

SUKUK

By,

Ijlal A. Alvi



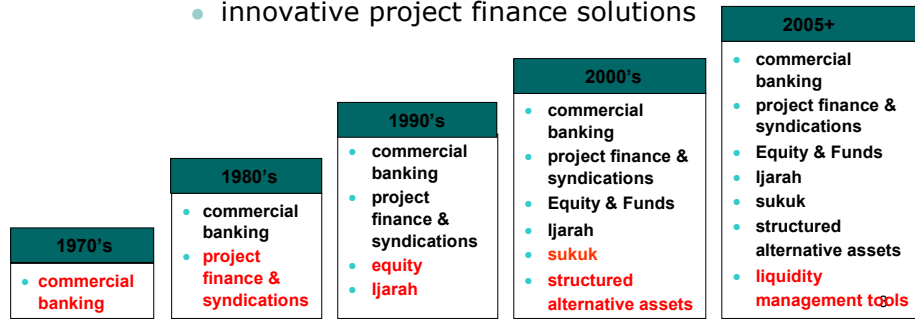
Contents



- Evolution of the Islamic Finance Industry & Islamic Capital Markets
- Sukuk Investment Opportunities and Analysis
- General Issues Limiting Secondary Market Development
- Sukuk - Development of a secondary Market
- Role of Takaful
- Role of Infrastructure institutions specifically IIFM
- Recommendations for Way Forward
- Conclusion

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
 - competitive retail offerings
 - sophisticated corporate banking products
 - innovative project finance solutions



Global Market Perspective

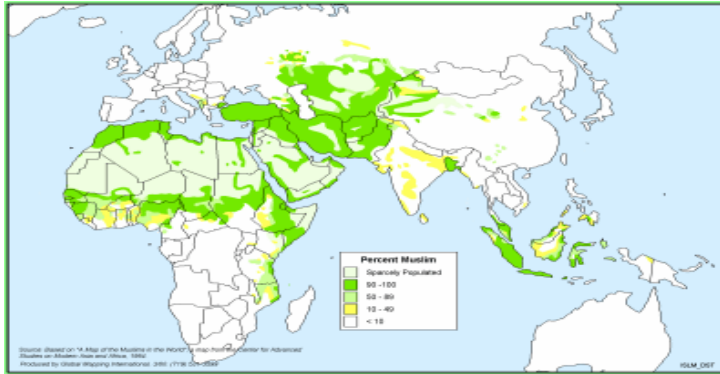
- **US Equity Market** **US\$ 15.1 trillion (39% Global)**
- **Global Equity Market** **US\$ 39.0 trillion (estimate)**
- **Islamic Equities @ 24%:** **US\$ 9.36 trillion Potential**

- **Islamic Financial Assets** **US\$ 400 billion (UAE MOF)**
- **Islamic Money Market** **US\$ 30 – 50 billion**

US REITs	MARKET CAPITALIZATION USD MIL.
DJW REIT	252,800

Malaysian REITs	MARKET CAPITALIZATION USD MIL.
	189

The Islamic Capital Market



- The total worldwide Muslim population is 1.5 billion, representing a sizeable 24% of total world population of 6.3 billion
- Shari'a-compliant assets, growing over the last 20 years, represent an estimated US\$ 300 billion banking assets & approximately \$400 billion Capital Market

5

The Islamic Capital Market

- Islamic funds in Global Financial institutions is said to be at US\$1.3 trillion while the Islamic Financial Market is estimated to be US\$400 billion in size, with an annual growth rate of 12% - 15 %
- There are over 300 Islamic Financial Institution currently operating in about 75 countries worldwide
- More than 100 Islamic Equity Funds managing assets in excess of US\$5.0 billion
- Estimated annual growth for Islamic Capital Market is between 15% to 20%

6

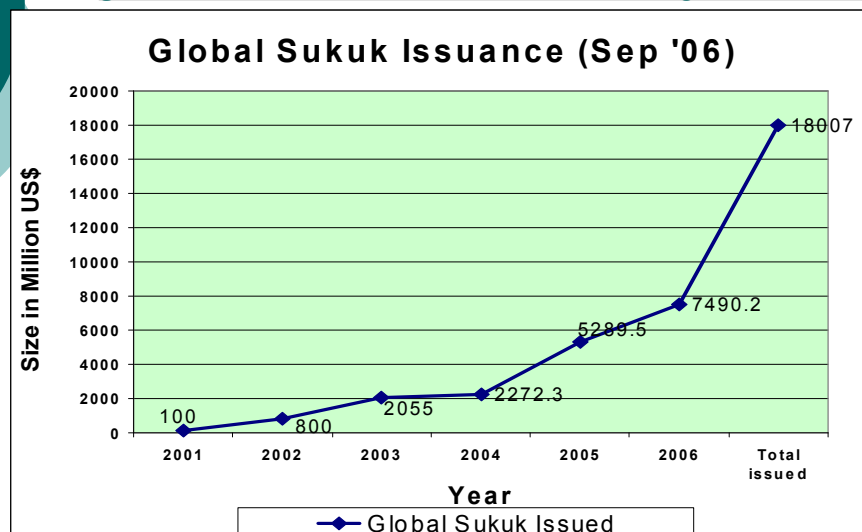
The Islamic Capital Market

- GCC equity markets are amongst the fastest growing in the world by both value and volume
 - Equity held in Islamic portfolios < US\$ 20 billion
 - Approx. 100 GCC companies plan IPO's in 2006
- Rapidly expanding GCC conventional and Islamic bond market
 - Islamic Bonds – approximately US\$ 9 billion issues announced in 2006
 - Growing at 100% pa
- 150+ Islamic Funds; 65% in equity, 10% in bond (equivalent) and 25% in cash and hybrid, valued at US\$ 9.5 billion
 - Over US\$ 1bn raised in GCC equity funds 2005/2006

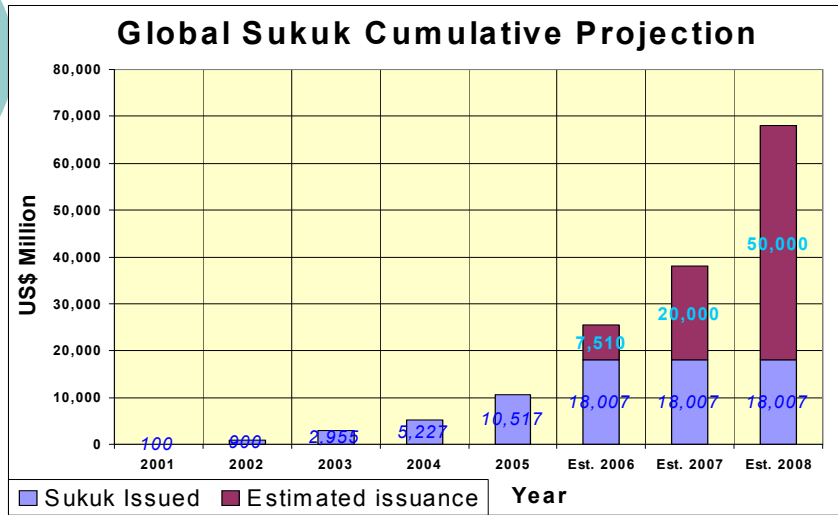
(Source: Dawnay, Day Co.)

7

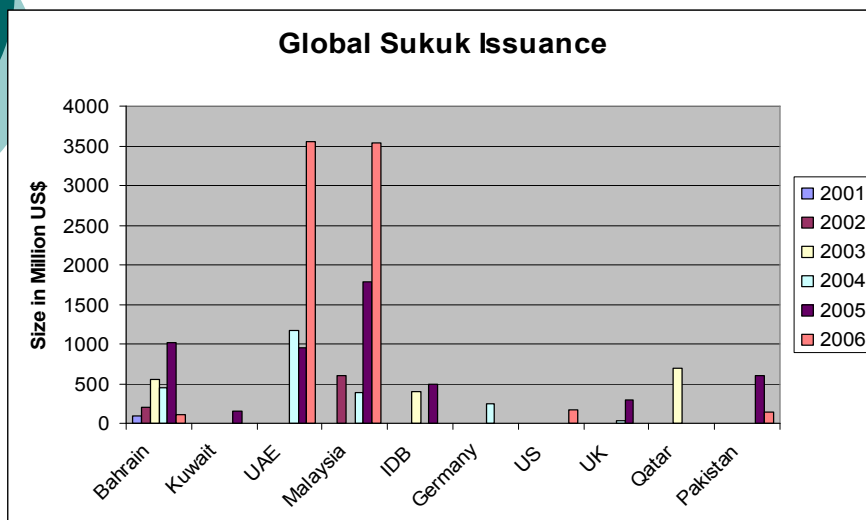
Global Sukuk Issuance (Year)



Global Sukuk Cumulative Issuance



Global Sukuk Issuance (Country)





Growing Sukuk Investment Opportunities

- Islamic financial institutions are seeking to diversify their portfolio and increase their portfolio size of tradable instruments with fixed income profile
- The industry requires Sukuk funds for retail distribution and once the concept becomes more popular, demand for Sukuk issues will surge exponentially
- Sukuk a Money Market instrument
- Islamic Inter-Bank or Short term Islamic Finance market can be developed through sukukuks
- Appetite for Sukuk among Reserve Managers and non-bank financial institutions increasing

11



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)
- It is estimated that by 2006, close to US\$ 25 billion of Sukuk would be outstanding and by 2008, approximately US\$ 50 billion Sukuk will be outstanding
- Bahrain was among the first sovereign to issue a Sukuk in the world, opening doors to whole new asset class for the global financial community. They now issue about 24 sukukuks a year which includes the Ijarah Sukuk as well as the short term-Al Salam Sukuk.

12



General Issues Limiting Secondary Market Development

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

13



Regulatory, Legal, Shariah & Other Issues

- Lack of regulatory support from key jurisdictions
- Lack of initiative in developing a separate legal framework for sukuku vis-à-vis conventional instruments
- Lack of harmonization in existing Sukuk structures and difference of opinions among various Shari'ah scholars, especially cross border
- Limited number of qualified personnel well versed in capital market issues both from Shari'ah and commercial perspective
- Few Islamic investment banks lacking capability in structuring, originating or arranging capital market transactions

14

Constraints of Sukuk Investments

- 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 – Sukuk Index
 - Limited supply of universally Shari'ah acceptable sukuk
 - Secondary market tradability of Balance Sheet based Sukuks

15

Sukuk – Development Requirements

- To use Sukuk as a liquidity management tool
- 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 10 Yr Sukuk)
- 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
 - Central Banks borrowing requirement through 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 (Example: Dubai Port Sukuks)
 - Use of balance sheet strength rather than real assets requirement

16

Sukuk - Development of Secondary Market

- 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, others
 - 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, support to market development bodies

17

Recommendations For Way Forward

- Formulation of widely acceptable and appropriate accounting and reporting principles
- Continue innovating structures such as convertible feature
- Establishment of regulatory framework
- Development of infrastructure required for secondary market including refining payment and settlement procedures
- Allocation of funds and resources by the industry and multilateral institutions for Research and Development
- Awareness and understanding drive and widely available information

18

Future Prospects

- Islamic Capital Markets have potential to reach several trillion USD
- GCC Surplus to continue for next 4-5 years mainly due to oil demand and price
- Customer acceptability, both Muslims and Non-Muslims, is increasing
- Increasing trend of going public i.e. IPO's
- Multi-Billion USD infrastructure projects in GCC and OIC Countries

19

Thank You

السوق
المالية
الإسلامية
الدولية



International
Islamic
Financial
Market

Phone No: +973 1750 0161 Fax: +973 1750 0171 Email: iifm@bateclo.com.bh
P. O. Box 11454, Manama, Kingdom of Bahrain

20