

Sukuk and Basel II

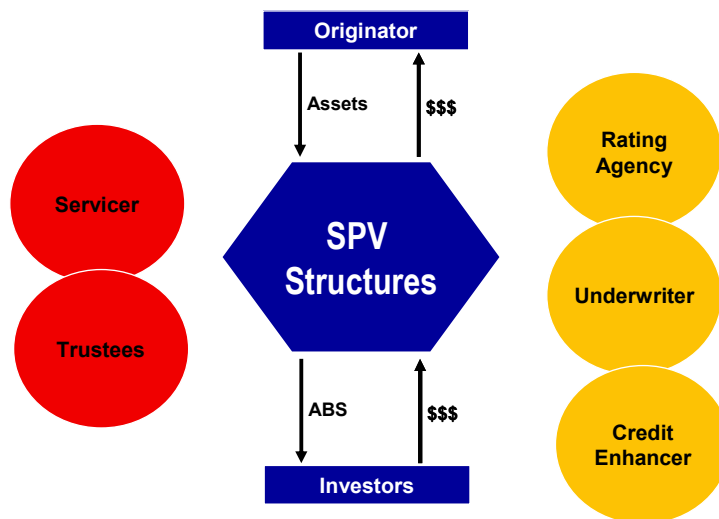
Ahmed Adil

Partner, Risk & Islamic Financial Services,
Bahrain

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Typical Structure of an ABS/ Sukuk



Wide Spectrum of Sukuk Structures

- **Ijarah Sukuk**
 - Bahrain Monetary Agency (medium term through SPV)
 - Malaysian Government ICM (without SPV)
 - Nakheel Group (convertible option)
- **Mudaraba and Musharaka Sukuk**
 - Dubai Ports Authority (convertible option)
 - Cagamas MBS (Malaysia's National Mortgage Corporation)
- **Salam and Istisnaa**
 - Bahrain Monetary Agency (short term)
 - Bahrain Financial Harbor (Istisnaa- Ijarah)

Sukuk and Basel II

Issuing Bank
Perspective

Investing Bank
Perspective

Dependent upon the nature of Sukuk

- Is it equity?
- Is it debt?
- Is it hybrid?
- Is it securitization?

What do SPV Sukuk structures represent?

Equity ?

- Redeemable through sale of investment or liquidation
- Not an obligation on the issuer
- Residual interest on assets and income of the issuer

Debt (Finance) ?

- Guaranteed principal and profit
- Obligation of issuer
- No residual interest on assets and income of the issuer

What do SPV Sukuk structures represent?

Hybrid ?

- Unsecured, subordinated and fully paid up
- Not redeemable at the initiative of the holder without prior supervisory consent
- Available to participate in losses without the bank being obliged to cease trading
- Allow service obligations to be deferred

Asset Backed Security (ABS) ?

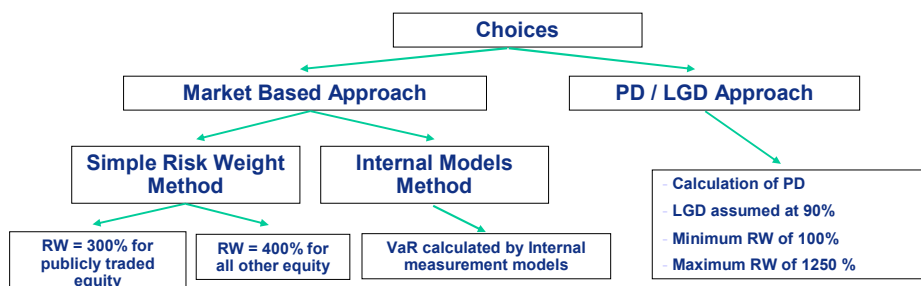
- Tranched structure in substance
- True sale of assets
- Uninterrupted rights to cash flow of the assets

Issuing Bank Perspective

- **Equity** – allowable as tier 1
- **Debt** – not allowed unless subordinated
- **Hybrid** – allowable as tier 2 if conditions met
- **Securitization** – not applicable

Investing Bank Perspective Equity, Hybrid or Subordinated Debt

- > 50% - Consolidate or carve out
- >20% <50% - Deduct from capital or pro rata consolidation
- <20% - Requirements under Standardized Approach
 - RW of 100 %, for investments in equity or regulatory capital instruments issued by banks or securities firms **unless deducted from capital**
- Requirements under IRB Approaches for Equity Exposures



Investing Bank Perspective - Debt

- Obligor can be a sovereign, bank or corporate
- Requirements under the Standardized Approach

Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
	0 %	20 %	50 %	100 %	150 %	100 %

Banks	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Option 1	20 %	50 %	100 %	100 %	150 %	100 %
Option 2	20 %	50 %	50 %	100 %	150 %	50 %

Corporates	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
	20 %	50 %	100 %	150 %	100 %

- Requirements under IRB Approaches
 $RWA = (f(PD, LGD, M)) * 12.5 * EAD$

Investing Bank Perspective - Securitization

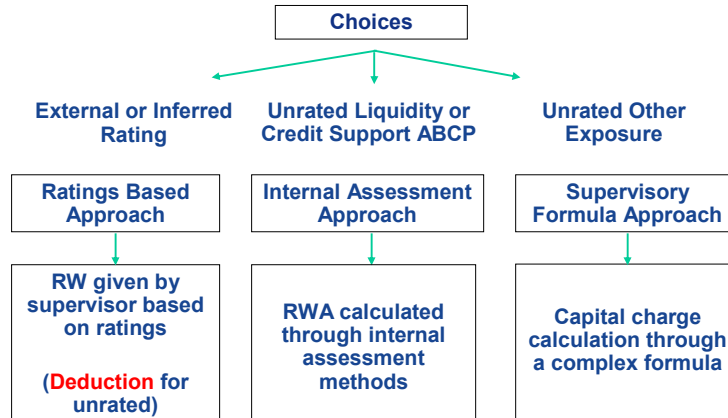
- Originating banks and investing banks
- Crucial question is rating
- Requirements under Standardised Approach

ECA (Long-term rating category)	AAA to AA -	A + to A -	BBB + to BBB -	BB + to BB -	B + and below / unrated
Risk Weight (for investors)	20 %	50 %	100 %	350 %	Deduction (50 % from Tier 1 and 50 % from Tier 2)
Risk Weight (for originators)	20 %	50 %	100 %	Deduction	Deduction

ECA (Short -term rating category)	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings or unrated
Risk Weight	20 %	50 %	100 %	Deduction

Investing Bank Perspective - Securitization

- Requirements under the IRB Approach



Securitization – Rating is Crucial

Many issues in rating if not guaranteed by obligor (Fitch Ratings report dated 24th March 2005)

- True sale
- Non consolidation
- Bankruptcy remoteness
- Security structures
- Enforceability
- Choice of law and enforcement of judgment

Ahmed Adil
Partner, Risk & Islamic Financial Services

Ernst & Young, Bahrain
P.O.Box 140
14th Floor, The Tower
Sheraton Commercial Complex
Manama, Bahrain

Phone: +973 17 535 455
Fax: +973 17 535 405
Email: ahmed.adil@bh.ey.com

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