



# Towards Global Standard for Islamic Sukuk – Issuance and Trading

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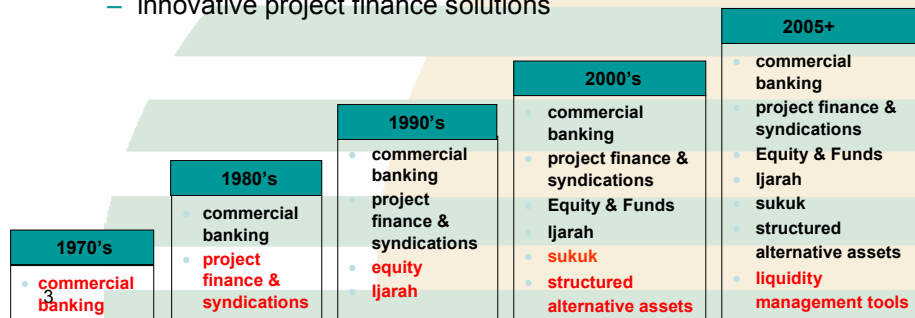


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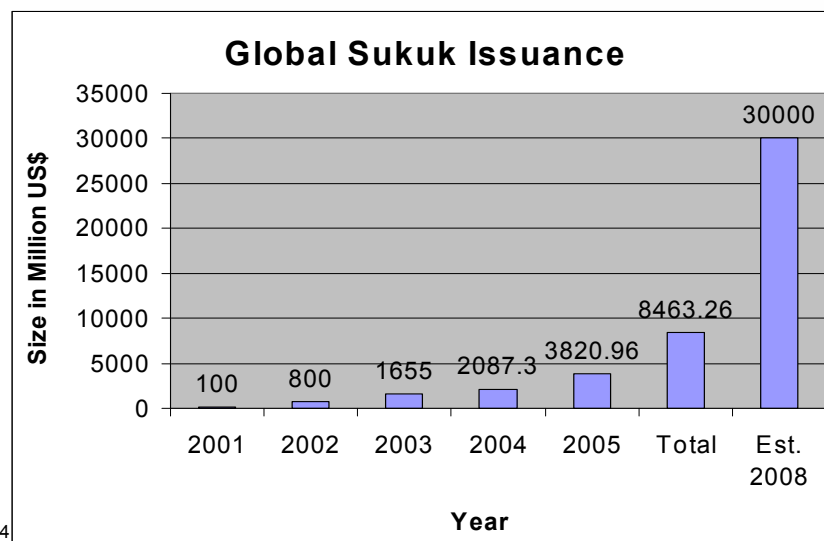
- **Evolution of the Islamic Finance Industry & Islamic Capital Markets**
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## Evolution of the Islamic Finance Industry & Islamic Capital Markets

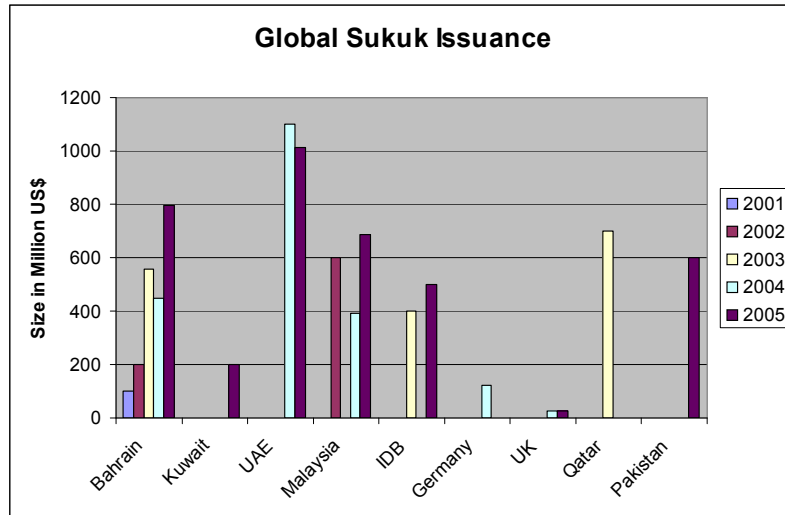
- Islamic finance has followed in the wake of innovations in the global financial services industry
- A natural progression of the Islamic finance industry
  - Islamic Capital and Short Term Financial Market
  - Competitive retail offerings
  - sophisticated corporate banking products
  - innovative project finance solutions



## Global Sukuk Issuance (Year)



## Global Sukuk Issuance (Country)



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## Listings of Sukuk at LFX, BSE & Luxembourg



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Source: LMC

## Growing Sukuk investment opportunities

- Increasing Demand for Sukuk issues among issuers from Muslim countries as well as other jurisdictions
- Islamic financial institutions are seeking to diversify their portfolio and increase their portfolio size of tradable instruments with fixed income profile
- Sukuk can be used to create Sukuk funds for retail distribution
- Once Sukuk Fund concept become more popular demand for Sukuk issues will surge exponentially
- Sukuk can be developed into a Money Market instrument
- Sukuk can play a major role in the development of Islamic Inter-Bank or Short term Islamic Finance market
- Appetite for Sukuk among Reserve Managers and non-bank financial institutions increasing
  - Central banks, state fund managers, insurance & takaful companies, are keen to invest in Sukuk issues as seen in all the sovereign sukuk issues.
  - Islamic FI's and also Western FI's

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## Sukuk Trend Analysis

- According to one estimate, the sukuk investments in 2005 increased by 35% to approximately US\$ 9 billion as compared to 2004 (US\$ 6.7 billion)
- Bahrain was among the first sovereign to issue a Sukuk in the world, providing a new asset class to global financial community.
- It is estimated that by 2006, close to US\$ 12-15 billion of Sukuk would be outstanding and by 2008, approximately US\$ 30 billion Sukuk will be outstanding

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## General Issues - Sukuk

- Limited number of issuance that constrains active trading of these instruments in the secondary market
- Buy and Hold Strategy by major investors of sukuk due to lack of alternative instruments in this asset class
- Limited quality assets available for Ijara securitization
- Limited Corporate Focus - Changing

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## Regulatory, Legal, Shariah & Other Issues

- Lack of regulatory support from key jurisdictions
- Lack of initiative in developing a separate legal framework for sukuk vis-à-vis conventional instruments
- Lack of harmonization in existing Islamic securitization products and difference of opinions among various shariah scholars
- Substantially more documentation and legal due diligence requirement for an Islamic issue
- Limited number of qualified personnel well versed in capital market issues both from shariah and commercial perspective
- Small number of Islamic investment banks lacking capability in structuring, originating or arranging capital market transactions

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## Benefits & Constraints of Sukuk investments

- The key benefits of investing in Sukuk instruments:
  - Sukuk are priced competitively in line with conventional bond issues
  - Sukuk are Shariah-compliant investments
  - Sukuk generally have better risk profile
  - Sukuk are tradable and fill the existing need for Shariah-compatible tradable instruments
  - Short Term Islamic Financial Market can benefit from Sukuk
- Major Constraints of investing in Sukuk instruments:
  - Secondary market illiquid due to absence of Critical Mass and Market Makers
  - Limited awareness about these instruments in the western market and some countries member jurisdictions
  - No benchmark for portfolio monitoring as available to conventional bonds

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## Sukuk Future Potential

- Sukuk instruments are ideal for liquidity management
- Typical Sukuk tenors have been 3-7 years
  - There is a need for shorter tenor commercial paper type Sukuk
  - There is a need for longer tenor Sukuk
  - BMA has launched the longest tenor Sukuk in the market (10 yrs)
- There is currently limited supply of Sukuk in the market
  - Leads to buy-and-hold type of investors as there are limited alternatives if the investors were to dispose of their Sukuk
- More Sukuk issuers need to come to the market
  - Sovereigns should initiate in jurisdictions that are new to Sukuk
  - Corporate issuers including project financing should form the bulk of issuers in any market
  - Use of balance sheet strength rather than real assets requirement

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## Islamic Liquidity Management – Challenges

- Islamic transactions generally pass through the ownership of real assets.
- Prohibited to invest in interest-bearing instruments
- Inability to trade money as commodity
- Lack of variable tenor tradable instruments
- Insufficient generation of quality assets
- Islamic banks, reliant, mostly on balance sheet assets for liquidity management
- Sub-optimal deployment of excess liquidity
- Risk Management techniques

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## Sukuk & Islamic Liquidity Management – Potential Role

- The sukuk market will be a developed market for Liquidity management when
  - There are issuers with differing credit qualities and Risk profile
  - There are Sukuk with maturities ranging from short-term to long-term
  - The investor base is broadened (via diversification of Sukuk products) to facilitate participation of more investors
  - Infrastructure and IT
- Industry standardization is needed for Sukuk products
  - Format of issuance i.e. Structures
  - Listing e.g. Bahrain, Luxembourg
  - Rating
  - Dual listing recommended to expand reach
- Market Makers & Brokers
  - Well defined role of Lead arrangers
  - To provide bid-offer prices on a continuous basis
  - Role of infrastructure institutions especially IIFM
  - Need for market development bodies

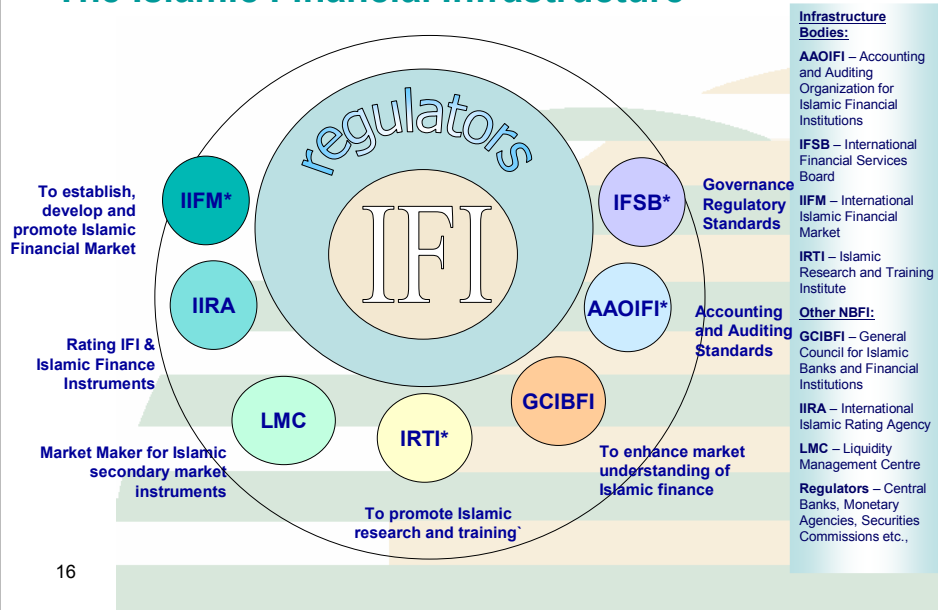
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## The Role of Takaful in Islamic Capital Markets

- The Takaful industry signifies an essential ingredient in the overall Islamic financial system.
  - Mobilization of long term funds in the form of contributions and investment of these in the available Islamic investment channels
  - Provides protection against risk
  - Supporting overall growth and economic development
- In Malaysia Takaful penetration is almost 4 % vs 35 % for conventional insurance. This represents potential scope for the continued development and need for Takaful
- The Takaful market in the Middle East is growing at 15-20% per year

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## The Islamic Financial Infrastructure



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## Recommendations for Way Forward

- Establishment of a Regulatory Framework
- Formulate Appropriate Accounting and Reporting Principles in all jurisdictions
- Skilled Human Resource
- Liquidity Enhancement Measures
- Required Infrastructure as available to conventional
- Active secondary market
- Uniformity of structuring and documentation
- Continuous review of earlier resolutions on Islamic capital Market issues which may have been the sources of divergence and harmonization

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## Recommendations for Way Forward contd.

- Research and Discussion on issues with direct implications to the development of Islamic Capital Market such as:
  - Sale of Debt for Debt (Bay al-Dayn)
  - Third party guarantee (in some of the global sukuk endorsed, the originator is the guarantor)
  - Risk in musharakah and mudarabah
  - Possibility of trading salam sukuk
- Financial support to research and development and training institutions
- Diversification of financial instruments and encouraging research on product development
- Increase number of Shari'ah scholars well versed in Finance and Banking issues
- Organizing conferences and seminars focusing on secondary market issues

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## Conclusion

For the Islamic Finance Industry to grow, move forward and capitalize on the enormous growth potentials, there should be:

- Greater cooperation among the industry players
- Better coordination to address the issue of Shari'ah harmonization
- Urgent need for the structuring of new capital market products that are Shari'ah compliant
- Creation of International Sukuk Fund

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# Thank You

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