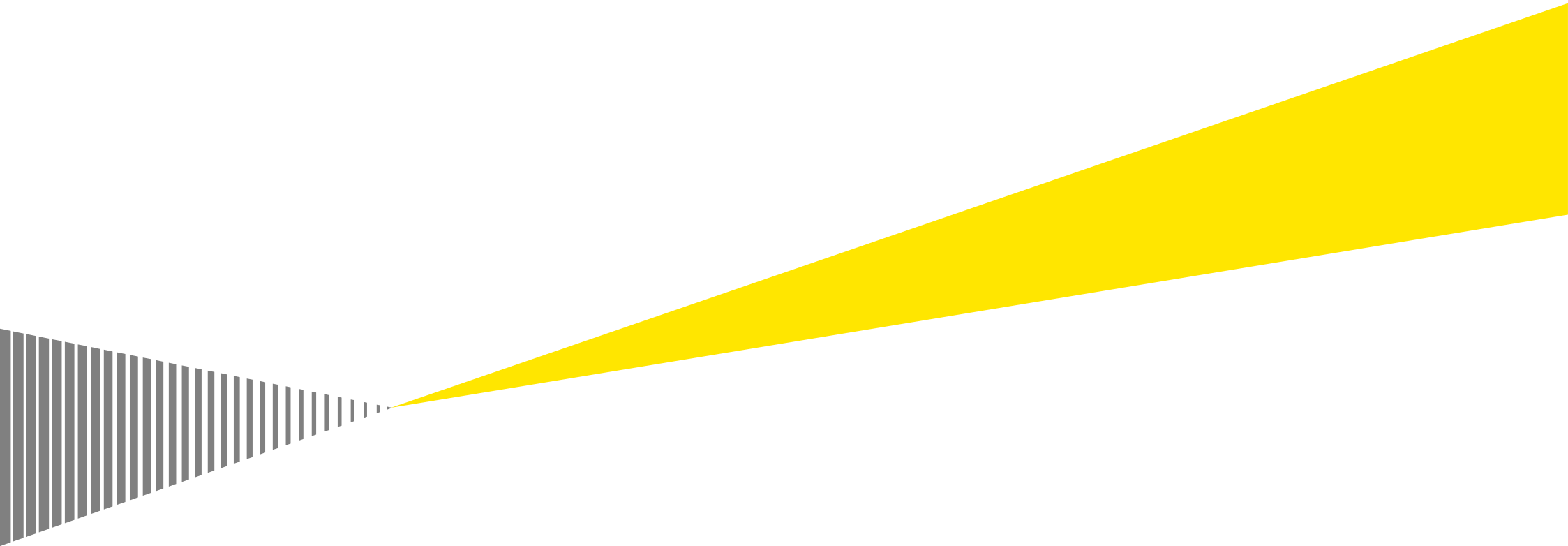


Discussion on Sukuk and Leasing



Building a better
working world

Sukuk and its Evolution

What is Sukuk?

- ▶ Sukuk in general may be understood as a Shariah compliant 'Bond'. In its simplest form Sukuk represents ownership of an asset or its usufruct. The claim embodied in Sukuk is not simply a claim to cash flow but an ownership also.
- ▶ This also differentiates Sukuk from conventional bonds as the latter proceed over interest bearing securities, whereas Sukuk are basically investment certificates consisting of ownership claims in a pool of assets.

Evolution of Sukuk

▶ AAOIFI defined Sukuk as:

“Certificates of equal value representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity”.

History of Sukuk:

- ▶ Islamic government used to pay soldiers and public servants both in cash and in kind. The payment in kind was in the form of Sukuk al Badai, which has been translated as “commodity coupons” or “grain permits”. The holders of the Sukuk were entitled to present the Sukuk on its maturity date at the treasury and receive a fixed amount of commodity, usually grains.

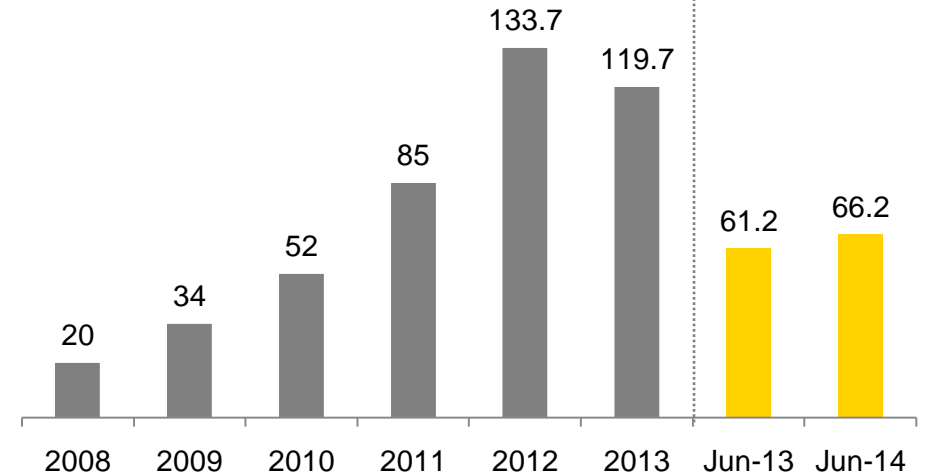
Overview of the Sukuk Market

Overview of the Sukuk Market

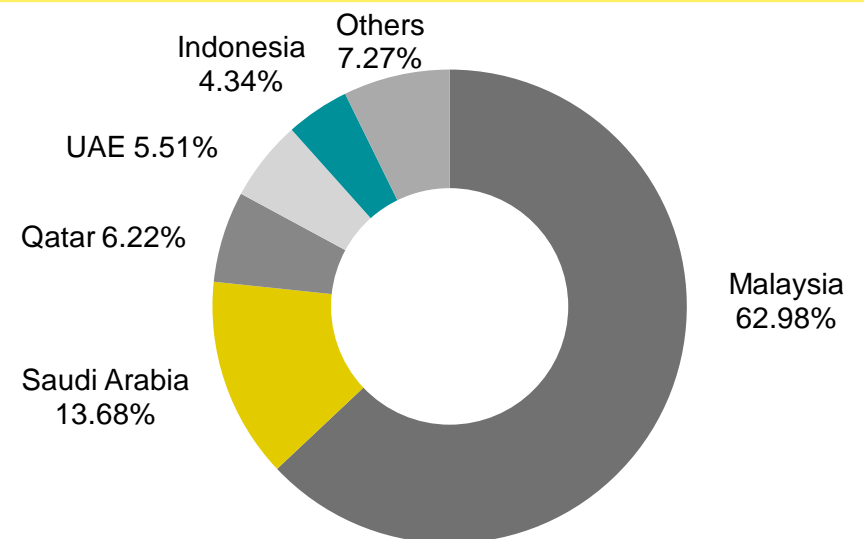
- In 2014, the global Sukuk market new issuances with total issuances amounting to USD118.8 billion.
- Malaysia continued to be the global Sukuk market leader with more than USD77.0 billion or approximately 63% of total issuances in 2014.
- The United Kingdom Government, through Her Majesty's Treasury, successfully priced, in June, an inaugural GBP 200 million 5-year fixed rate Sukuk issuance. The offering was issued at par with a profit rate of 2.036% (flat 5-year Gilt rate).

Global Sukuk Issuances (2008 - June 14)

USD billions

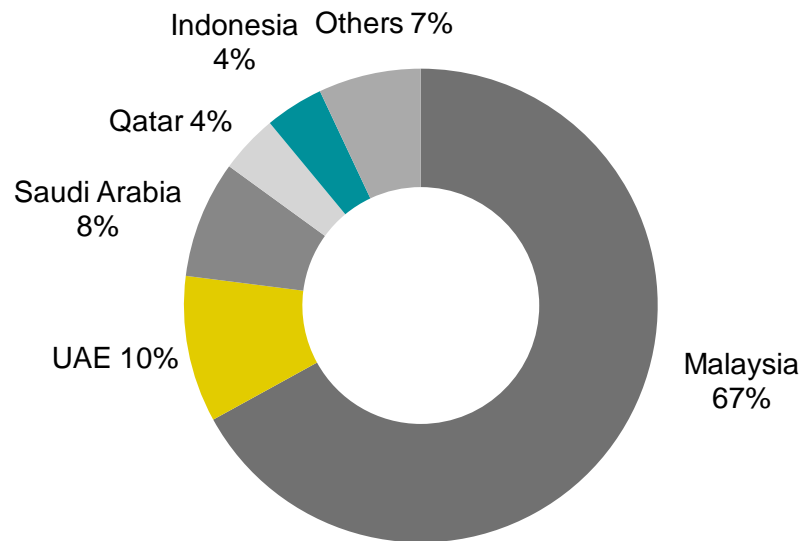


Global New Sukuk Issuances by Domicile (1H2014)

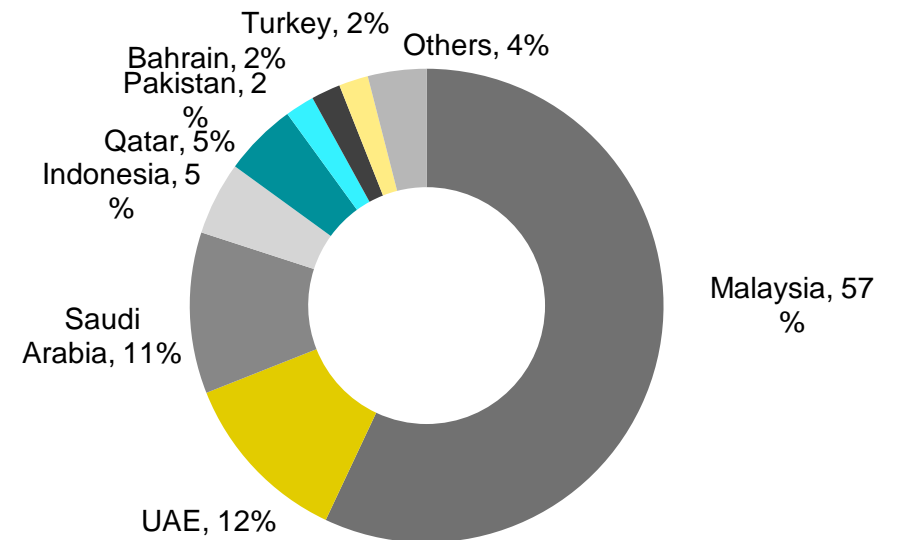


Overview of the Sukuk Market (Cont'd)

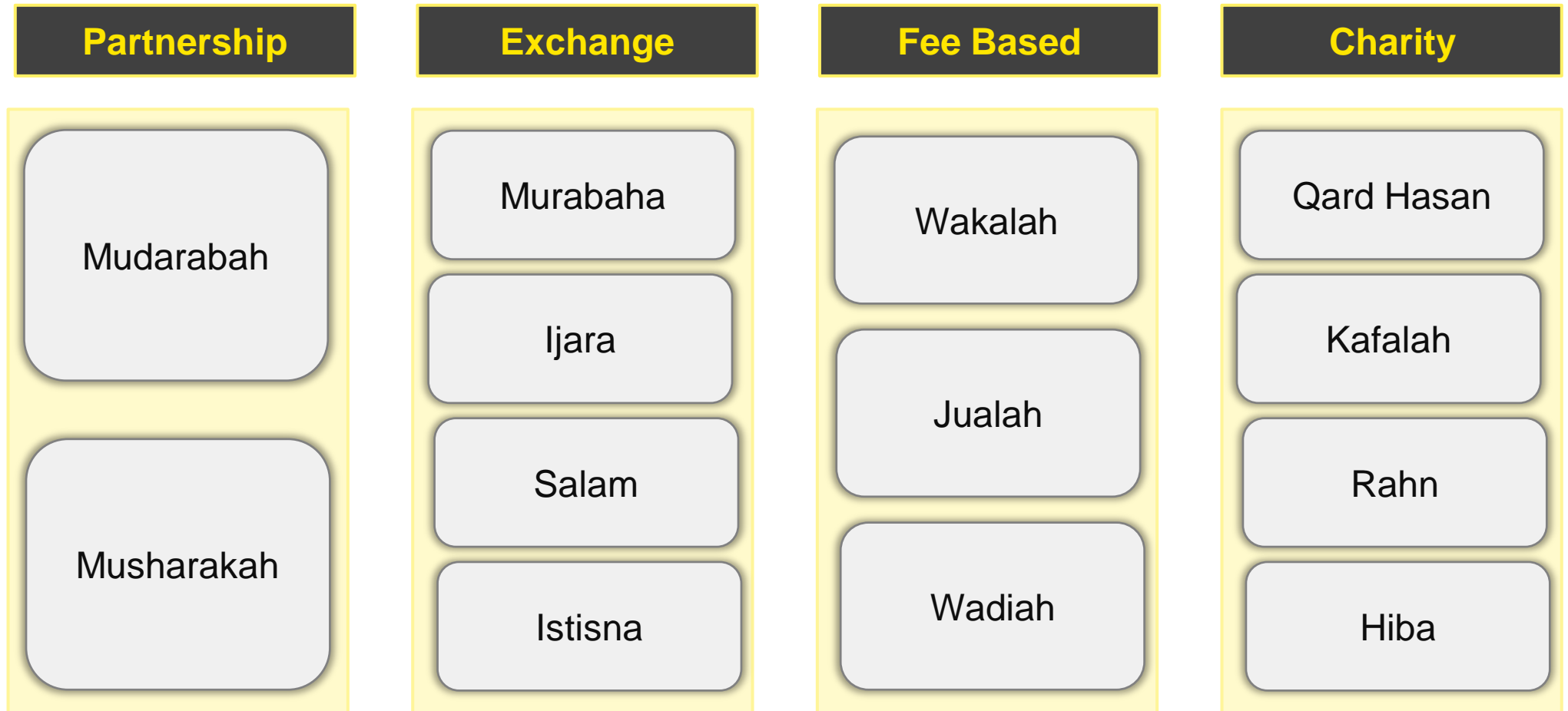
Global Sukuk Issued By Country (1996–1H2014)



Global Outstanding Sukuk by Country (1H2014)



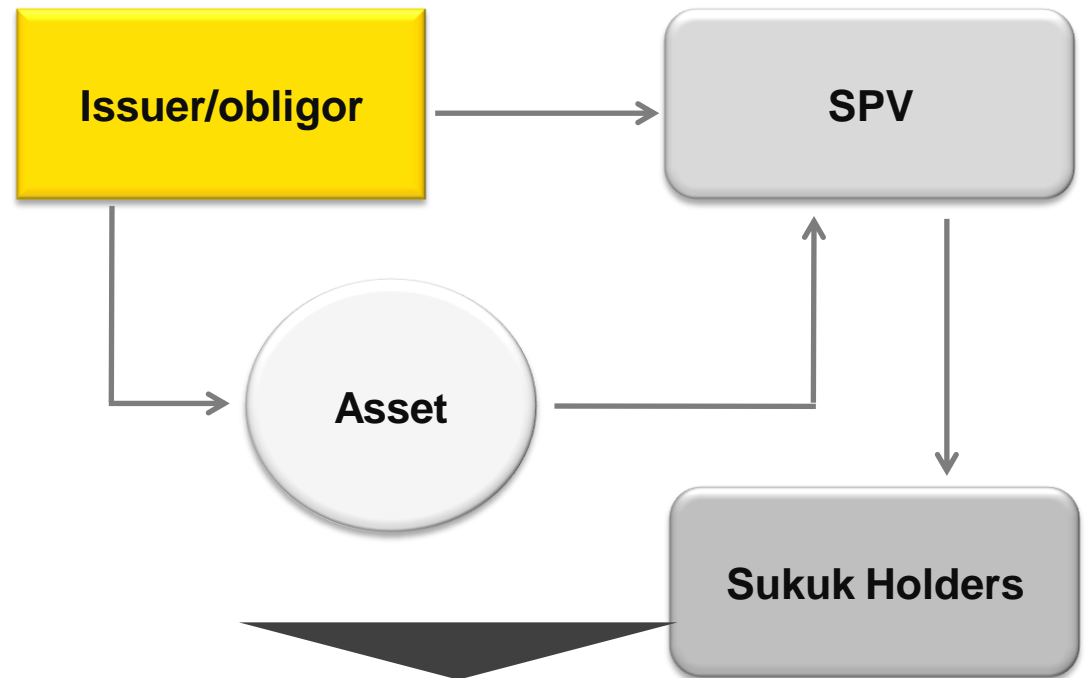
Islamic Finance Contracts



Ijarah Sukuk & its Structure

Ijarah Sukuk

- This is the most common structure used by obligors worldwide.
- Obligor has certain Shariah compliant asset which he parts through sale agreement with SPV created for the purpose.
- SPV raises the financing from investors against the asset and pays it to the obligor.
- SPV then leases the asset back to the obligor and receives the rent in lieu thereof which is passed on to the Sukuk holders.
- After the end of lease the asset is bought back by the obligor (normally) at the price equivalent to the original sale price.
- Four types of agreements are crucial for this structure:
 - Sale/Purchase agreement (between obligor and SPV)
 - Master Ijarah Agreement
 - Purchase undertaking by the issuer
 - Sale undertaking by the SPV



1. Issuer and SPV (purchase agreement)
2. SPV buys the asset through proceeds received from Sukuk holders
3. SPV (on behalf of Sukuk holders leases the asset back to the Issuer
4. Issuer pays the rent till the period of lease
5. At the end of lease period the Issuer buys back the asset and the proceed is paid back to Sukuk holders

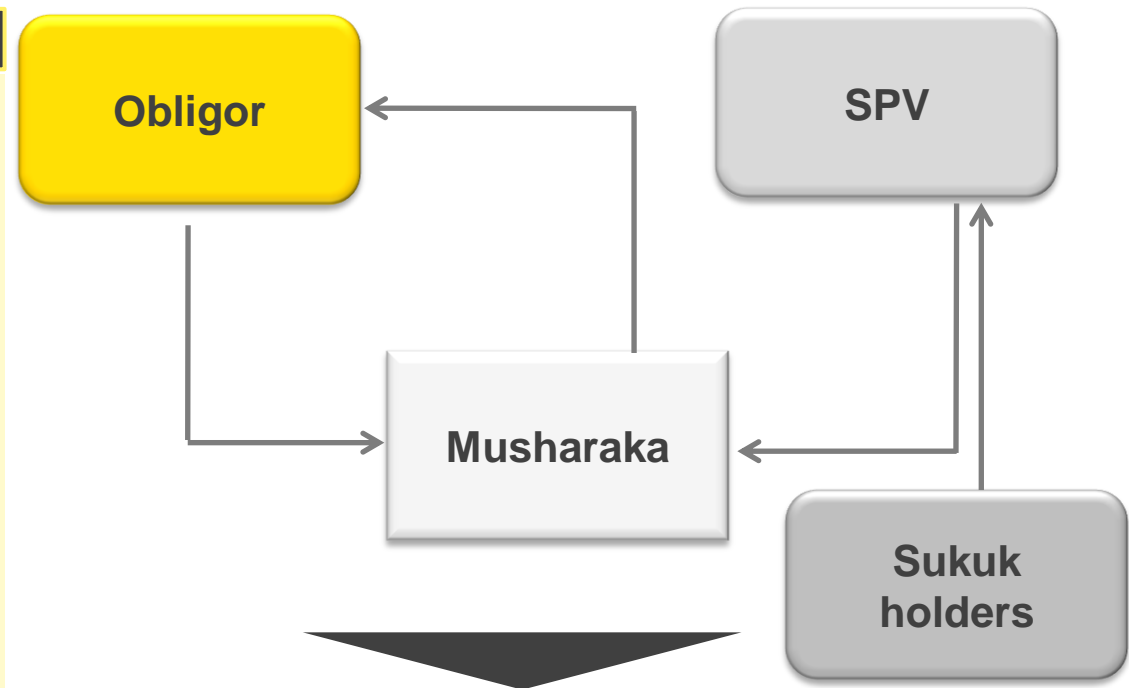
Ijarah Sukuk (Case Study)

- ▶ Malaysia Global Sukuk
- ▶ Issuer: Government of Malaysia
- ▶ Year: 2002
- ▶ Tenor: 5 years
- ▶ Purpose: Financing the development of Land parcel for government owned hospitals and office complex)
- ▶ Issue Size USD 600 million
- ▶ Return (LIBOR Plus 95 basis points) Semi annual (floating rate)
- ▶ Principal repayment affirmed by government of Malaysia on face value of the Sukuk
- ▶ Rating BBB+ (S&P)
- ▶ Major investors: Middle East (50%), Asia (30%), Europe and others (20%).

Musharaka Sukuk & its Structure

Musharaka Sukuk

- Musharaka Sukuk is an investment partnership between the issuer and the Sukuk holders. This structure is used when issuer needs financing in much larger proportion than the asset it has.
- Obligor brings some asset (tangible or intangible) to the Musharaka as his contribution to the partnership whereas finance is brought in by the Sukuk holder through an SPV.
- Obligor is appointed as manager of the Musharaka, for which he receives a fee.
- Profit is shared between the obligor and SPV in a pre-agreed ratio. Losses are shared in accordance of their respective contribution.
- Musharaka Sukuk are popular because of:
 - **Assured return (indicated in the Musharaka agreement)**
 - Shortfall if any is made good by the obligor through provision of liquidity arrangement in the form of qard-e-hasana.
 - Returns over and above the indicated rate is offered to the obligor as incentive fee.
 - Musharaka Asset are purchased by the issuer at face value.
 - This type of Sukuk receives Good Rating.



1. Obligor and SPV join in to create Musharaka, which is managed by the former for a fee.
2. SPV gets an indicative returned normally linked to a conventional benchmark.
3. Shortfall if any is made good by the obligor in return for any excess earned by Musharaka in future.
4. At the end Musharaka asset is purchased by the obligor at face value.

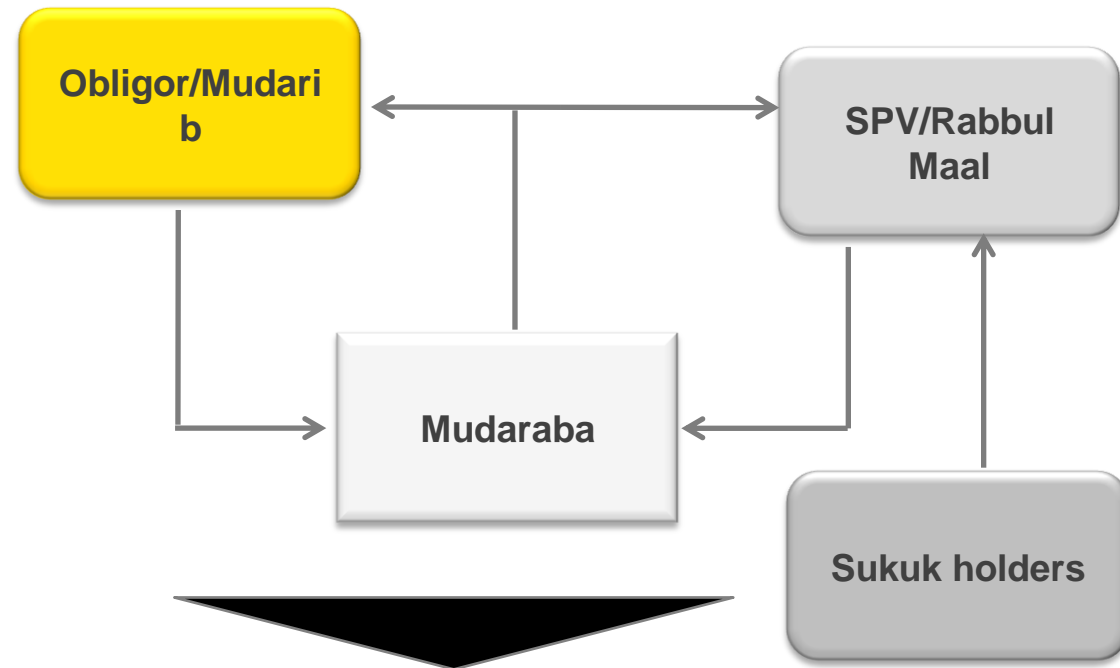
Musharaka Sukuk (Case Study)

- ▶ DMCE Sukuk
- ▶ Issuer: Dubai Metal and Commodity Exchange, UAE
- ▶ Year: 2005
- ▶ Tenor: 5 years
- ▶ Purpose: Proceeds raised invested in the ongoing business of the company.
- ▶ Issue Size USD 300 million
- ▶ Diminishing Musharka principle where USD 300 million is amortised in ten installments of USD 30 million each at six monthly interval.
- ▶ Profit sharing ratio (80:20)
- ▶ Return LIBOR plus margin.
- ▶ Tradable papers

Mudaraba Sukuk & its Structure

Mudaraba Sukuk

- Relation between the obligor and Sukuk holders (via SPV) is governed under Mudaraba agreement.
- Mudaraba Sukuk essence lie in its sharing the profits and passing on its losses to the Sukuk holders.
- Obligor is appointed a Mudarib or an investment manager while the SPV acts as the financier or rab-al-maal. The proceeds of the issue collected by the SPV from the Sukuk investors are applied as the capital of the Mudaraba which the Mudarib will manage for a share in the profits.
- Mudaraba Sukuk are popular because of:
 - **Assured return (indicated in the agreement)**
 - Shortfall if any is made good by the obligor through provision of liquidity arrangement in the form of qard-e-hasana.
 - Returns over and above the indicated rate is directed to reserve account.
 - Unconditional purchased undertaking by the issuer at face value.
 - Provision of redemption before maturity at the option of Sukuk holder or SPV
 - This type of Sukuk receives Good Rating.
 - Tradable papers (if all assets are not in liquid form).



1. Obligor and SPV join in to create Mudaraba, which is managed by the former for a share in the profit.
2. SPV gets an indicative returned normally linked to a conventional benchmark.
3. Shortfall if any is made good by the Mudarib
4. Excess profits are directed to reserve account for future distribution.
5. At the end Mudaraba asset is purchased by the Mudarib/obligor at face value.

Mudaraba Sukuk (Case Study)

- ▶ Dana Gas Sukuk
- ▶ Issuer: Dana Gas, a private company in UAE
- ▶ Year: 2007
- ▶ Tenor: 5 years
- ▶ Purpose: Proceeds raised invested in the ongoing business of the company.
- ▶ Issue Size USD 1000 million
- ▶ Return 7.5 % (payable quarterly)
- ▶ Profit sharing ratio (99:1)
- ▶ Return over and above 7.5 % would go to Mudarib as incentive.
- ▶ Principal repayment affirmed by the company through purchase undertaking given to SPV
- ▶ Tradable papers

Exchangeable Sukuk

- Khazana is an investment holding arm of the Government of Malaysia
- Telecom Malaysia another government owned entity needed funding for its business
- Sukuk worth USD 750 million (green shoe option of USD 100 million)
- Offering return of 1.25 % per annum payable annually with five year tenor.
- Khazana is a appointed manager of the Sukuk
- Redemption amount guaranteed through purchase undertaking.
- Periodic payment to be paid from the dividend income received on account of shares held in trust
- Provision of sinking fund to meet all periodic payments.

IDB Hybrid Sukuk & its Structure

IDB Hybrid Sukuk

- Launched in September 2009 the issue size is USD 1.5 billion
- This IDB Trust Sukuk Program has hybrid structure making use of Ijarah, Istisna, Murabaha and Wakala.
- 51% of the Trust asset are tangible in the form of Ijarah contracts and equity investments. Thus making the Sukuk tradable
- 49% assets are in the form of intangible like Istisna and Murabaha receivables.
- IDB is appointed as Wakeel of the Trust for which it will get a fixed fee plus incentive.
- Redemption amount guaranteed through purchase undertaking.

