuk structures

Apart from these examples of exotic sukuk based on various underlying sharia contracts, the global sukuk market has also witnessed other episodes of innovation in sukuk structures. Due to the lack of suitable underlying assets to back sukuk issuance, the market moved from "asset-backed" to "asset-based" structures and from "blended-assets" to "asset-light" structures.

### In the beginning: 100% asset-backed

When sukuk were first developed, the requirement was to have 100% tangible assets to provide full asset backing to investors. In asset-backed securities, the sukuk holders enjoy the full backing of the underlying assets as there is true sale and legal transfer of the ownership of the



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Dr Salma Sairally is currently the Editor of the ISRA International Journal of Islamic Finance. She is also a partner and trainer in Islamic Banking and Finance at the Latiff Mohamudally Institute of Management, a private training institution in Mauritius. Her research interests are in the areas of Islamic banking and finance, Socially Responsible Investments, Corporate Social Responsibility, and Islamic capital market. Dr Salma holds a PhD (Economics) from Loughborough University, UK; Masters (Distinction) in Islamic Studies (Islamic finance) from Portsmouth University, UK; BSc in Economics and Finance, University of New South Wales, Australia.

assets to sukuk holders. Sukuk holders thus enjoy the guarantee of having recourse to the assets to recover their capital in the event the obligor becomes insolvent or faces difficulties in meeting payments.

However, corporates and governments faced challenges in finding suitable assets for the structuring of such sukuk. The assets were not available, or were not sufficient, or were already encumbered, or such sale of assets would be subject to transfer taxes. On the part of governments, especially in countries of the Gulf Cooperation Council (GCC), the law does not allow for the sale of public assets such as land and property to foreigners – which made the structuring of asset-backed sovereign sukuk difficult.



### Emergence of asset-based structures with no true sale of underlying assets

Malaysia then issued, in 2002, an asset-based sukuk al-ijara which bore no true sale of the underlying assets to sukuk holders; rather there would be beneficial ownership of the assets throughout the life of the sukuk. In this case, in the event of default, sukuk holders would have recourse to the Federation of Malaysia (the obligor) instead of the sukuk assets. From this first issuance of asset-based sukuk, this structure spread the world over, with most of the sukuk offerings being asset-based.

### Dilution: Blended-assets sukuk

Whilst asset-based sukuk still require 100% physical assets which are sharia-compliant to support the sukuk at the time of issuance, for those issuers who do not have sufficient physical assets for structuring sukuk, the concept of blended-assets sukuk was recommended. This type of sukuk combined sharia-compatible receivables and physical assets, with the main condition that the proportion of the physical assets has to exceed that of the receivables for sukuk issuance and trading. In the beginning, some sharia scholars required the majority portion to be at least 51% or 66% of the portfolio. In 2003, the IDB issued a similar sukuk with a mixed portfolio consisting of 65.8% ijara assets combined with 34.2% of murabaha and istisna receivables. In 2005, however, it was permitted to reduce the minimum physical assets to 30% in a mixed portfolio sukuk.

### Further watering down: Development of asset-light sukuk

Eventually, the requirements for physical assets became further diluted in order to meet the increasing demand of issuers who did not even have the 30% physical assets. This led to the development of asset-light sukuk structures which do not require any physical assets at the time of sukuk issuance. These sukuk are based on the mudaraba (profit sharing) or musharaka (profit and loss sharing) arrangements between the issuer and the sukuk holders and the proceeds raised from the sukuk holders are invested in the mudaraba or musharaka business.

Over time therefore, although in theory sukuk are meant to represent an undivided ownership rights or interest in sharia-compliant assets, they have been essentially certificates of equal value that entitle the holder(s) to a claim to an asset and/or its cash flow. This is mainly because not all sukuk constitute the full ownership in the underlying assets; some have limited degrees of ownership in the assets while some refer to a pool of reference or collateral assets.

These developments have raised strong criticisms among sharia scholars. In particular, the asset-light sukuk faced fierce criticisms from many jurists, academics and practitioners as the way they were structured in practice incorporated the mudarib (as manager in the mudaraba venture) or the obligor (as the partner in the musharaka venture) who effectively guarantees or protects the principal investment and the expected return of the sukuk holders. This practice goes against the

sharia principle of impermissibility to guarantee the capital investment and profits under equity-based contracts. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) eventually banned such types of sukuk structures in its 2008 pronouncement.

### Sharia Scholars' Criticisms against Asset-Light Sukuk

At the AAOIFI annual event in Bahrain in November 2007, Sheikh Taqi Usmani stirred the global sukuk market with his strong remark that almost 85 percent of sukuk issued in the GCC were not sharia-compliant. Broadly, he raised three main criticisms against sukuk relating to the following aspects:

- (i) sukuk holders did not have real ownership interest in the underlying assets;
- (ii) the regular distributions to sukuk holders were not based on actual performance of the underlying assets; and
- (iii) guarantee of the return on capital via the use of purchase undertakings.

The first criticism pertained to asset-based sukuk where there is no legal sale of the underlying assets and as such no real transfer of ownership of the assets to sukuk holders from the originating company. Legal documentation in asset-based sukuk on the other hand indicates that the sukuk holders do not have interest in the underlying asset, as opposed to sharia principles which require that sukuk investors should have rights over the sukuk assets.

The other two criticisms focused mainly on equity-based sukuk, namely musharaka, mudaraba and wakala structures. The criticisms highlighted the use of liquidity facilities to make up for any shortfalls in actual profit below the stipulated percentage to sukuk holders; the payment of any excess profit realized above the expected profit percentage as incentive fees to the manager for good management; and the use of purchase undertakings to guarantee the sukuk holders' principal such that it is expected that the issuer will buy back the underlying asset at the maturity date of the sukuk or in the event of default at face value regardless of their actual value on that day. Such practices convert the equity-based sukuk to debt-based features whereby the sukuk are redeemed at par value at the maturity date and sukuk holders are paid a guaranteed periodic return on capital throughout the duration of the sukuk.

Pursuant to the sharia concerns raised, the AAOIFI pronouncement issued in February 2008 resolved that the following credit enhancements are prohibited in equity-based sukuk:

- (i) the use of sharia-compliant funding to smooth out periodic income distribution amounts to sukuk holders; and
- (ii) the use of purchase undertakings in order to guarantee the return of the principal amount to sukuk holders at its par or nominal value.

Despite the above prohibitions, the AAOIFI pronouncement states that the use of a reserve account to cover shortfalls is permitted and so is distribution on account, so long as the latter is subject to reconciliation prior to a final distribution.

The AAOIFI pronouncement also allows purchase undertakings to repurchase the assets for its net value, its market value, fair value or a price to be agreed, at the time of their actual purchase. Moreover, it does not prohibit the use of purchase undertakings in ijara sukuk, if the lessee is not an investment partner, mudarib or agent. In addition, if the sukuk consist of mixed asset portfolio in which the assets of musharaka, mudaraba, and wakala sukuk are of lesser value than the leased assets of lease ending in ownership (ijara muntahia bittamlik) contracts, the AAOIFI pronouncement permits the sukuk manager to undertake to purchase those assets – at the time the sukuk are extinguished – for the remaining rental value of the remaining assets; since it actually represents its net value.

### Post-AAOIFI Pronouncement: Global Sukuk Market Responses

To what extent do sharia criticisms against the authenticity of equity-based sukuk, particularly musharaka structures, have an impact on the trend of sukuk issuances?

Figure 1 indicates that in the early years of the sukuk market, murabaha and ijara sukuk were predominant issues as they mimicked conventional bonds with fixed periodic rental payments. However, from 2004 to 2007 musharaka sukuk steadily increased until the strong criticisms were raised against equity-based sukuk by Sheikh Taqi Usmani in 2007. Similarly, mudaraba sukuk also reached its peak in 2007. Thereafter, particularly in 2008, musharaka and mudaraba sukuk issues slumped considerably and were taken over by ijara sukuk between 2008 and 2009. Meanwhile, from 2009 to 2012, the global sukuk market was again dominated by murabaha sukuk despite its non-tradability in the secondary market, and ijara sukuk. Issues based on the musharaka contract appear to have again recovered in 2012, reaching \$15.37 billion compared to ijara and murabaha sukuk which stood at \$21.41 billion and \$69.2 billion respectively. Wakala sukuk have also shown a steady growth since 2009.

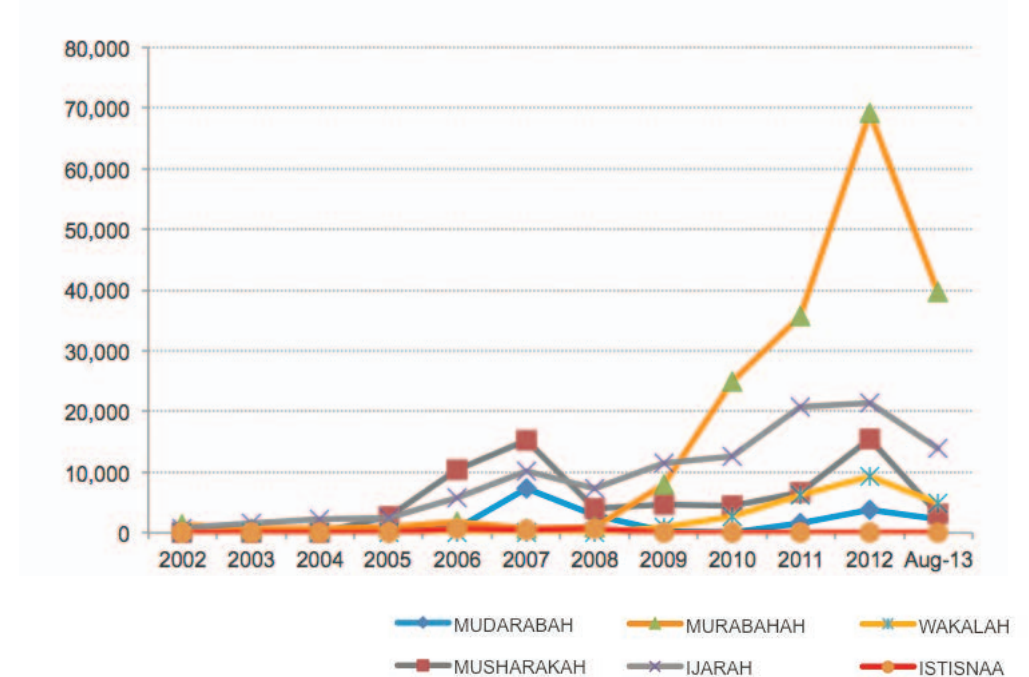
Based on 2002 to August 2013 figures which depict the trend of sukuk issuances using various underlying sharia contracts, it can be summarised that the criticisms raised by some scholars concerning the authenticity of equity-based sukuk to some extent have had an impact on the global market's sukuk issues.

According to an empirical study conducted by Mokhtar (2011) (1), there is a significant change of style in the post-AAOIFI issuances of equity-based sukuk, particularly in the following transactions:

- Villamar (Gulf Holding Company) 2008 – no purchase undertaking was used in this musharaka sukuk

- Purple Island (Bin Ladin) 2008 – no purchase undertaking featured in this mudaraba sukuk, but there was a guarantee given by the Saudi Bin Ladin Group
- Sorouh 2008 – conditional purchase undertaking returns principal and profit
- PLSA 2008 – purchase undertaking in this mudaraba sukuk is at market value

FIGURE 1: SUKUK ISSUES (BASED ON SHARIA CONTRACTS) IN THE GLOBAL MARKET FROM 2002 TO AUGUST 2013



However, it is important to note that jurisdictions like Malaysia, for instance, still allow the equity-based sukuk to behave as a fixed income instrument similar to the debt-based sukuk. Sharia scholars in Malaysia view that those features deemed impermissible by the AAOIFI are standalone arrangements that do not nullify the nature of the musharaka, mudaraba and wakala contract themselves. Therefore, despite the strong criticisms against different types of equity-based sukuk, these sukuk are still widely issued in Malaysia.

Latest Resolutions on Ijara Sukuk from OIC International Islamic Fiqh Academy in 2012.

### Current Market Trend: Back to Blended-Assets Sukuk

Post-AAOIFI criticisms on equity-based sukuk structures, murabaha and ijara sukuk have been dominating the market for quite some time, as shown in Figure 1. Unavailability of suitable assets for ijara sukuk and the non-tradability of murabaha sukuk on the secondary market however constantly put pressure on market participants and sharia scholars to come up with innovative structures that will rely less on physical assets and be widely acceptable to investors, sharia experts and stakeholders at large. More so, with the IFA criticisms on ijara sukuk the pressure for alternatives to this commonly used structure is increasingly felt in the Islamic finance community.

In recent years, the market has been slowly moving towards the sukuk wakala structure, which seems to provide a logical solution to this issue. It was for the purpose of seeking wider acceptability of stakeholders involved that the Malaysian government decided in 2011 to enter the global sukuk market with this innovative structure. It issued the \$2 billion dual-tranche sukuk wakala which saw an overwhelming response from international and domestic investors, with significant participation from the Middle East. The underlying assets comprised tangible assets of leased assets and sharia-compliant shares (totalling 52%) and murabaha receivables arising from sharia-compliant commodities (totalling 48%). The obligor is appointed as agent (wakil) to invest and manage the sukuk proceeds on behalf of the sukuk holders, hence giving the name of sukuk wakala to the structure. Essentially, the sukuk relies again on a blended-assets structure which is based on the principle of khultah (mixture of assets). This structure had the added advantage of allowing issuances above the value of available physical assets. This sukuk structure has seen wider acceptability in the sukuk market, avoiding the earlier sharia criticisms raised regarding equity-based and ijara structures.

### Sharia Practice in Sukuk: Deviations or Innovation?

It may be asked how the sharia community has allowed for a dilution in sharia practice in sukuk issuances which has ultimately culminated in sharia criticisms on equity-based and ijara sukuk. Were these sharia deviations per se? Or were the sharia scholars and committees who approved the sukuk issuances supporting innovative practices and sought to take care of the practical challenges faced by issuers in balancing between sharia requirements and market realities? Given the sharia criticisms raised against certain market practices in sukuk, is it possible to call for standardisation or at least harmonisation in sharia rulings in order to establish greater sharia certainty in the sukuk market?

At the outset, it is important to highlight that financial institutions face a number of practical challenges when issuing sukuk which have the possibility of affecting the sharia rulings related to the issuing and trading of these instruments, especially if the original rulings are based upon presumptive (zanni) rather than definitive (qat'i) evidence. In view of the structuring challenges,

a number of financial engineering techniques have been adopted to increase the market viability of the instruments and reduce the level of risks involved so that they are more appealing to investors and issuers. These innovative techniques in sukuk structuring – such as the evolution in terms of underlying assets requirements, purchase undertaking in equity-based sukuk, sharia-compliant funding to smooth out the distributions to sukuk holders – have in turn contributed to the sharia issues noted earlier in this article.

Among the most important challenges that confront sukuk issuers include the following: (i) the marketing challenges of promoting sukuk as non-fixed income securities which cannot guarantee the return of capital and profits to prospective investors who are used to such guarantees in the conventional market; (ii) the challenge posed by the religious consciousness or commitment of institutional investors and issuers to avoid transactions that involve sharia violations; (iii) the challenge of securing high ratings by ratings agencies which base their judgment on similar criteria used to rating conventional bonds, notably, the creditworthiness of the sukuk issuer (obligor) and the provision of acceptable guarantees to investors relating to capital protection and/or payment of returns; and (iv) the challenge posed by legal impediments to the ownership of sovereign assets which prompted governments to increasingly adopt asset-based sukuk structures.

In the light of such market realities, sharia scholars and committees are then confronted with the added challenge of proposing sharia solutions which are not based on definitive evidence.

More so, there is no standardisation of sharia rulings which prevail as such, given the acceptance of differences in opinions arising from the difference in schools of thought. This lends further support for divergence in sharia practices to prevail in the sukuk market. For instance, while sharia criticisms were raised by the AAOIFI against the practice of Purchase Undertaking in equity-based sukuk structures, the Malaysian practice perceives Purchase Undertaking as not representing a condition in the contract between the issuer and the investors as it is not included in the main sukuk contract. In form, therefore, Purchase Undertaking is not deemed as violating the nature and implication of the sharia contract (muqtada al aqd) and thus it is not deemed as representing a guarantee of capital repayment of the sukuk. The AAOIFI's view on the other hand considers the overall effect of the Purchase Undertaking in the sukuk transaction and deems it as unacceptable particularly in equity-based sukuk. The underlying debate is therefore that of form or substance of the matter.

On the other hand, some degree of sharia harmonisation can be said to prevail when examining the attempts at shifting away from bay al inah practices in the Malaysian market. This drive is mainly a result of an attempt to align Malaysian market practices with the Middle Eastern practice to seek greater international acceptance of Islamic financial transactions. Thus, although sharia opinions may still differ, an attempt at bringing convergence to market practices is being made in the interest of the future development of Islamic finance.



REUTERS/Mike Hutchings

### Conclusion: Way Forward

With increasing sharia concerns raised about sukuk structures, the key question asked is: How should the global sukuk market move forward? Should all sukuk structures, regardless of their underlying sharia contracts, maintain their original idea of being an alternative to conventional bonds, and thus become a fixed income instrument? Or, should sukuk truly behave according to their specific underlying sharia contracts? As such, should all equity-based sukuk move from the debt-like instrument to pure equity structures similar to shares, where sharing of profit and loss is their essence?

Although the immediate responses to all sharia criticisms against sukuk were apparent at the initial stage, the extent to which all the prohibitions are fully adhered to in all sukuk structuring still remains questionable.

In order to establish greater understanding of the requirements of sukuk structuring and better align sharia compliance with market realities, it is deemed important that meetings bringing together sharia scholars, rating agencies, industry professionals, accounting and auditing organisations and academics be facilitated. This will ensure that all parties involved in sukuk structuring and issuance better align the needs of stakeholders and compliance with sharia. The aim is to demarcate clearly the differences between sukuk and conventional bonds in terms of the structure, design, utilisation of proceeds and overall objective of supporting genuine activities and economic development. The aim is also to develop a sukuk market that is internationally accepted. This is to add confidence to the sukuk market and contribute to the further growth of the overall Islamic finance industry.



## Chapter Four

# Sukuk Demand and Supply Equilibrium

*Connecting  
the dots*

...right after the  
family came to the  
ag: didn't matter if  
you own or part of a gr  
with toys or text as  
rtenoreven: sprinkl  
umme: you could  
'hours: you could  
you're: with every imp  
idea: providing all  
terms: you get a term  
'have: little time for a  
to the: little time for a  
to win: instead of having  
to break: the boundaries  
to get: that feeling and  
ing: free media: free be  
ing: mangie: as you  
Joseph: science: music to  
he: the: of your: imagine

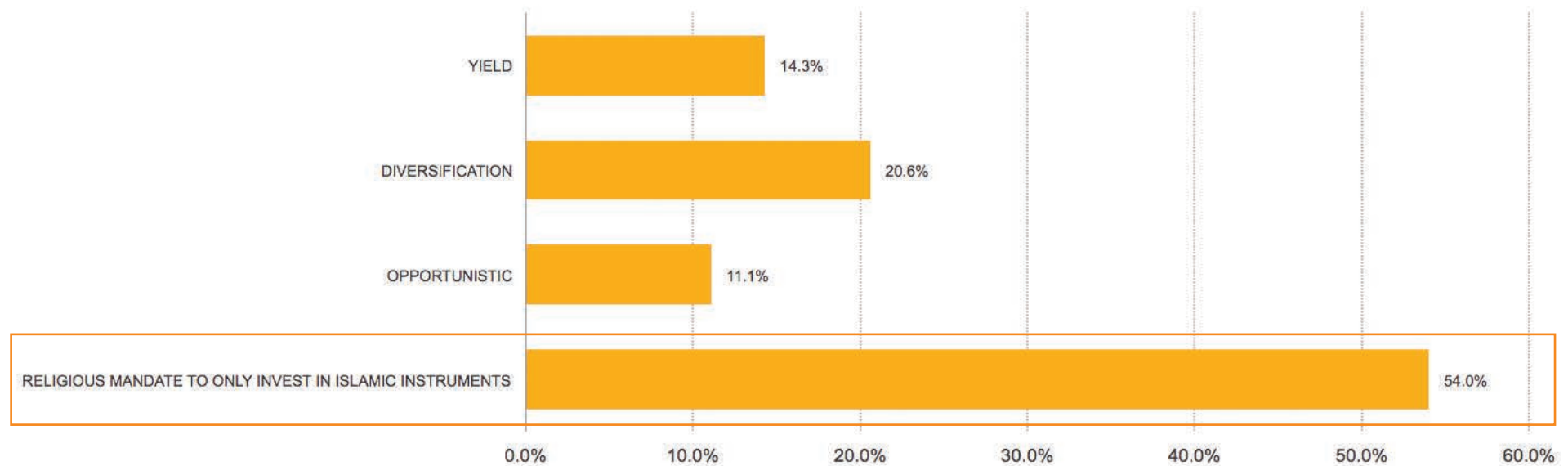
## Sukuk demand is mostly driven by sharia requirements

### Sukuk Demand

The survey results reveal that 54% of investors invest in sukuk due to religious mandate to only invest in Islamic instruments; these investors are mainly Islamic banks. Diversification is the second primary reason for investing in sukuk; these are mainly by conventional banks that are looking to diversify their investment portfolio given the attractive yields offered by sukuk.

	Respondants	Skipped
BUY SIDE	63	57

### BUY SIDE: what is your primary reason for investing in sukuk?



## On average, global investors expect to allocate at least 40% to Islamic financial products

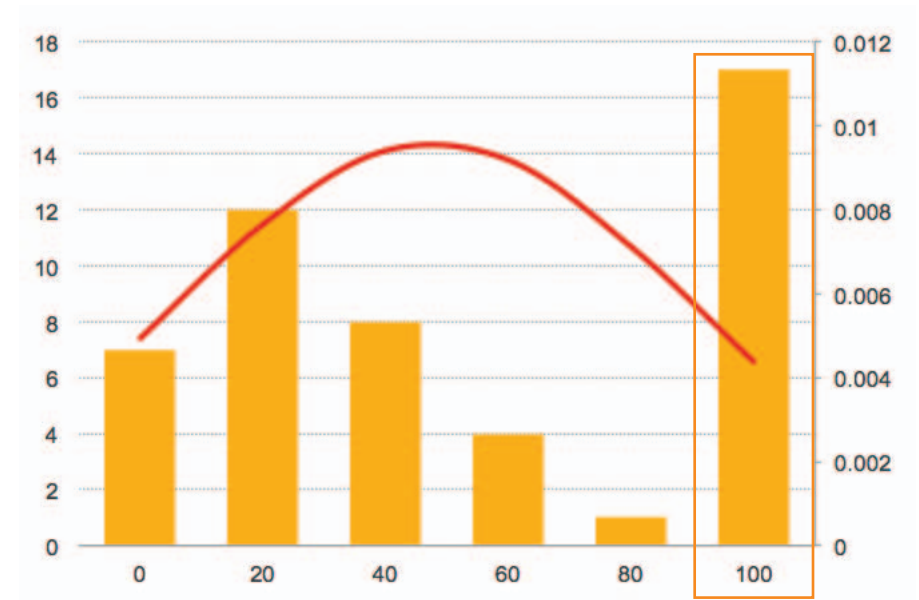
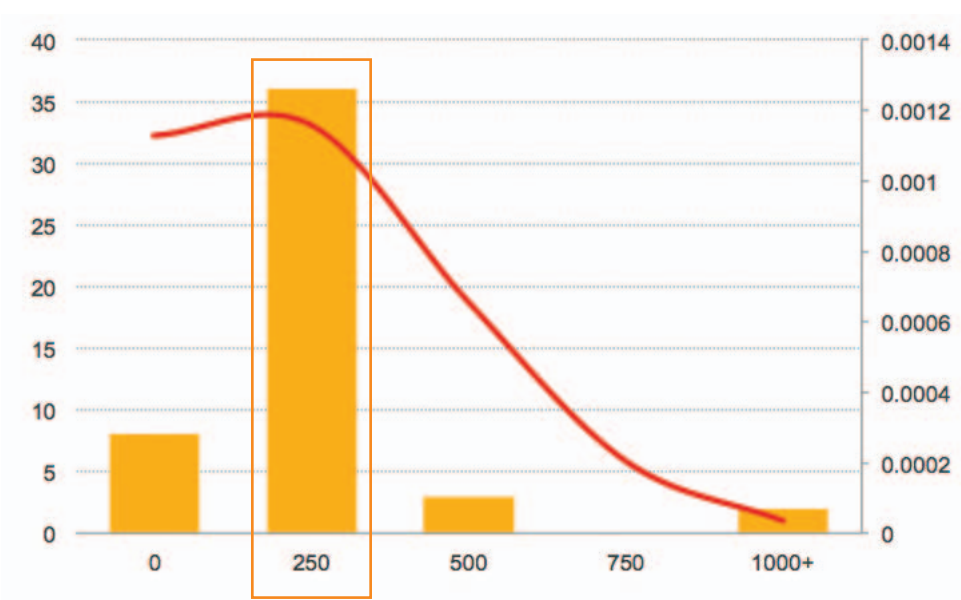
Investors expect to allocate between \$250 million to \$500 million of their investments to Islamic financial products. On average, they expect the amount of their investments to be between \$250 million to \$2 billion.

Investors expect to allocate between 20% and 100% of their portfolios to Islamic assets. On average investors expect 40% to 50% of their portfolios to be allocated to sharia-compliant products.

	Respondants	Skipped
BUY SIDE	53	67

BUY SIDE: For the rest of 2013 and 2014, how much of your investment portfolio will you allocate to Islamic financial products in US\$?

BUY SIDE: For the rest of 2013 and 2014, how much of your investment portfolio will you allocate to Islamic financial products in %?





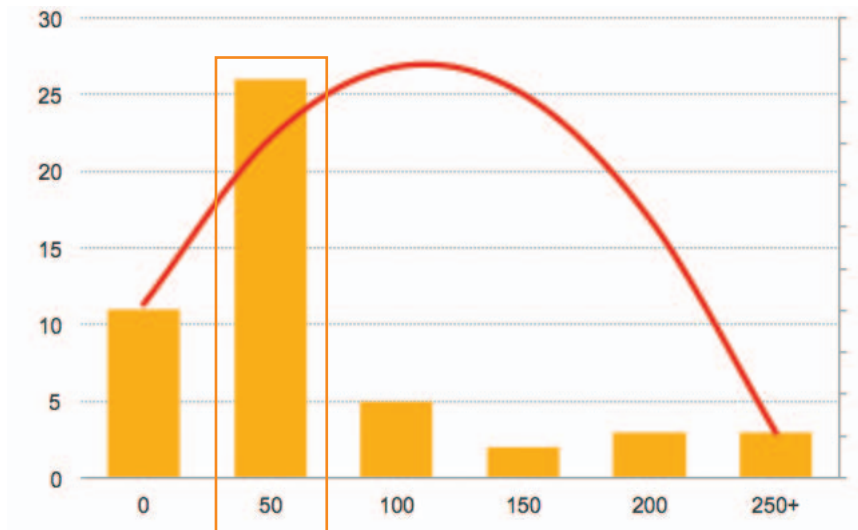
## Around \$150 million of Islamic financial Institutions' investment portfolio is allocated to sukuk

Investors mostly expect to allocate between US\$50 million to US\$100 million of their Islamic finance investments to sukuk. On average, they expect the amount of their investments to be \$150 million from a range between US\$10,000 to US\$2 billion.

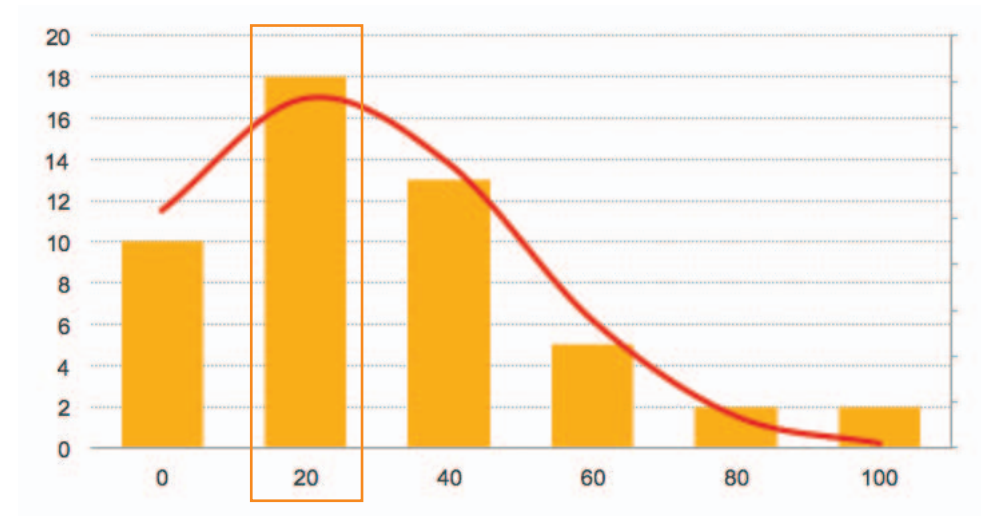
On average investors expect 25% to 35% of their portfolios to be allocated to sukuk.

	Respondants	Skipped
BUY SIDE	56	64

BUY SIDE: For the rest of 2013 and 2014, how much of your investment portfolio will you allocate to sukuk products in US\$?



BUY SIDE: For the rest of 2013 and 2014, how much of your investment portfolio will you allocate to sukuk products in %?



## However, investors still expect scarcity of sukuk papers in the next couple of years

An equal proportion of investors – 42.9% – expect the dollar amount of sukuk in 2013 to be either between \$100 billion to \$149.9 billion or less than \$100 billion. However, more investors are optimistic for 2014, with a higher 48.3% expecting issuance volume to be between \$100 billion - \$149.9 billion.

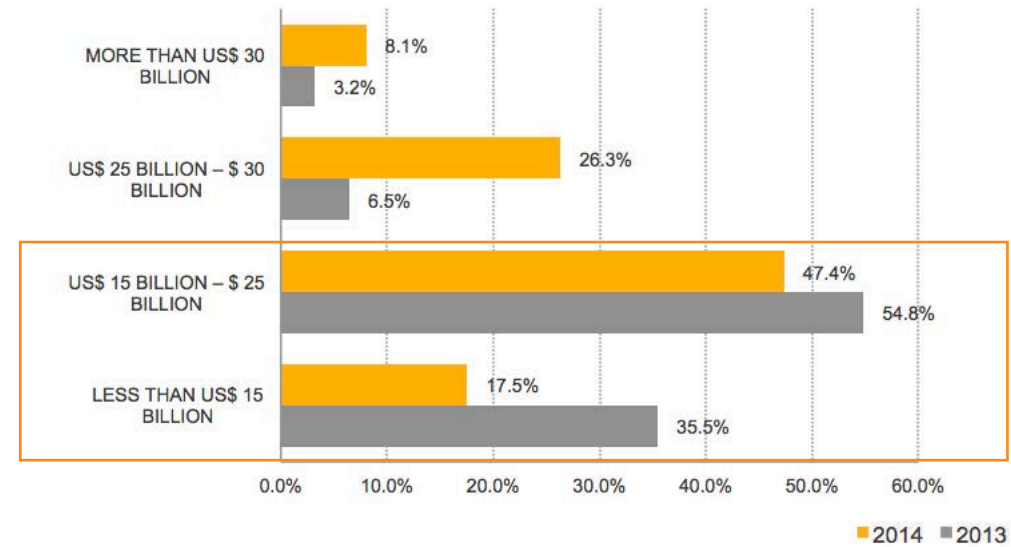
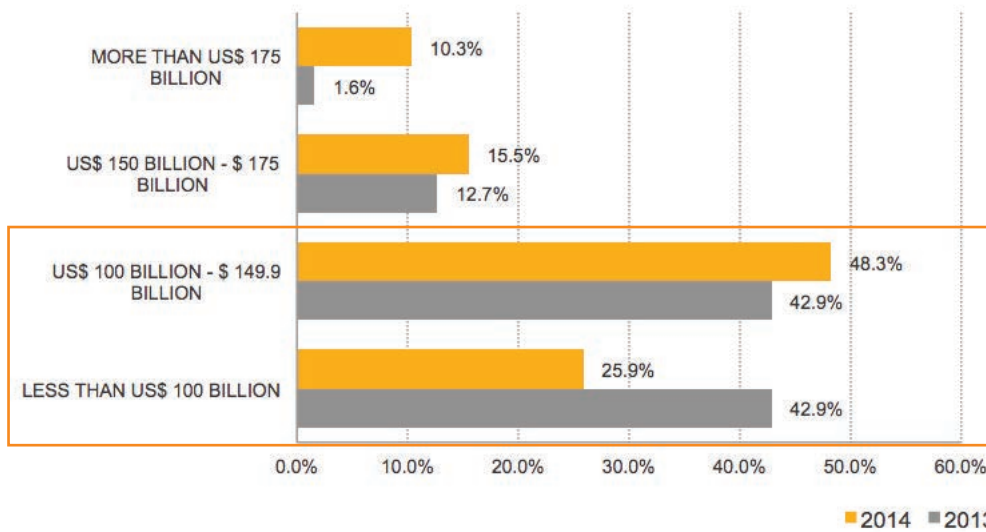
Most investors expect international sukuk issuance to be in the range of \$15 billion – \$25 billion in 2013 and 2014 which accurately reflects the current status of the market.

	Respondants	Skipped
BUY SIDE	62	58

	Respondants	Skipped
BUY SIDE	63	57

BUY SIDE: What volume of global (Int'l + domestic) sukuk issuance do you expect in 2013 and 2014? The total Global Sukuk issuance in 2012 was US\$ 135 billion and H1 2013 was

BUY SIDE: What volume of international sukuk issuance do you expect in 2013 and 2014? The total international sukuk issuance in 2012 was US\$ 19 billion and H1 2013 was



## And lead arrangers match investors in the sukuk supply forecast

### Sukuk Supply

60.7% of lead arrangers expect the dollar amount of sukuk in 2013 to be between \$100 billion - \$149.9 billion, followed by an equal proportion – 17.9% – expecting \$150 billion – \$175 billion and less than \$100 billion.

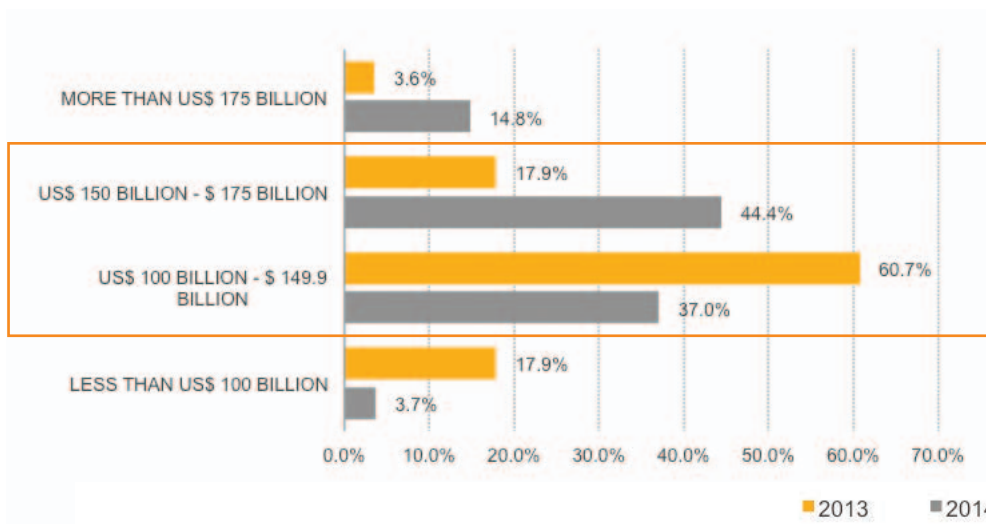
44.4% of lead arrangers expect sukuk issuance to pick up in 2014 to reach \$150 billion – \$175 billion, with the \$100 billion – \$149.9 billion range a close second choice.

Similarly, the majority of lead arrangers expect international sukuk issuance to be in the range of \$15 billion - \$25 billion in 2013 and 2014.

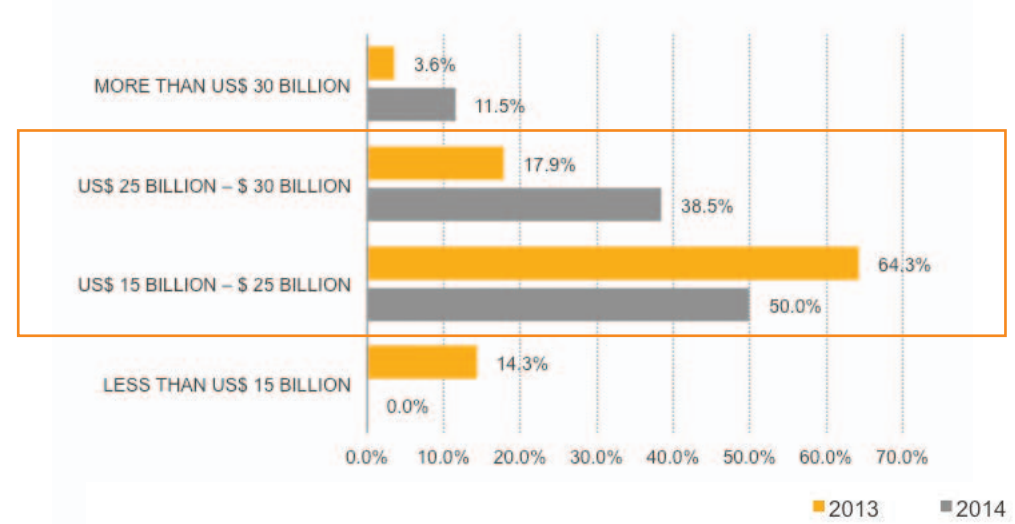
	Respondants	Skipped
SELL SIDE	29	6

	Respondants	Skipped
SELL SIDE	29	6

SELL SIDE: What volume of global (Int'l + domestic) sukuk issuance do you expect in 2013 and 2014? The total global sukuk issuance in 2012 was US\$ 135 billion and H1 2013 was US\$ 57 billion



SELL SIDE: What volume of international sukuk issuance do you expect in 2013 and 2014? The total international sukuk issuance in 2012 was US\$ 19 billion and H1, 2013 was US\$ 11 billion

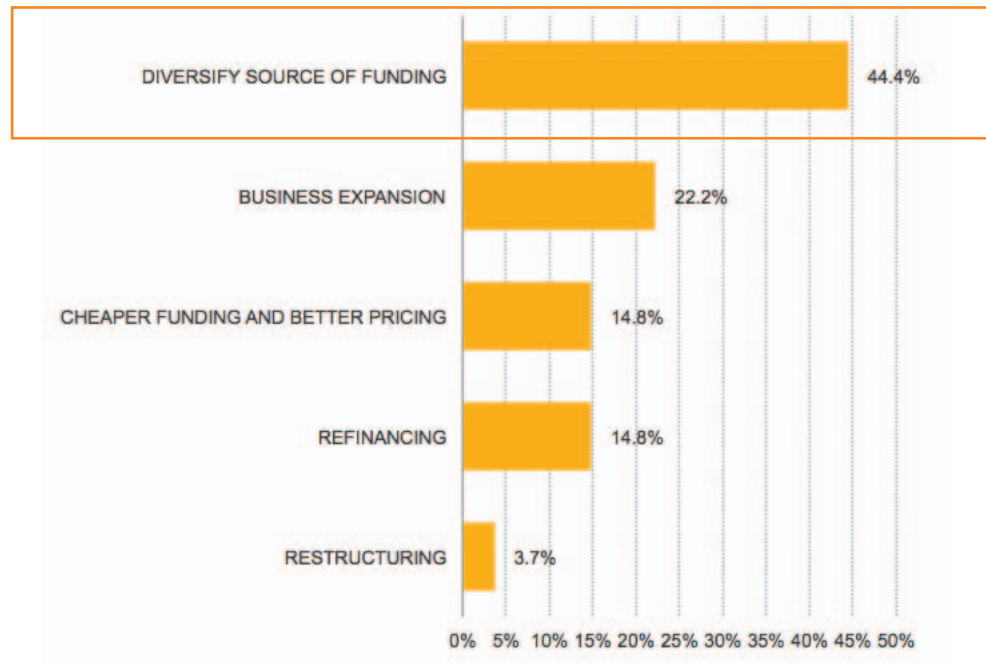


## Lead arrangers and issuers say the main reason for issuing sukuk is to diversify their sources of funding

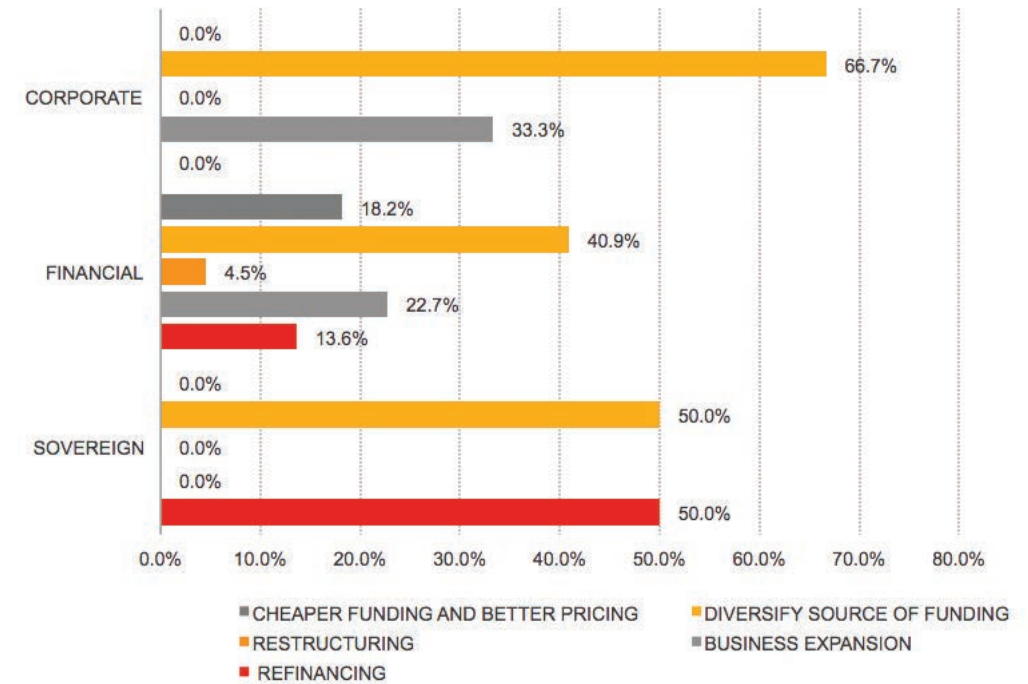
Lead arrangers and issuers say that the main reason to tap the sukuk market is to diversify their sources of funding, as sukuk enjoy a wider investor base as it attracts both conventional and Islamic investors.

	Respondants	Skipped
SELL SIDE	27	8

SELL SIDE: What is your most common reason for sukuk issuance?



SELL SIDE: SECTOR BREAKDOWN



## DEMAND SIDE

### Assumptions

Sukuk demand is driven by two types of investors – sharia-sensitive investors, and other global investors seeking diversification and attractive yields.

We project the demand from the broadest group of sharia-sensitive investors - the Islamic financial institutions (IFIs), as the core base for continued sukuk investment. While there is a much wider group of investors beyond IFIs, it is this category that forms the most captive investor base that can be relied on regardless of market conditions. Other investors may tend to be cyclical or opportunistic.

According to data from the ICD-Thomson Reuters Islamic Finance Indicator 2012 (IFDI), total Islamic finance assets of banks, takaful, other Islamic financial institutions, funds and sukuk issuance amount to \$1.35 billion (this was generated by 825 institutions worldwide).

For last year's study, we derived sharia-compliant assets of all Islamic financial institutions from The Banker's Top 500 Islamic Financial Institutions database, including all sharia-compliant assets excluding Iran, who is not a direct investor in sukuk given its limited interaction with the broader global Islamic financial services industry up to 2011. For 2012 data, we have used IFDI data which includes all available financials across all countries (including Iran).

We then conservatively forecast that sharia-compliant assets will grow by 15% on an annual basis; this is in line with growth estimates from Ernst & Young, Deutsche Bank and Kuwait Finance House, although their forecasts are higher at around 18-20 percent.

We assume that the average portfolio allocation of sukuk required by sharia-sensitive investors is 30%. This proportion is supported by data from Islamic commercial banks, which suggests that they hold, on average, 29% of liquid assets and securities, from 2005 to 2008 (source: Bankscope). We believe our estimation is conservative given that our Survey Findings in 2013 show that majority of investors hold between 20% to 50% of their investment portfolio in sukuk; our 30% estimation is just past the mid-mark for sukuk holdings.

## SUPPLY SIDE

### Assumptions

According to Thomson Reuters Zawya data, global sukuk issued in 2013 were below market expectations, amounting to \$94.7 billion as at November 3, 2013. For our modelling purposes and with a little more than a month to the close of 2013, we assume that sukuk issuance will increase over YTD amounts to \$100 billion.

According to Thomson Reuters Zawya data, on average, the sukuk market grew 47% from 2002 to 2013. Last year's average stood at 53% but due to negative sukuk growth in 2013 (-25%), the overall average dropped.

Despite the decline in 2013, the sukuk market is expected to pick up again in 2014 due to the high expected number of issuance in the pipeline, starting with the IDB announcement of a \$10 billion sukuk programme, and expected debuts from North Africa and the UK. Investors have adjusted their expectations for 2013 and 2014 based on recent market events and issuance decline, and they expect sukuk issuance in 2013 to be less than \$100 billion and for 2014 between \$150 –\$175 billion.

Therefore, conservatively, we estimate total issuance growth rate to pick up again to 30% in 2014, sliding down to 20% in 2015 and then dipping further to a steady growth of 15% for the following three years (2016-2018) along the expected growth of Islamic financial assets. This increase was added to total global outstanding sukuk per up to date sukuk issued for each year.

For total global sukuk matured, we derive the numbers from Thomson Reuters Zawya as per existing sukuk maturity profiles. In addition, we have calculated the average of short term sukuk that are issued and matured at the same year for the last three years (2011-2013) equal to 32% and subtracted the amounts from the total.

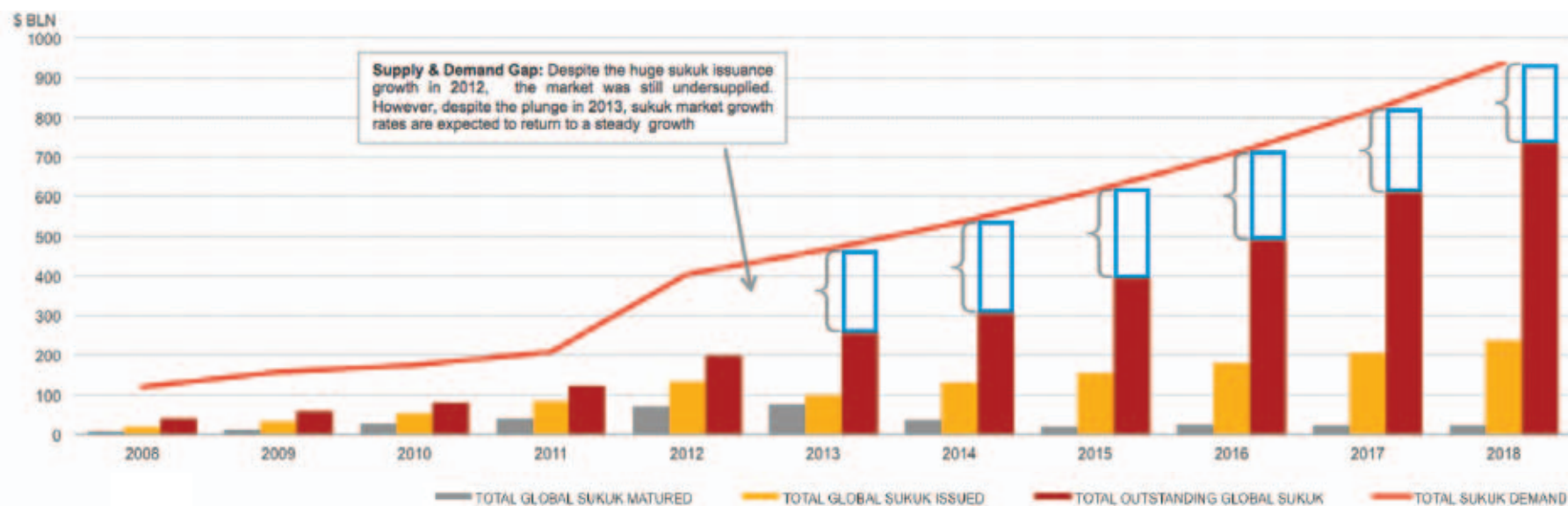
## Sukuk & Demand gap is expected to drop significantly by 2018 to \$187.4 billion from \$230 billion in 2014

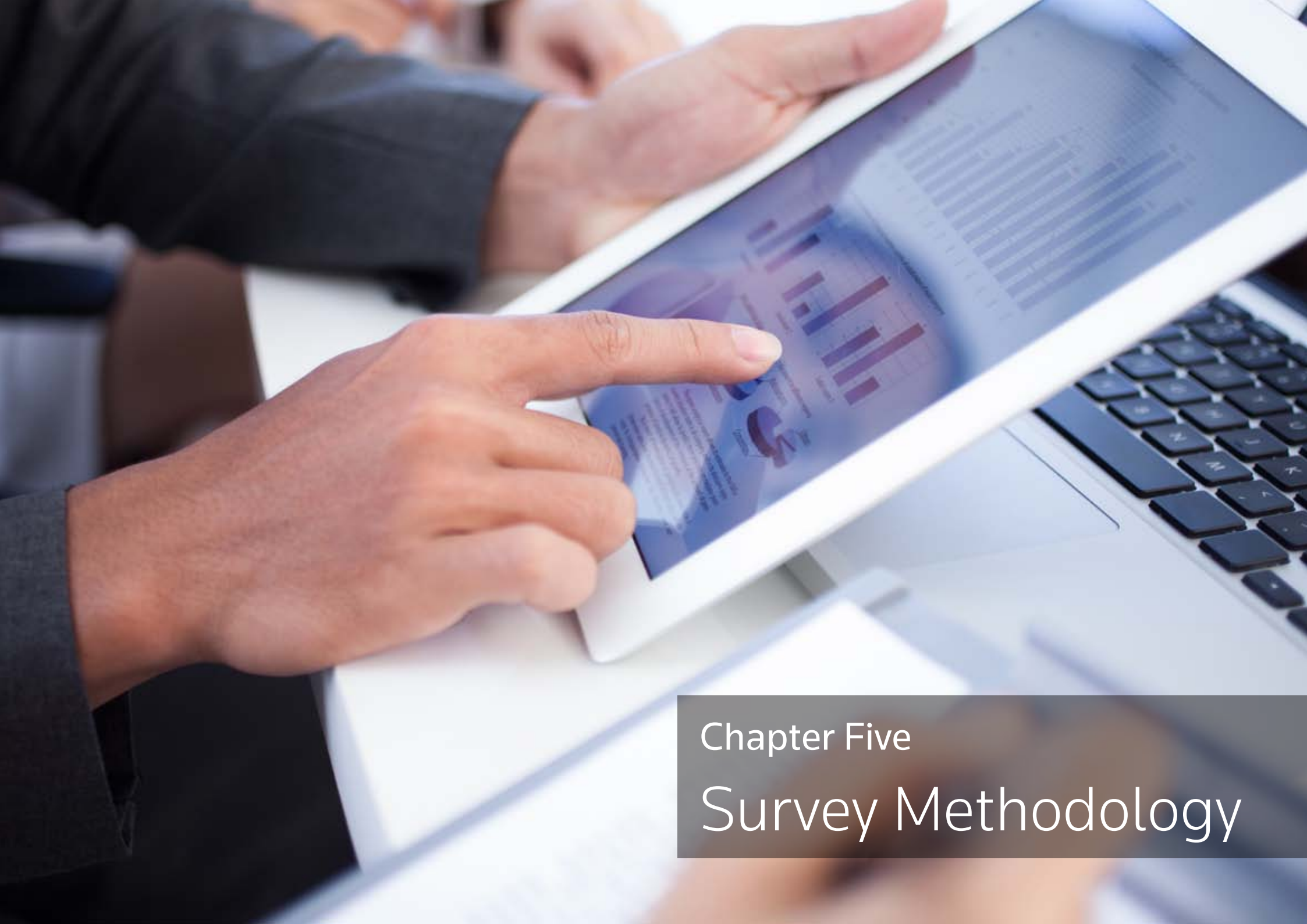
Based on a number of data points, we project the potential demand and the supply pipeline growth. Sukuk demand will continue to outstrip supply, despite the increased growth in issuances. Sukuk Supply and Demand gap is expected to reach its peak by 2014 amounting to \$230 billion; however, it is expected to drop steadily due to market issuance increase to reach \$187 billion by 2018.

### Sukuk Demand and Supply Equilibrium

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Percentage Sukuk Growth	-48%	69%	57%	58%	57%	-25%	30%	20%	15%	15%	15%
Total Global Sukuk Issued	20.21	34.12	53.71	85.12	133.72	100.00	130.00	156.00	179.40	206.31	237.26
Total Global Sukuk Matured	6.34	11.35	27.02	39.46	70.99	74.58	36.93	19.29	23.22	22.09	22.18
Total Global Sukuk Outstanding	38.11	58.68	81.16	124.69	198.61	255.00	306.47	393.26	492.03	610.23	749.38
Total Sukuk Demand	119.70	158.40	174.00	209.40	405.00	465.75	535.61	615.95	708.35	814.60	936.79
Sukuk Supply & Demand Gap	81.59	99.72	92.84	84.71	206.39	210.75	229.14	222.70	216.32	204.37	187.41

### SUKUK DEMAND & SUPPLY LEVELS (2013 - 2016)





Chapter Five  
Survey Methodology

The Sukuk Forecast and Perceptions Survey 2014 consists of two separate samples: lead arrangers/issuers and investors/traders.

#### LEAD ARRANGERS

In collating the population of lead arrangers, level of activity in the sukuk market was the major consideration. A total population of 60 lead arrangers was targeted based on the sukuk league table by Zawya Sukuk Monitor, in addition to Thomson Reuters data. The 60 arrangers were chosen as a target population to represent not only the regular arrangers who usually arrange five to seven international sukuk per year, but also to represent a wider range of arrangers that are continuously involved in arranging local currency issuances.

This ensures a more representative sample. With a minimum sample size of 30 the margin of error of ( $\pm 11$ ) would be achieved. The final number of respondents exceeded this required minimum representative sample.

#### INVESTORS

In determining the target population of investors their level of activity was considered. We chose investors across the full spectrum of sectors, with activity in sukuk investment within the last two years.

A target population of 400 investment firms and investor representatives was extracted from Zawya Sukuk Monitor. With a minimum sample size of 120 the margin of error of ( $\pm 7$ ) would be achieved. The final number of respondents exceeded this required minimum representative sample.

Returned responses for both arrangers and investors surveys include data that some would consider to be proprietary information related to the objectives of the institutions represented by respondents. The survey has also elicited responses that reveal methods of analysis and perceptions of sukuk characteristics that are expected to influence demand and supply in the market.

The response rates for both lead arrangers/issuers and investors/traders are sufficiently significant for this exercise. We believe that the respondents' perceptions and forecasts about sukuk have provided an indicative and representative cross sample of the sukuk industry as a whole.

#### Data Collection and Survey Period

The 60 arrangers were first contacted via telephone to request their participation in the survey prior to sending invitations via email. Email invitations for the survey were sent on Aug. 13, 2013 and reminders were sent to non-respondents on Aug. 27, 2013. The survey was closed at 1600 GMT on Sept. 16, 2013.

#### Distribution and Representativeness

##### LEAD ARRANGERS

The arrangers' survey received 35 responses from a target population of 60 top lead arrangers and issuers, a 58.3% response rate. The 35 respondents were surveyed with a confidence level of 95%. Accordingly, the sample size of 35 should reflect the target population of the top 60 lead arrangers and issuers with a margin of error of ( $\pm 11$ ).

##### INVESTORS

The investors' survey generated 120 responses from a target population of 400 investors and traders, a 30% response rate. The sample size of 120 has a confidence level of 95% and a margin of error of ( $\pm 7$ ).

#### Survey Questions

Three types of questions were presented to the target population – multiple-choice questions, ranking questions, and open-ended questions.

For ranking questions, the data was analysed such that eight points were awarded to the first choice, seven points to the second, six points to the third and so on. The weighted average results are represented in the charts.



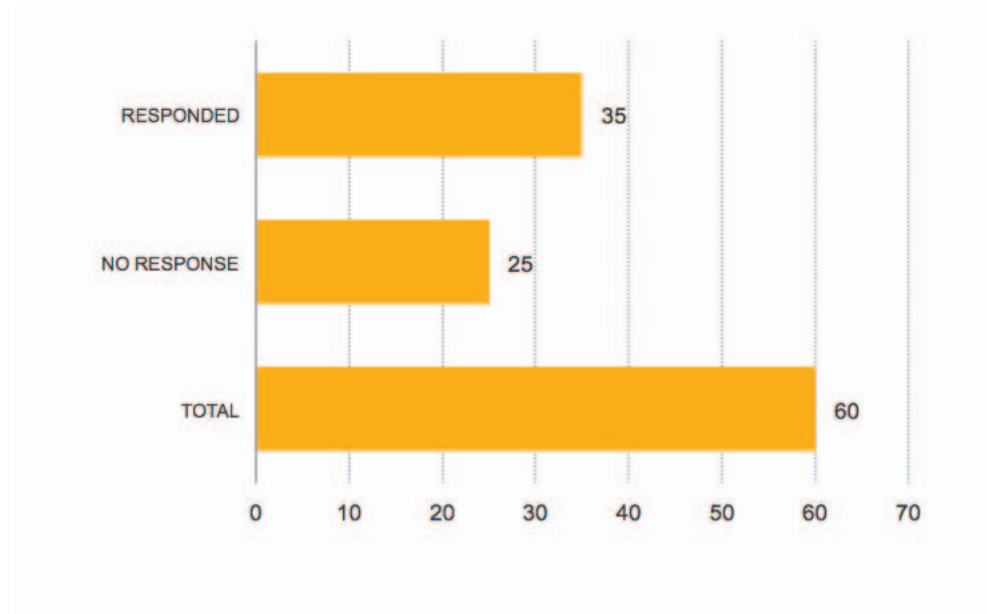
## Ex-post analysis

### Response Statistics

#### SELL SIDE

The arranger population of 60 was comprised of international banks, local banks, and asset management firms. A total of 35 responses was received, with 25 non-respondents. This results in a total participation rate of 5%.

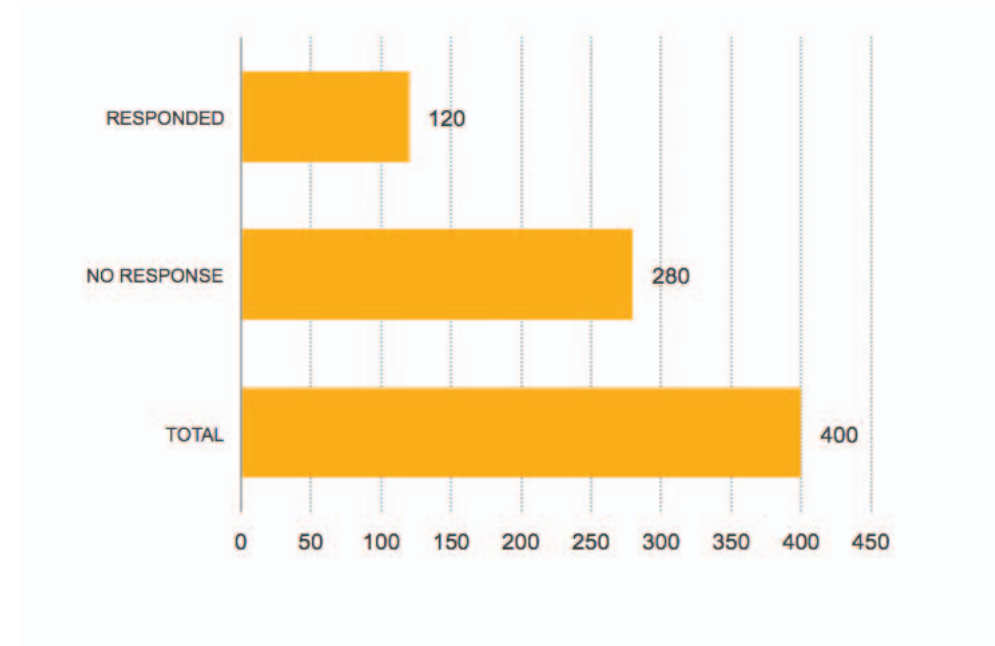
#### SELL SIDE: LEAD ARRANGERS ALLOCATION AND RESPONSE RATE



#### BUY SIDE

The investor population of 400 comprised international and local investors/investor representatives. A total of 120 responses was received, with 280 non-respondents. This results in a total participation rate of 30%.

#### BUY SIDE: INVESTORS ALLOCATION AND RESPONSE RATE

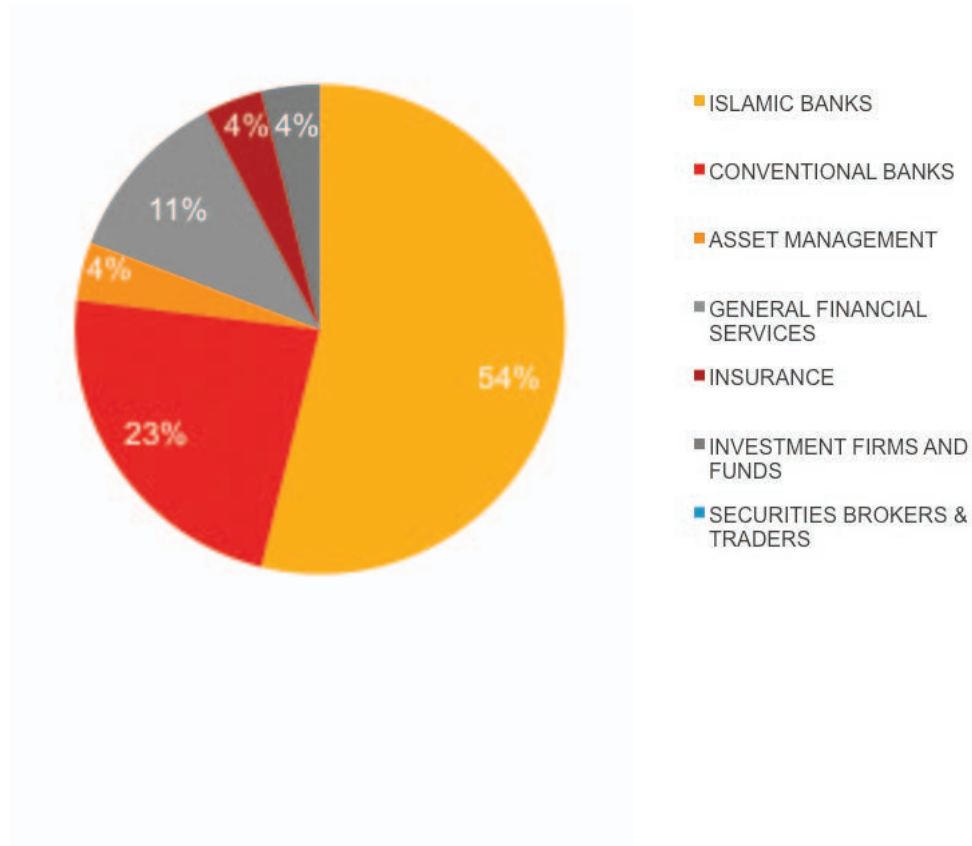


## Sector Distribution

### SELL SIDE

By sector distribution, Islamic banks take the lead, followed by conventional banks.

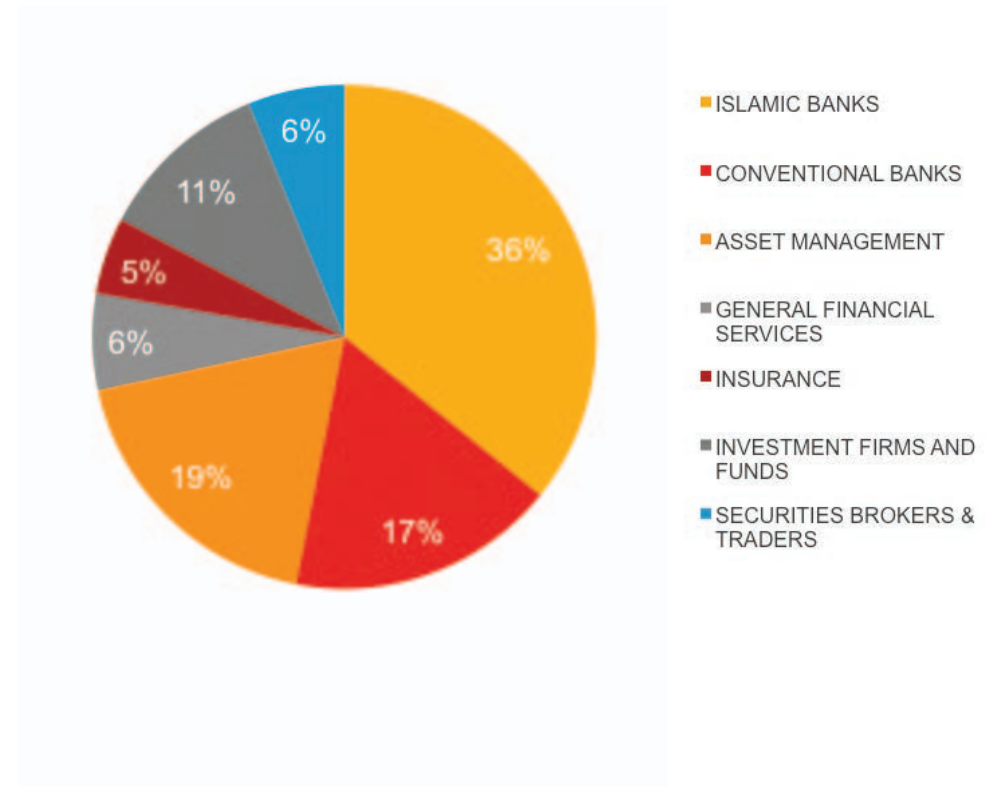
#### SELL SIDE: BY SECTOR



### BUY SIDE

On the buy side, demand for sukuk from a broad range of sectors and segments, with banking ranking highest, followed by asset management firms. Investment firms and funds come third.

#### BUY SIDE: BY SECTOR



## Geographical Distribution

### SELL SIDE

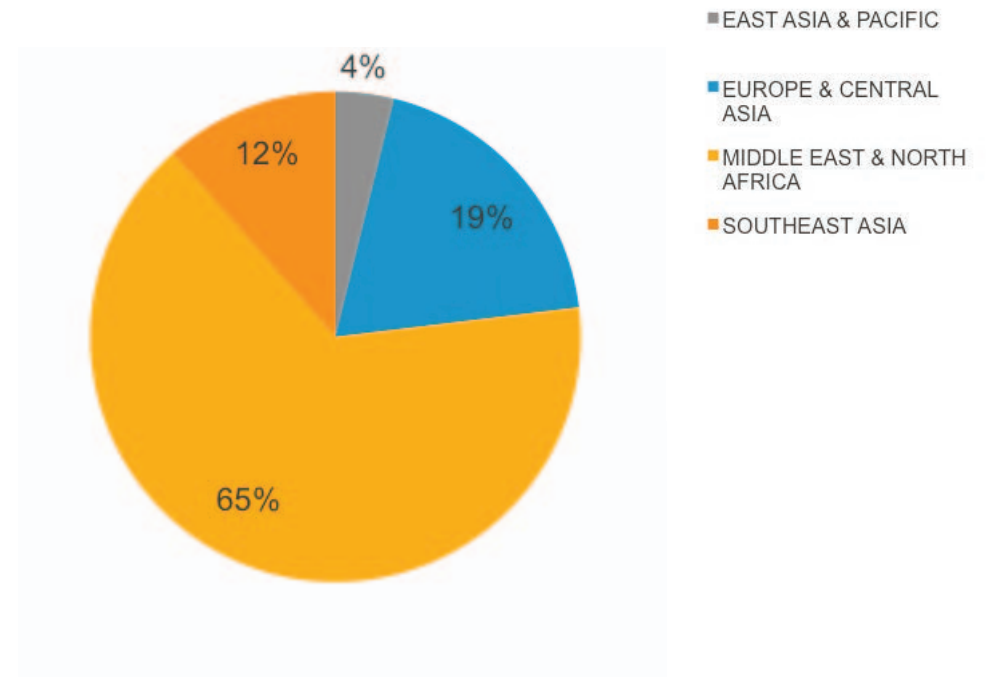
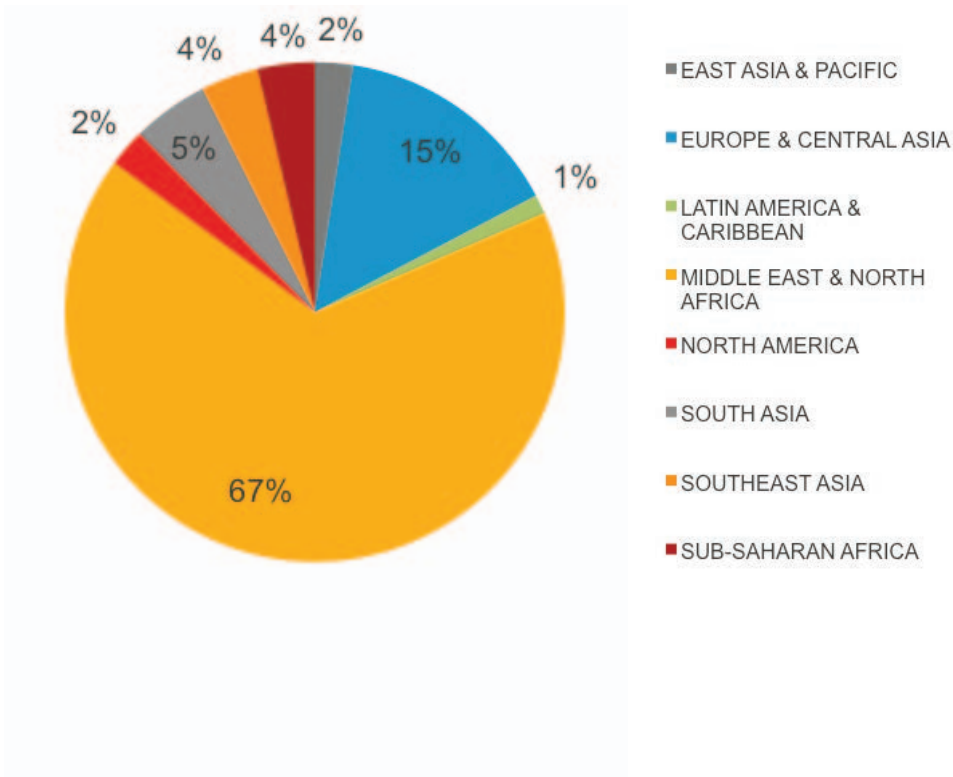
65 percent of the lead arrangers are from MENA, followed by 15 percent from Europe & Central Asia.

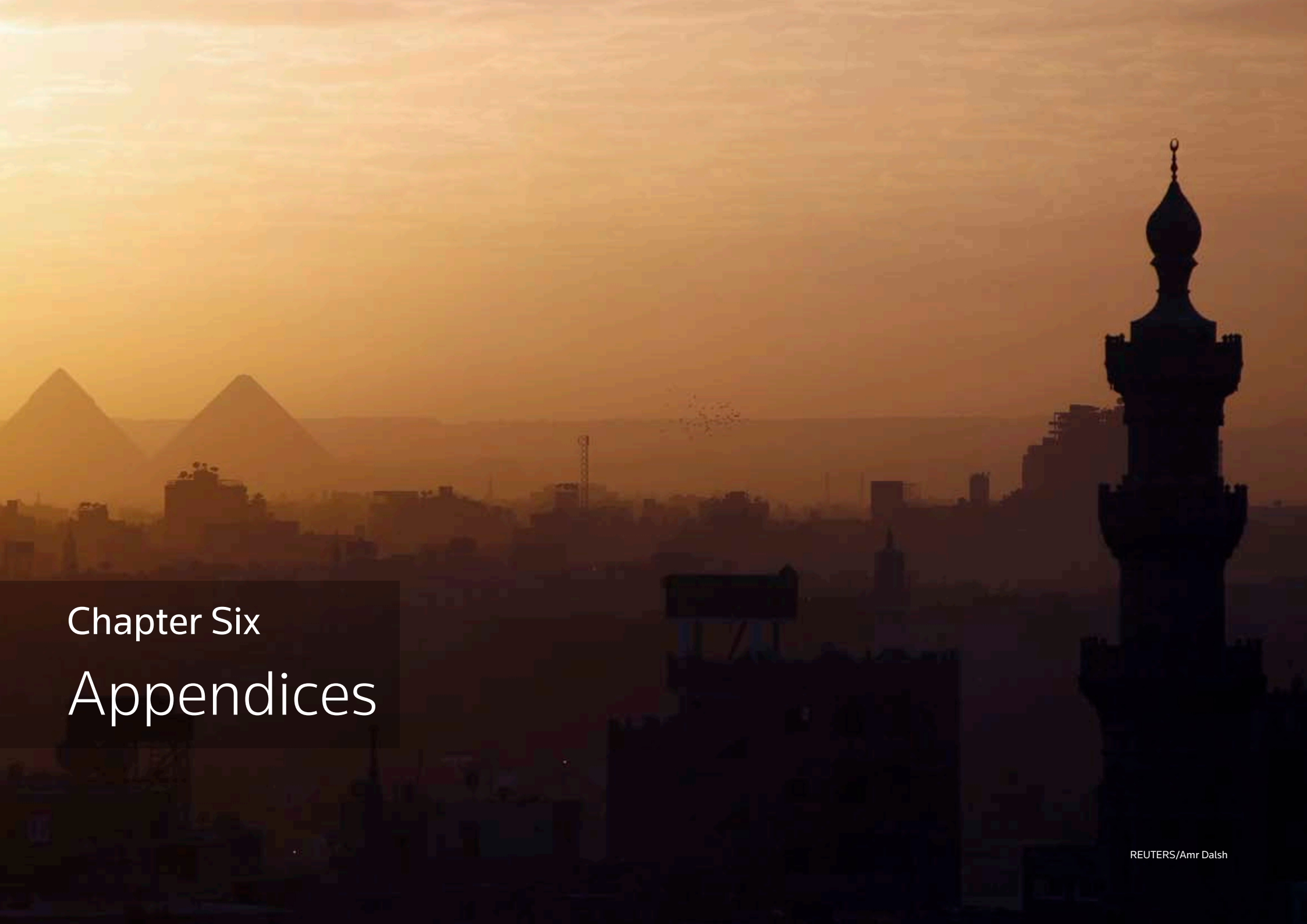
### BUY SIDE

Similarly, the majority of responses came from MENA at 65% followed by Europe & Central Asia.

### BUY SIDE: REGION BREAKDOWN

### SELL SIDE: REGION BREAKDOWN



A silhouette of a cityscape at sunset. In the background, two large pyramids are visible against a hazy, orange sky. In the foreground, a tall, ornate minaret with a crescent moon on top stands prominently on the right side. The rest of the city is in shadow, with some buildings and a crane visible in the distance.

# Chapter Six Appendices

## Glossary

### **(Bay') al 'ajil bil ajil**

Sale with delayed delivery or payment

A type of sale in which the sale price is paid immediately and delivery of the sale item is delayed, or one in which the sale price is deferred and the sale item is delivered immediately. Synonym: bay' al salam, murabaha.

### **Ijara**

Lease, rent or wage

The sale of a defined usufruct of any asset in exchange for defined compensation. In the context of Islamic finance, it refers to an arrangement under which one party leases equipment, buildings or other facilities to a client for an agreed rent. Synonym: isti'jar.

### **Istisna**

Manufacturing contract

A type of sale, similar to salam, in which the price is paid to the manufacturer by the purchaser for specified goods that are subsequently manufactured and delivered on a stipulated date.

### **Mudaraba**

Investment management partnership

A form of partnership where one party provides the funds while the other provides expertise and management. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne by the provider(s) of the capital. Synonym: qirad.

### **Murabaha**

Full disclosure trust sale; also, Mark-up/Cost plus sale

Originally a term describing a sale in which the seller sells his merchandise for more than the price at which he acquired it. The term is used in contemporary Islamic finance to describe a financing scheme in which a financial institution, usually a bank, agrees to purchase merchandise for a client provided that the client promises to purchase it from the financial institution at an agreed mark-up.

### **Musharaka**

Investment partnership

A standard Islamic transaction in which two or more parties enter into any one of several related types of partnerships (see mudaraba, musaqa, muzara'a). In a typical musharaka agreement, two or more parties agree to provide capital (ra's mal) towards the financing of a commercial venture, share profits according to a stipulated ratio and share losses on the basis of equity participation.

### **Bay' as Salam**

Deferred delivery sale

The sale of fungible goods to be delivered in the future for a price to be paid in the present. Synonym: salaf, bay' 'ajil bil ajil.

### **Sharia law**

Islamic law, originating from the Qu'ran, as defined by practices and explanations rendered by the Prophet Muhammad (pbuh) and ijtehad of 'ulama (personal efforts by qualified sharia scholars to determine the true ruling of the divine law in a subject matter).

### **Sukuk**

Islamic Bond

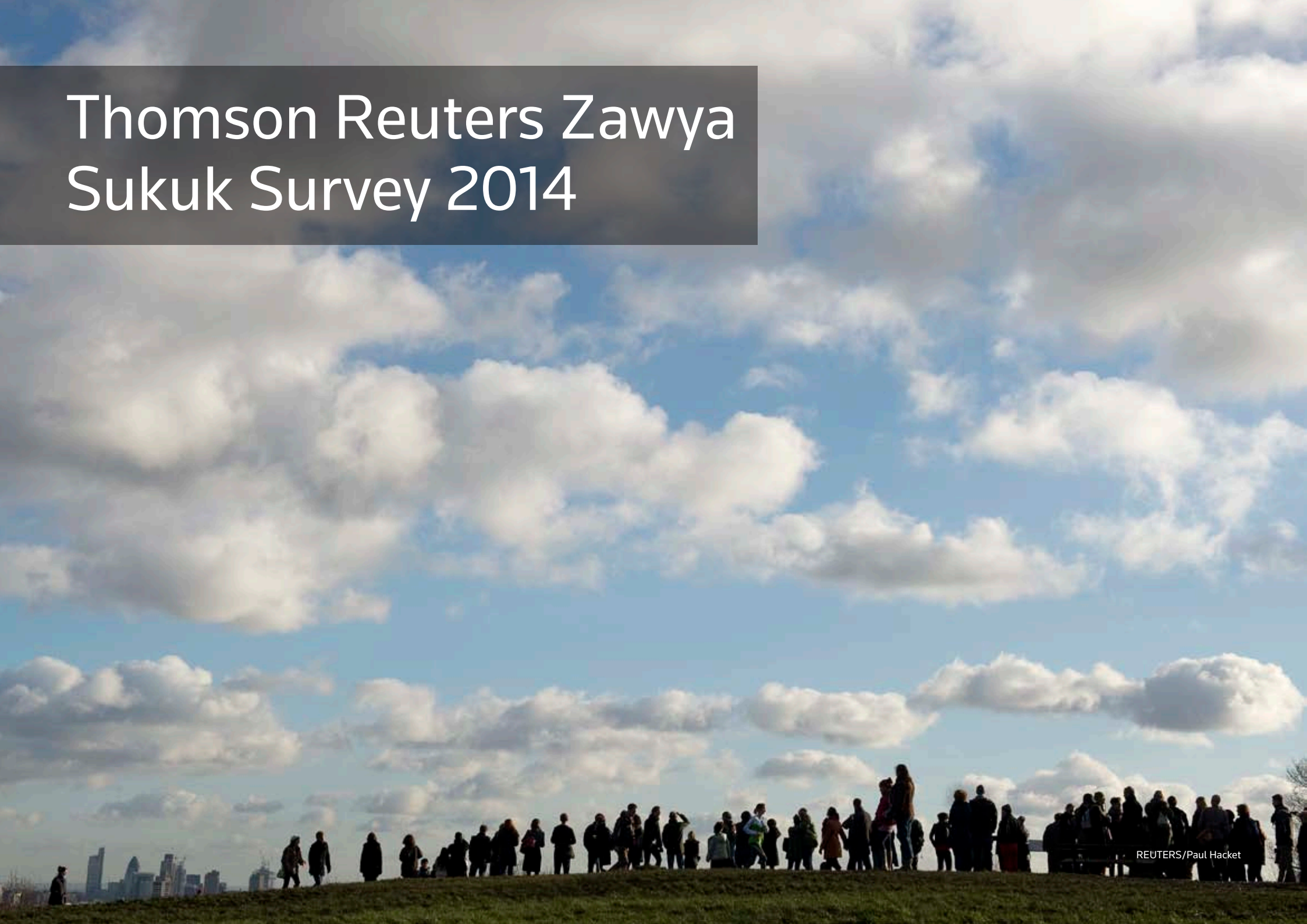
A term used in contemporary Islamic finance to describe financial certificate equivalents to conventional debt issuances such as bonds. However, unlike debt issuances, sukuk holders are the legal and/or beneficial owners of the underlying assets, and as such, receive the equivalent of a coupon from the performance of the yielding asset.

### **Wakala**

Agency

A standard Islamic practice, often used in financial transactions, wherein one party acts as an agent (wakil) for another party.

# Thomson Reuters Zawya Sukuk Survey 2014



REUTERS/Paul Hackett

## Introduction

The Thomson Reuters Sukuk Survey – Issuers and Investors have been developed to capture the outlook, appetite, and specific sukuk characteristics that appeal to you as an issuer and/ or investor.

The survey is targeted specifically at issuers and/or investors of the global sukuk market. If you do not fall into either category but are interested in our sukuk report please get in touch with our team separately. The survey is one of a kind and your responses will be collated and aggregated to gain a broad market perspective.

Your cooperation in this survey is highly appreciated. The findings of the survey will serve the Islamic finance industry, as well as potential new issuers who will rely on them to assess if, when and how they should establish a sukuk issuance programme.

Again, your insights and contributions are highly appreciated and we thank you very much for your participation.

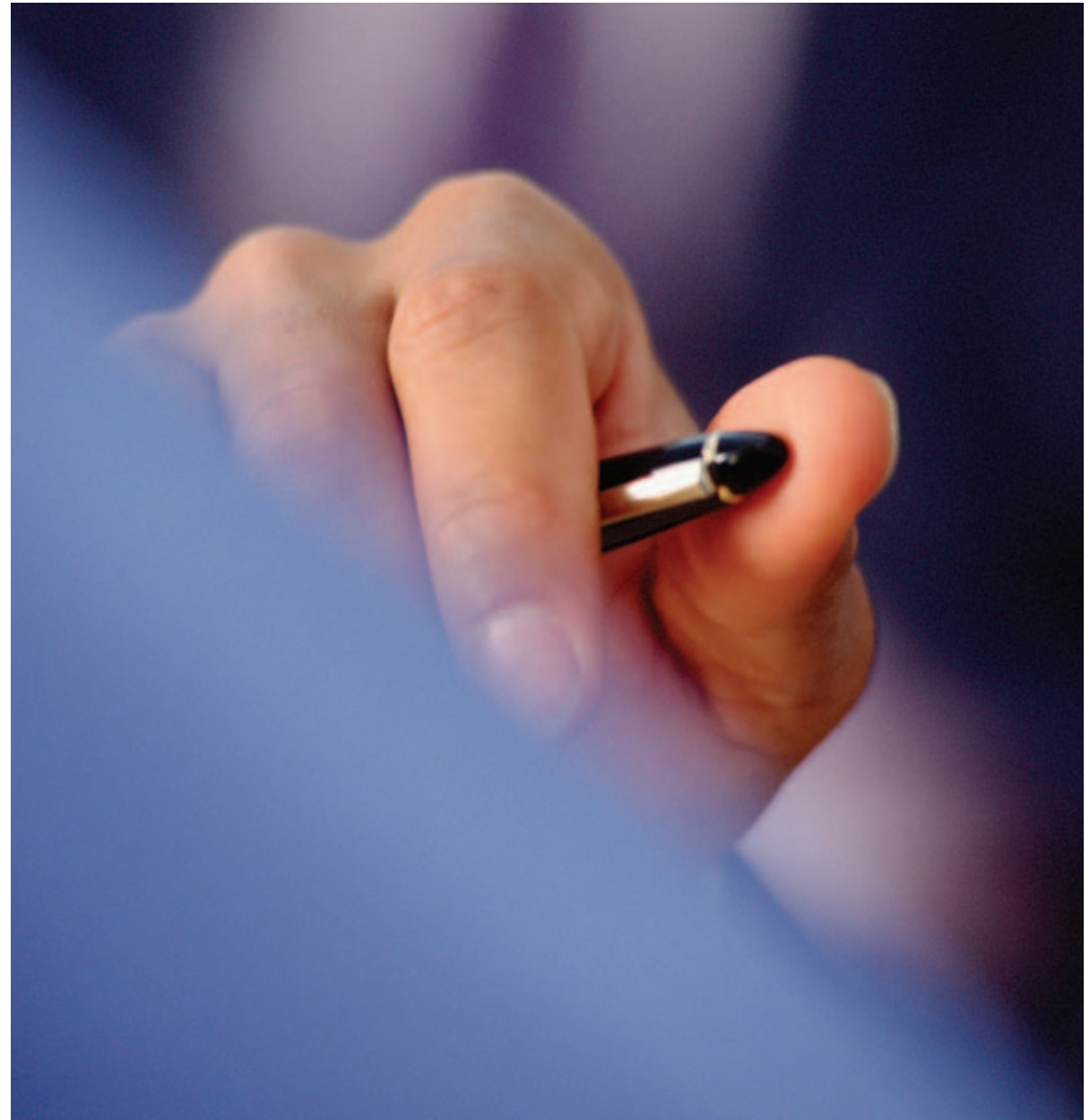
Sincerely,

Thomson Reuters Islamic Finance Team  
islamic.finance@thomsonreuters.com

### Survey Disclaimer

Thomson Reuters warrants that individual responses are confidential and will not be shared or distributed other than in aggregate averages with responses from other participants. Thomson Reuters endeavors to store your data in a secure manner and will spare every effort to ensure that such contents remain secure.

If you would prefer not to respond to a particular question, simply leave it blank.



1. Demographic Questions

Name: .....  
Company:.....  
Country: .....  
Email Address: .....

2. Physical address (To receive the report hardcopy)

.....  
.....  
.....  
.....  
.....

3. Which of the following best describes your company/organization?

- Sovereign
- Financial
- Corporate

4. Which region is your company/organization based in?

- East Asia & Pacific
- Europe & Central Asia
- Latin America & Caribbean
- Middle East & North Africa
- North America
- South Asia
- Southeast Asia
- SubSaharan
- Africa

5. What would you classify your company as?

- Islamic Bank
- Conventional Bank
- Asset Management
- General Financial Services
- Insurance
- Investment Firms and Funds
- Securities Brokers & Traders

Other (please specify) .....



## General Questions

6. In your current position, how would you describe your primary role in the sukuk market?

- Investor
- Issuer
- Lead arranger
- Trader
- None of the above

## Issuers & Lead Arrangers Survey

7. What volume of global (Int'l + domestic) sukuk issuance do you expect in 2013 and 2014? The total global sukuk issuance in 2012 was US\$ 135 billion and H1 2013 was US\$ 57 billion

	Less than US\$ 100 billion	US\$ 100 billion \$149.9 billion	US\$ 150 billion \$ 175 billion	More than US\$ 175 billion
2013	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2014	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

8. What volume of international sukuk issuance do you expect in 2013 and 2014? The total international sukuk issuance in 2012 was US\$ 19 billion and H1, 2013 was US\$ 11 billion

	Less than US\$ 15 billion	US\$ 15 billion - \$ 25 billion	US\$ 25 billion - \$ 30 billion	More than US\$ 30 billion
2013	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2014	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>







## 22. What is your most common reason for sukuk issuance?

- Refinancing
- Business Expansion
- Restructuring
- Diversify source of funding
- Cheaper funding and better pricing

## Sukuk Price Sensitivity / Elasticity

## 23. In your estimation, if there were a 1% point rise in global interest rates would the yield on sukuk:

- Rise more than 1%
- Rise less than 1%
- Fall less than 1%
- Fall more than 1%
- No impact

## 24. Rank the 5 most important factors below based on their significance to sukuk pricing (1 being the most significant)

	1	2	3	4	5
Global market interest rates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Investor business structure/diversity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Purpose of sukuk issuance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Size of sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk rating	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of currency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of issuer	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of market (international or domestic)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of sukuk asset based or assetbacked	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## 25. Is the cost of issuing sukuk less than the cost of issuing conventional bonds?

- Yes
- No

**26. What is the average additional cost of issuing sukuk, for an issuer, compared to a conventional bond, in US dollar terms?**

- Less than US\$ 50K
- US\$ 50K - \$ 199K
- US\$ 200K - \$ 349K
- US\$ 350K - \$ 499K
- Above US\$ 500K

**27. On average, what is the cost of a single sukuk issue expressed as a percentage of its total size?**

(Please provide a best estimate and enter a number).....

**28. Would you still issue sukuk if**

- Yield was 50 bps higher than a conventional bond?
- Yield was 100 bps higher than a conventional bond?
- Yield was 200 bps higher than a conventional bond?
- Regardless of the yield? (Indifferent)

**29. What drives the price gap between sukuk and bond?**

- Liquidity & Tradability
- Sharia non compliance risk
- Sukuk paper scarcity
- Sukuk structure

**Liquidity and Tradability**

**30. Does the regional distribution in the sukuk primary market affect its tradability and liquidity?**

- Yes
- No

**31. Please rank the regions listed below as your expected regional distribution for sukuk investors/holders. (1 being the most expected)**

	1	2	3	4	5	6	7	8
East Asia & Pacific	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Europe & Central Asia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Latin America & Caribbean	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Middle East & North Africa	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
North America	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
South Asia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Southeast Asia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SubSaharan Africa	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**32. Does the distribution allocation in the primary market between the different types of investors (banks, government, funds. etc) affect tradability and liquidity?**

- Yes
- No

33. Please rank the sectors listed below as your expected distribution allocation in the primary market between the different types of investors. (1 being the most expected and 5 the least expected)

	1	2	3	4	5
Global market interest rates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Banks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Government	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Hedge Funds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pension Funds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

34. As a lead arranger and/or issuer, do you monitor sukuk prices, tradability and availability in the market?

Yes

No

35. How relevant is sukuk categorization (Available for sale (AFS), Hold to maturity (HTM), Held for trading (HFT)) on the investor's balance sheet for liquidity and tradability?

Relevant

Neutral

Not Relevant

36. What is the most significant sukuk tradability and liquidity setback (1 being the most significant setback)

	1	2	3	4	5
Global market interest rates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Lack of dedicated traders that provide tradable prices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Lack of international Islamic banks with the same global network and reach as international conventional banks such as Citi, HSBC and JP Morgan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk investor's regional distribution	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk investor's sectors distribution	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk structure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## Investors and Traders Survey

37. For the rest of 2013 and 2014, how much of your investment portfolio will you allocate to Islamic financial products?  
(Please make an estimate and enter a number)

In US dollar.....

As percentage of total portfolio value .....

38. For the rest of 2013 and 2014, what proportion of your Islamic investments will be allocated to sukuk?  
(Please make an estimate and enter a number)

In US dollar.....

As percentage of total portfolio value .....

39. What is your primary reason for investing in sukuk?

- Religious mandate to only invest in Islamic instruments
- Opportunistic
- Diversification
- Yield

40. What volume of global (Int'l + domestic) sukuk issuance do you expect in 2013 and 2014? The total Global Sukuk issuance in 2012 was US\$ 135 billion and H1 2013 was US\$ 57 billion

	Less than US\$ 100 billion	US\$ 100 billion - \$ 149.9 billion	US\$ 150 billion \$ 175 billion	More than US\$ 175 billion
2013	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2014	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

41. What volume of international sukuk issuance do you expect in 2013 and 2014? The total international sukuk issuance in 2012 was US\$ 19 billion and H1 2013 was US\$ 11 billion

	Less than US\$ 15 billion	US\$ 15 billion - \$ 25 billion	US\$ 25 billion - \$ 30 billion	More than US\$ 30 billion
2013	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2014	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

42. For 2013 and 2014, what is the total proportion of investors' portfolio that have moved and are moving from fixed income (bonds and sukuk) to equities given the equity market recovery? (please round off to nearest quintile)

- 0% of portfolio
- 20% of portfolio
- 40% of portfolio
- 60% of portfolio
- 80% of portfolio
- 100% of portfolio



## Market Expectation

43. Out of the following group of locations, please rank the top 5 you would prefer for sukuk investments for the rest of 2013 and 2014. (1 being the most preferred)

	1	2	3	4	5
Bahrain	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
France	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Hong Kong	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Indonesia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Kuwait	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Malaysia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Oman	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Qatar	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Saudi Arabia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Singapore	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Turkey	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
United Arab Emirates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
United Kingdom	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
United States	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

44. For Questions 13 to 19, please rank the following sukuk characteristics according to your preference for the rest of 2013 and 2014. Sector (1 being the most preferred)

	1	2	3	4	5	6	7	8	9	10
Construction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Financial Services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Oil & Gas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Power & Utilities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
QuasiSovereign	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Real Estate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sovereign	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Telecommunication	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transport	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

45. Rating (1 being the most preferred)

- Investment Grade (BBB/ Baa3 and above)
- A and above
- SubInvestment
- Grade (BB or B)
- Unrated



51. Out of the following group of frontier and emerging markets, which are the 5 most attractive for sukuk investment? (1 being the most attractive)

	1	2	3	4	5
Azerbaijan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Bangladesh	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Egypt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Iraq	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Jordan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Kenya	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Libya	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Mauritius	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Morocco	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Nigeria	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Oman	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Russia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sri Lanka	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Tunisia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

52. To what extent do you agree with the following statement:

	Agree	Neutral	Disagree
Sukuk listing should be compulsory	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

53. To what extent do you agree with the following statement:

	Agree	Neutral	Disagree
Sukuk rating should be compulsory	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

54. Which type of sukuk do you prefer to invest in? (1 being the most preferred)

	1	2	3	4	5
Azerbaijan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Perpetual sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Secured sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Senior sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Subordinated tier 1 sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Subordinated tier 2 sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

55. If you have a crossborder investment mandate, which currency (besides local currency) would be preferable? (1 being the most preferred)

	1	2	3	4	5	6	7
AED	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
BHD	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
EUR	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
IDR	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
MYR	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SAR	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
USD	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

56. In your estimation, if there were a 1% point rise in global interest rates would the yield on sukuk:

- Rise more than 1%
- Rise less than 1%
- Fall less than 1%
- Fall more than 1%
- No impact

57. Rank 5 factors below based on their significance to sukuk pricing. (1 being the most important)

	1	2	3	4	5
Global market interest rates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Investor business structure/diversity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Purpose of sukuk issuance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Size of sukuk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk rating	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of currency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of issuer nmlkj	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of market (international or domestic)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Type of sukuk – assetbased or assetbacked	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

58. Would you still invest in sukuk if:

- Yield was 50 bps lower than a conventional bond?
- Yield was 100 bps lower than a conventional bond?
- Yield was 200 bps lower than a conventional bond?
- Regardless of the yield?

## Liquidity and Tradability

59. How do you categorize sukuk in your balance sheet?

- Available for sale (AFS)
- Hold to Maturity (HTM)
- Held for Trading (HFT)

60. As a trader, how relevant is the sukuk categorization (AFS, HTM & HFT) in the investor’s balance sheet on liquidity and tradability?

- Relevant
- Neutral
- Not Relevant

61. Does the regional distribution in the sukuk primary market affect its tradability and liquidity?

- Yes
- No

62. Please rank the regions below according to your preferred regional distribution for sukuk investors/ holders. (1 being the most preferred and 5 the least preferred)

	1	2	3	4	5	6	7	8
East Asia & Pacific	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Europe & Central Asia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Latin America & Caribbean	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Middle East & North Africa	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
North America	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
South Asia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Southeast Asia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SubSaharan Africa	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

63. Does the distribution allocation in the primary market between the different types of investors (banks, government, funds.etc) affect tradability and liquidity?

- Yes
- No

64. Please rank the sectors below according to your preferred distribution allocation in the primary market between the different types of investors. (1 being the most preferred)

	1	2	3	4	5
Banks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Government	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Hedge Funds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pension Funds	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

65. If you invest in sukuk, what is your average hold period for the sukuk you buy?

- Less than 1 year
- 1 - 3 years
- 3 - 5 years
- Hold to maturity

66. As a sukuk trader, what is your preferred type of sukuk structure to trade. (1 being the most preferred)

	1	2	3	4	5	6
Bai Bithaman Ajil	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ijara	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Mudharaba	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Murabaha	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Musharaka	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Wakala	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

67. As a sukuk trader, what is the most significant sukuk tradability and liquidity setback. (1 being the most significant)

	1	2	3	4	5
Lack of dedicated traders that provide firm quotes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Lack of international Islamic banks with the same global network and reach as international conventional banks such as Citi, HSBC and JP Morgan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk investor's regional distribution	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk investor's sectors distribution	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sukuk structure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## Top Sukuk pipeline 2013-2014

SUKUK NAME	COUNTRY	STRUCTURE	CURRENCY	AMOUNT (\$M)	STATUS	TENOR	LEADS
SGI – Matibu Sukuk	Australia	Istisnaa	MYR	156.056	Announced	7 Years	-
GIB IMTN Sukuk	Bahrain	Wakala	MYR	-	Announced	-	CIMB
Al Baraka Sukuk Al Wakala	Bahrain	Wakala	USD	200	Announced	1 Year 6 Months	-
Egypt Sovereign Sukuk	Egypt	Musharaka	USD	2000	Announced	3 Years to 5 Years	National Bank of Egypt
France Sovereign Sukuk	France	Ijara	-	-	Rumored	-	-
Credit Agricole Sukuk	France	Ijara	USD	-	Rumored	-	-
Orasis Sukuk	France	Ijara	EUR	0.014	Announced	20 Years	-
Airport Authority Hong Kong	Hong Kong	Ijara	-	-	Rumored	-	Citigroup
Islamic Development Bank Indonesian Sukuk	Indonesia	Ijara	IDR	-	Rumored	-	-
Aneka Gas Sukuk (2017)	Indonesia	Ijara	IDR	-	Announced	5 Years	-
Kencana Petroleum Sukuk	Malaysia	Mudaraba	MYR	111.696	Announced	-	-
Bank Islam Subordinated Sukuk	Malaysia	Murabaha	MYR	319.132	Announced	-	-
Petronas Dagangan Sukuk	Malaysia	Murabaha	MYR	-	Announced	7 Years	CIMB
Unique Wealth Management Sukuk	Malaysia	Musharaka	MYR	319.132	Announced	-	-
Tital Development Company Sukuk	Oman	Ijara	OMR	129.874	Announced	5 Years	Al Madina Financial & Investment Services Co.
Meezan Bank Sukuk	Pakistan	Ijara	PKR	-	Announced	5 Years to 10 Years	Meezan Bank Limited
Government of Philippines Sukuk	Philippines	Ijara	USD	1000	Rumored	5 Years	-
Senegal Sovereign Sukuk	Senegal	Ijara	-	200	Announced	-	Citigroup Global Markets Limited
Sabana REIT Sukuk	Singapore	Wakala	USD	-	Announced	-	CIMB Middle East
South Africa Sovereign Sukuk	South Africa	Ijara	USD	500 - 700	Announced	5 Years	Al Baraka Banking Group
Dialog Axiata Sukuk	Sri Lanka	Murabaha	MYR	-	Rumored	15 Years	-
Sudan Sovereign Sukuk	Sudan	Ijara	USD	758	Announced	-	Sudan Financial Services Company
ADCB Malaysian Sukuk	UAE	Ijara	MYR	95.74	Rumored	3 Years	Standard Chartered Bank
Dubai Bank Sukuk(Tranche 1)	UAE	Ijara	USD	500	Delayed	-	Standard Chartered Bank

Source: Thomson Reuters Zawya

## International Sukuk Issued in 2013

SUKUK NAME	COUNTRY	SECTOR	CURRENCY	OFFER SIZE (MLN)	OFFER SIZE (\$MLN)	ISSUE DATE	MATURITY DATE	SUKUK STRUCTURE
Hazine Mustesarligi Varlik Kiralama Anonim Sirketi	Turkey	Financial Services	USD	1,500	1,500	17-Sep-12	26-Mar-18	Ijara
Saudi Electricity Global SUKUK Co.	Saudi Arabia	Power and Utilities	USD	500	500	28-Mar-12	28-Mar-17	Ijara
EIB Sukuk Company Ltd	UAE	Financial Services	USD	500	500	18-Jan-12	18-Jan-17	Musharaka
IDB Trust Services Limited	Saudi Arabia	Financial Services	USD	800	800	12-Jun-12	26-Jun-17	Al-Wakala Bil-Istithmar
MAF Sukuk Ltd	UAE	Real Estate	USD	400	400	7-Feb-12	7-Feb-17	Wakala
Dubai DOF Sukuk Limited	UAE	Governmental Institutions	USD	650	650	25-Apr-12	2-May-22	Ijara
SoQ Sukuk A QSC	Qatar	Governmental Institutions	USD	2,000	2,000	11-Jul-12	18-Jul-18	Ijara
FGB Sukuk Company Limited	UAE	Financial Services	USD	500	500	18-Jan-12	18-Jan-17	Wakala-Mudaraba
JAFZ Sukuk (2019) Ltd	UAE	Real Estate	USD	650	650	12-Jun-12	19-Jun-19	Wakala
Emaar Sukuk Limited	UAE	Real Estate	USD	500	500	12-Jul-12	18-Jul-19	Ijara
Central Bank of Bahrain	Bahrain	Governmental Institutions	BHD	18	48	27-Aug-12	28-Nov-12	Al Salam
Banque Saudi Fransi Sukuk Limited	Saudi Arabia	Financial Services	USD	750	750	15-May-12	22-May-17	Wakala
DIB Sukuk Company Limited	UAE	Financial Services	USD	500	500	22-May-12	30-May-17	Ijara
Axiata SPV2	Malaysia	Telecommunications	CNY	1,000	158	18-Sep-12	18-Sep-14	Wakala
EIB Sukuk Company Ltd	UAE	Financial Services	USD	500	500	4-Jul-12	11-Jan-18	Musharaka
Pulai Capital (Khazanah Nasional)	Malaysia	Financial Services	USD	358	358	22-Mar-12	22-Mar-19	Musharaka
Saudi Electricity Global SUKUK Co.	Saudi Arabia	Power and Utilities	USD	1,250	1,250	28-Mar-12	28-Mar-22	Ijara
Dubai DOF Sukuk Limited	UAE	Governmental Institutions	USD	600	600	25-Apr-12	2-May-17	Ijara
Tamweel Funding III	UAE	Financial Services	USD	300	300	18-Jan-12	18-Jan-17	Wakala-Mudaraba
SoQ Sukuk A QSC	Qatar	Governmental Institutions	USD	2,000	2,000	11-Jul-12	18-Jul-23	Ijara

Source: Thomson Reuters Zawya



## International Lead Arranger League Table (YTD Q3, 2013)

BOOK RUNNER	AMOUNT ISSUED (\$MILLION)	MARKET SHARE	NUMBER OF ISSUES
HSBC Holdings PLC	1,987.5	14.8	7
Standard Chartered PLC	1,682.0	12.5	9
Citi	1,282.2	9.5	5
Emirates NBD PJSC	886.0	6.6	7
Dubai Islamic Bank Ltd	682.2	5.1	4
National Bank of Abu Dhabi	537.5	4.0	4
Riyadh Bank Ltd	500.0	3.7	1
Bank Al Bilad	500.0	3.7	1
Alinma Bank	500.0	3.7	1
RHB	434.4	3.2	3
Abu Dhabi Islamic Bank (ADIB)	332.2	2.5	2
RBS	291.7	2.2	2
Malayan Banking Bhd	200.0	1.5	1
Abu Dhabi Commercial Bank Ltd	165.6	1.2	1
Natl Comml Bank Saudi Arabia	125.0	.9	1
Kuwait Finance House	125.0	.9	1
Natixis	125.0	.9	1
Al Hilal Islamic Bank	125.0	.9	1
CIMB Group Sdn Bhd	125.0	.9	1
Credit Agricole CIB	125.0	.9	1
Barwa Bank QSC	125.0	.9	1
Masraf Al Rayan	74.6	.6	1
QInvest LLC	74.6	.6	1
Alkhair Capital Saudi Arabia	74.6	.6	1
<b>TOTAL</b>	<b>13,479.9</b>	<b>100</b>	<b>18</b>

Source: Thomson Reuters

## International Sukuk Industry League Table (YTD)

INDUSTRY	PROCEEDS AMOUNT (US\$ MILLIONS)	MARKET SHARE	NUMBER OF ISSUES
Energy and Power	19,895.1	13.6	38
Industrials	13,916.1	9.5	65
Government and Agencies	9,862.1	6.8	15
Telecommunications	8,857.3	6.1	15
Real Estate	5,041.8	3.5	21
Materials	4,751.1	3.3	19
Consumer Products and Services	1,792.7	1.2	8
Consumer Staples	724.4	.5	10
High Technology	530.1	.4	1
Healthcare	208.4	.1	3
Retail	15.4	.0	2
Media and Entertainment	1.4	.0	1
<b>INDUSTRY TOTAL</b>	<b>146,008.3</b>	<b>100</b>	<b>401</b>

Source: Thomson Reuters

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 <p>USD 750m 10yr RegS Sukuk</p> <p>May 2013 Joint Lead Manager &amp; Bookrunner</p>	 <p>USD 500m 7yr RegS</p> <p>May 2013 Joint Lead Manager &amp; Bookrunner</p>	 <p>USD 500m 5yr RegS Sukuk</p> <p>May 2013 Joint Lead Manager &amp; Bookrunner</p>	 <p>USD 650m 7yr Sukuk</p> <p>May 2013 Joint Lead Manager &amp; Bookrunner</p>	 <p>USD 500m 5yr Sukuk</p> <p>May 2013 Joint Lead Manager &amp; Bookrunner</p>	 <p>USD 2,000m Global Sukuk Programme</p> <p>May 2013 Arranger</p>

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