



## Quarterly Global Sukuk Report

APRIL 2014

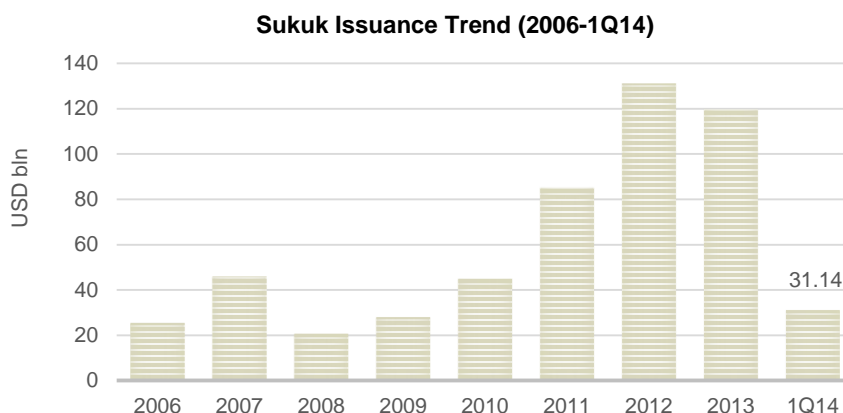
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## Executive Summary

The global sukuk market produced a total volume of USD31.14bln in primary market issuances during the first quarter of 2014 (1Q14) which represents a modest performance as compared to the USD34.53bln issuances in 1Q13 and a record USD40.53bln volume in 1Q12. The decline in 1Q14 volume was contributed by two main factors: (1) the beginning of tapering in quantitative easing (QE) programme by the US Federal Reserve starting January 2014; and (2) the absence of GCC sukuk issuers from the primary market in March 2014 (except for short-term liquidity management sukuk issues by the Central Bank of Bahrain). The volume of sukuk issuances in the GCC fell by 12.5% in 1Q14 as compared to the volume in 1Q13.

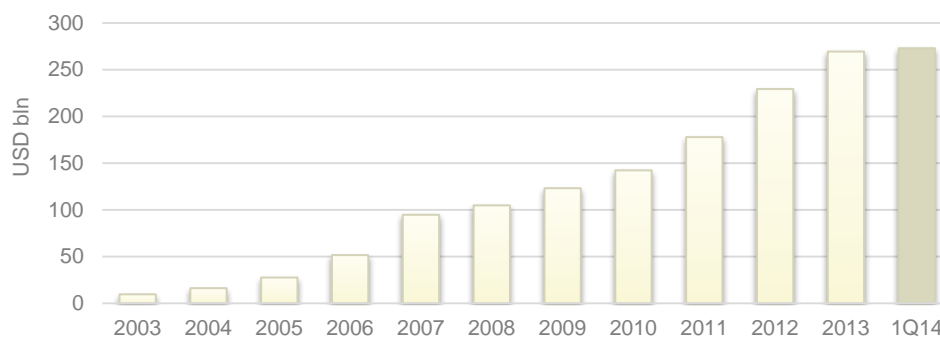
The primary market was led by sovereign issuances that accounted for 68.6% of the total issuances in 1Q14. In terms of absolute amount of issuances, 1Q14 saw sovereign issuers produce a volume of USD21.37bln, which is the highest since 3Q12 when sovereign issuers generated USD25.66bln. Collectively, the sovereign and government-related entities issuers accounted for over 81% of the primary market issuances in 1Q14. The volume in 1Q14 has also been spearheaded by nearly USD2.9bln in sukuk issuances by the multilaterals Islamic Development Bank (IDB) and the International Islamic Liquidity Management Corporation (IILM). In contrast, the corporate issuances slid down to USD5.7bln in volume during 1Q14 which stands in contrast to USD8.12bln volume during 1Q13 (decrease of 29.8% in 1Q14) and record USD13.29bln volume during 4Q13 (decrease of 57.1% in 1Q14) which is the best quarter for corporate sukuk issuances since 1Q12. During the quarter, Maldives was a debutant in the global sukuk market with its inaugural 10-year corporate sukuk issuance worth USD3.9mln.



Source: Bloomberg, IFIS, Zawya, KFHR

In the secondary market, the global sukuk outstanding reached USD272.96bln as at 1Q14, a very modest 1.3% growth from USD269.4bln as at end-2013 and a 15.96% growth y-o-y since 1Q13. The slow growth in 1Q14 was contributed, in part, by the redemption of a huge USD9.07bln sukuk by the Central Bank of Qatar in January 2014. On the back of this redemption in Qatar, the total GCC (including Oman) sukuk outstanding portfolio valued almost USD85bln, a 0.4% decline q-o-q as compared to the USD85.3bln outstanding as at end-2013. Malaysia continues to be the only secondary sukuk market with over USD100bln in outstanding sukuk and as at 1Q14, the sukuk outstanding portfolio for Malaysia amounted to approximately USD160.6bln, a 1.5% increase compared to the USD158.3bln outstanding as at end-2013. In terms of outstanding portfolio growth q-o-q, double digit growth rates in 1Q14 were recorded in Brunei (47.2%); Singapore (34.3%); Turkey (12.4%); and Saudi Arabia (10.8%). During the same period, decline in outstanding portfolio were recorded in Qatar (32.1%) and Pakistan (14.3%).

## Sukuk Outstanding Trend (2003-1Q14)



Source: Bloomberg, IFIS, Zawya, KFHR

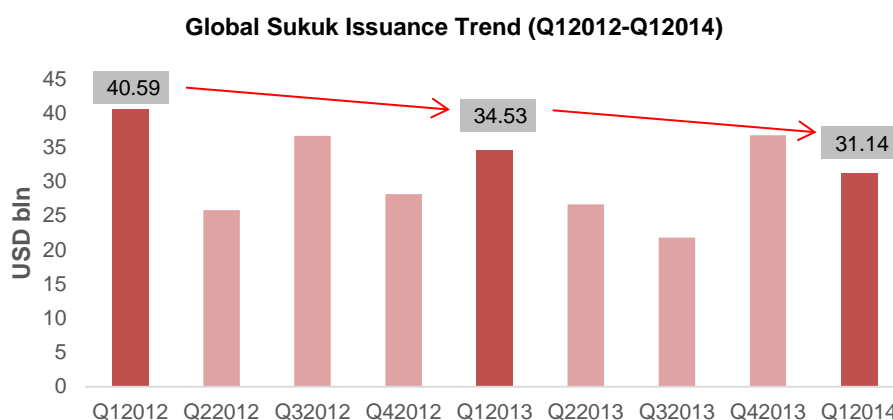
In terms of returns on sukuk papers in 1Q14, there has been a considerable heterogeneity in yields between various jurisdictions. Markets have generally reflected upon the macroeconomic fundamentals and characteristics of the issuing economies when pricing sukuk instruments. The yields on sukuk instruments in the GCC markets have performed most favourably in the first quarter of 2014, reflecting increased investor confidence in the region. Except for a brief period during the first two weeks of March, the yields on the GCC sukuk instruments have generally eased and in 1Q14, yields on various instruments have declined by 50bps to 70bps YTD. On the other hand, sukuk instruments in emerging markets have been affected by the emerging market funds outflow crisis since 22<sup>nd</sup> May 2013, when the then US Federal Reserve Chairman Ben Bernanke first indicated possibility of a US tapering in its monthly stimulus program. For instance, the yields on Turkish Lira Sovereign Sukuk Hazine 10/14 have increased by a significant 393bps y-o-y to close at 9.48% as at 31<sup>st</sup> March 2014; 72bps increase YTD in 2014. In the largest sukuk market of Malaysia, the yields on sukuk instruments experienced steep upward spiralling in two timeframes: (Stage 1): 27bps and 40bps increase between 22<sup>nd</sup> May and 22<sup>nd</sup> July 2013 on the Sovereign 5 Year and 10 Year yields respectively; (Stage 2): 36bps and 50bps increase between 6<sup>th</sup> November 2013 and 6<sup>th</sup> January 2014 on the 5 Year and 10 Year yields respectively. However, in 2014, the yields have eased in the Malaysian markets as the economy has fared better and the yields on the 5 Year and 10 Year Benchmark Sovereign sukuks have decreased 9.2bps and 13.2bps respectively YTD.

Despite the modest primary market momentum in 1Q14, the global sukuk market is expected to once again surpass the USD100bln market in the primary market in 2014 on the back of a number of high profile issuances in the pipeline for this year. The sovereign sukuk sector is to be of much stakeholder interest in 2014 as sovereigns to the likes of the United Kingdom, Luxembourg, South Africa, Tunisia, Mauritania, Senegal and Oman, among others, are expected to debut with sovereign issuances in 2014. In the corporate sukuk sector, debut corporate sukuk issuances in 2014 are expected in Australia, Ireland, Russia and Thailand which will expand the total number of jurisdictions that have tapped the sukuk market to date to well over 30 (excluding offshore jurisdictions). Based on the announced pipelines, 2014 will also witness the return of France into the corporate sukuk sector after its inaugural and only issuance in 2012.

Notwithstanding the above, a critical factor to closely observe in 2014 would be the US Federal Reserve's interest rates policy. The new Fed Chairman Janet Yellen has recently indicated that the US could start raising interest rates as early as 2015. An increase in US interest rates will be followed by identical rates increase in the rest of the world leading to higher funding costs for issuers. In such a scenario, higher fund costs may deter potential issuers from the sukuk market and any early rates increase prior to 2015 is likely to dent the global primary market sukuk issuances this year.

## Review of Primary Global Sukuk Market 1Q 2014

The global sukuk market produced a total volume of USD31.14bln in primary market issuances during 1Q14 which represents a modest performance as compared to the USD34.53bln issuances in 1Q13 and a record USD40.59bln volume in 1Q12. Despite the build-up of expectations on a noteworthy pipeline of sukuku in 2014 (which includes debut sovereign issuances by the United Kingdom, Luxembourg, South Africa, Tunisia, Senegal, Hong Kong and others) on the back of resurgence in new sukuk issuances in 4Q13 worth USD36.73bln, the primary sukuk market's issuances in 1Q14 fell 9.82% short of the issuance volume in 1Q13.

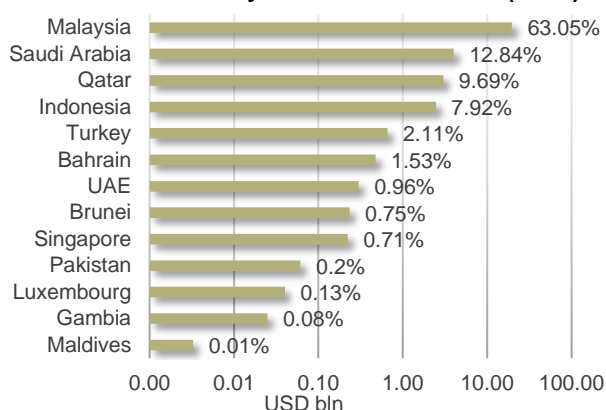


Source: Bloomberg, Zawya, IFIS, KFHR

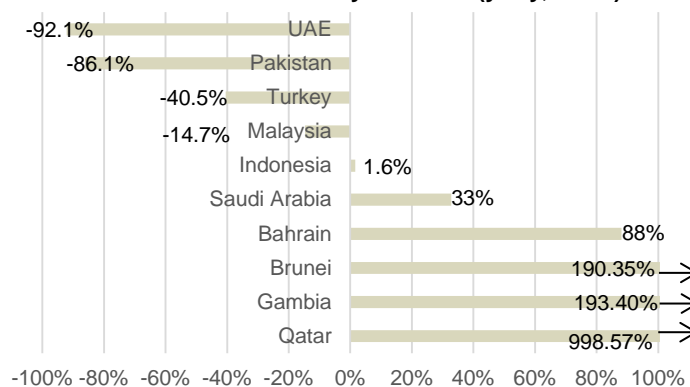
The decline in 1Q14's issuances, partly, was an outcome of the tapering by the US Federal Reserve in its monthly asset purchases programme. After months of speculation by market participants, the US Fed began tapering its quantitative easing (QE) programme from January 2014 when it cut its monthly asset purchases by USD10bln. The resulting effect had been an increase in funding costs, particularly in emerging markets, which saw yields on fixed-income instruments increase. As a consequence, the decline in issuance activity during 1Q14 is partly on account of the higher funding costs following the US Fed's tapering decision, which is likely to have restrained issuers from tapping the market.

Another notable factor contributing towards the decline in volume in 1Q14 includes the slowdown of issuances in the GCC primary sukuk market. The only sukuk issued during the month of March in the GCC, which is the second largest sukuk market (behind Malaysia), were short-term liquidity management sukuk issuances by the Central Bank of Bahrain. This is in sharp comparison to nearly USD6bln worth of issuances by the GCC-based obligors in March 2013. The volume of sukuk issuances in the GCC fell by 12.5% in 1Q14 as compared to the volume in 1Q13. The decline in this region was led by the UAE which saw issuances drop by 92.1% to USD300mln from USD3.82bln in 1Q13. Saudi Arabia followed next with a 17% decline to USD2.5bln (excluding Islamic Development Bank's USD1.5bln issuance) from USD3.01bln issuances in 1Q13. Qatar and Bahrain however saw remarkable improvements on issuances on a y-o-y basis. Qatar saw issuances increase by nearly 1000% over the same period spearheaded by a USD3.02bln issuance by the Central Bank of Qatar. Similarly, Bahrain saw issuances increase by 88% on the back of increased volume of its short-term liquidity management Sukuk al-Salam.

**Sukuk Issuances by Domicile and Share\* (1Q14)**



**Sukuk Issuance Trend by Domicile (y-o-y, 1Q14)**



\*Numbers in percentage indicate share of total issuances for each domicile (based on obligors' domiciles)

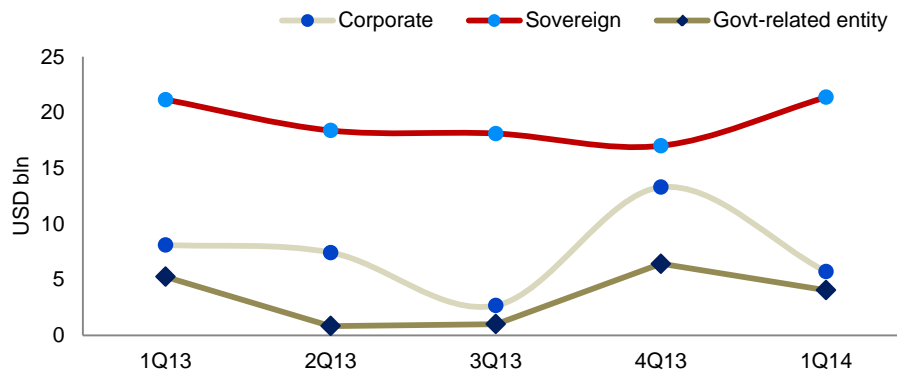
Source: Bloomberg, IFIS, Zawya, KFHR

The most vibrant markets for 1Q14 in terms of y-o-y growth in volume of new sukuk issuances were Qatar (998.6% increase), Gambia (193.4%), Brunei (190.4%) and Bahrain (88%). However, it is pertinent to note that all the sukuk issuances during the quarter in these markets were by each country's respective central banks. The largest sukuk market, Malaysia, saw a 14.7% decline y-o-y while in the other emerging markets, Turkey saw volume decline by 40.5%; Pakistan saw volume decline by 86.1% while Indonesia saw a marginal growth by 1.6% during the same period. Singapore and Luxembourg posted 100% gains in 1Q14 given their absence from the primary sukuk market in 1Q13 while Maldives was a debutant in the global sukuk market with its inaugural issuance during the quarter.

As has been the case over the past many quarters, the primary market was led by issuances by the sovereign issuers who accounted for 68.6% of the total issuances in 1Q14. In terms of absolute amount of issuances, 1Q14 saw sovereign issuers produce a volume of USD21.37bln, which is the highest since 3Q12 when sovereign issuers generated USD25.66bln. Collectively, the sovereign and government-related entities issuers accounted for over 81% of the primary market issuances in 1Q14. Bank Negara Malaysia (BNM), which accounted for 56.2% of the sovereign and quasi-sovereign market in 2013 and 60.5% share in 2012, saw its share fall to 38.9% in 1Q14 as a number of other sovereign and quasi-sovereign issuers tapped the market including from Indonesia, Saudi Arabia, Bahrain, Brunei and Gambia. The volume in 1Q14 has also been spearheaded by nearly USD2.9bln in sukuk issuances by the multilaterals Islamic Development Bank and the International Islamic Liquidity Management Corporation (IILM). The growing prominence of the sovereign and quasi-sovereign issuers in the sukuk market indicates the widespread acceptability of sukuk as tools for raising liquidity by public institutions worldwide.

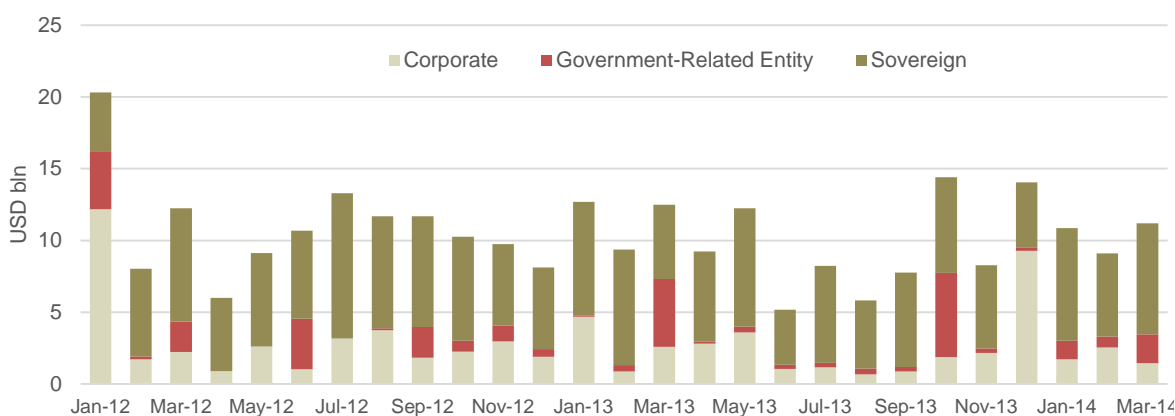
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### Sukuk Issuance by Issuer Type (q-o-q)



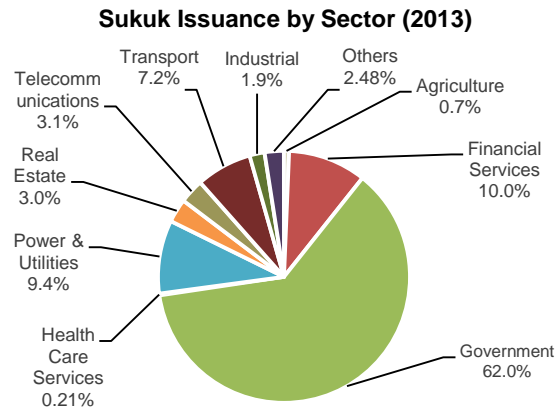
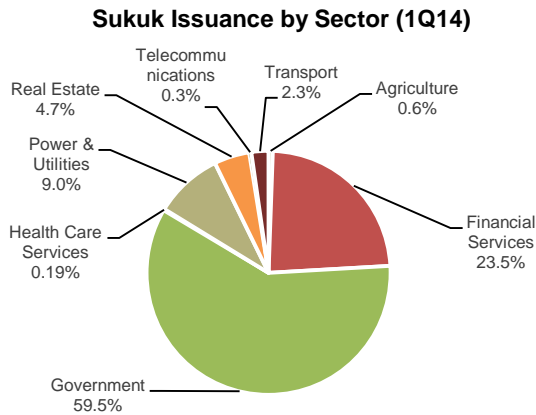
Source: Bloomberg, IFIS, Zawya, KFHR

### Sukuk Issuance by Issuer Type (m-o-m)



Source: Bloomberg, IFIS, Zawya, KFHR

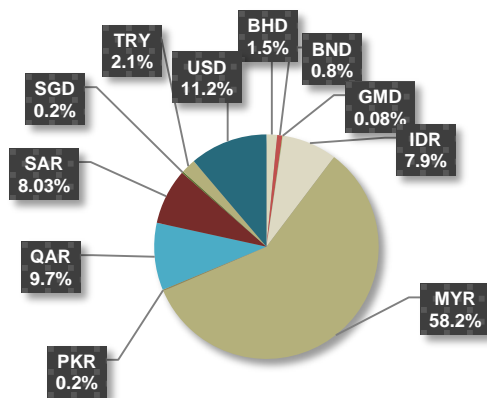
The government sector continues to account for the majority of the sukuk issuances in the primary market making up almost 60% of the new issuances during 1Q14. However, this share is slightly lower than the overall 62% share of the government sector in 2013 and a 61.8% share overall in 2012. The other two main industries with strong issuances during 1Q14 have been the financial services sector and the power and utility industry. Notably, the financial services sector accounted for an impressive 23.5% share in 1Q14 [2013: 10%; 2012: 11.4%] led by the record-breaking SAR5bln (USD1.33bln) sukuk by National Commercial Bank of Saudi Arabia which marked the largest issuance by a financial institution in Saudi Arabia and the largest ever subordinated debt instrument issued by a financial institution in the Middle East and North Africa (MENA) region. The trend in sukuk issuances by financial institutions has gained momentum in recent months following the implementation of Basel III regulations which require banks (including Islamic) to consolidate and further shore up their capital as per the new standards. Meanwhile, the power and utilities sector accounted for a 9% share in 1Q14, which is consistent with its overall share of 9.4% in 2013.



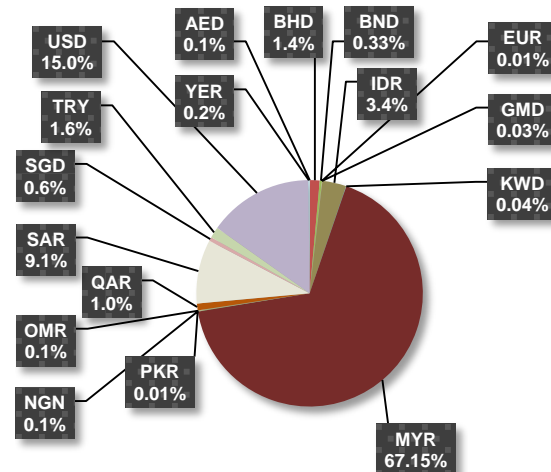
Source: Bloomberg, IFIS, Zawya, KFHR

The primary sukuk market in 1Q14 utilised a total of 11 different currencies for the issuances [2013: 17 currencies]. The remaining six currencies from 2013 and which have not witnessed any issuances in 1Q14 are as follows: AED, KWD, EUR, NGN, OMR and YER. The share of Malaysian Ringgit issuances remains the largest at 58.2% although its proportion has declined [1Q13: 64.6%; 2013: 67.2%]. Similar observation is witnessed for the second most utilised currency USD, whose share declined to 11.2% in 1Q14 [1Q13: 20.9%; 2013: 15.02%]. The decline in the MYR and USD denominated instruments are on account of the emergence of huge local-currency sukuk issuances from the GCC which has spurred the share of SAR and QAR denominated sukuk. The SAR-denominated sukuk remains prominent at 8.03% share in 1Q14 [1Q13: 2.9%; 2013: 9.1%]; QAR 9.7% [1Q13: 0.8%; 2013: 1.0%]; and also BHD 1.5% [1Q13: 0.7%; 2013: 1.4%]. Other notable currencies utilised in 1Q14 include IDR with a 7.9% [1Q13: 7.0%; 2013: 3.4%] share spurred by sovereign issuances in Indonesia; TRY at 2.1% share [1Q13: 2.5%; 2013: 1.6%] driven by a TRY1.33bln Turkish Sovereign Sukuk in February; and the rest of the currencies including PKR, SGD, BND and GMD had lower than 1% shares.

### Sukuk Issuances by Currency (1Q14)



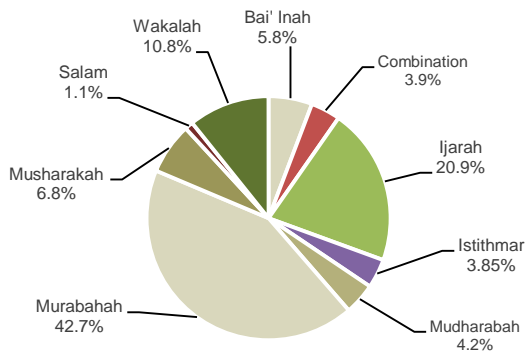
### Sukuk Issuances by Currency (2013)



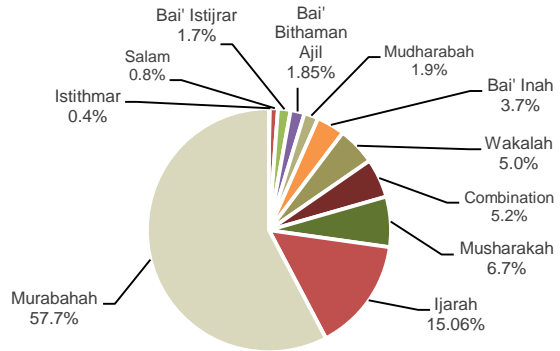
Source: Bloomberg, IFIS, Zawya, KFHR

By structure, Murabahah and Ijarah remain the popular choice among issuers in 1Q14 with 42.8% and 20.9% respective shares for each structure in total sukuk issuances [2013: 58% and 15%]. However, sukuk structured on Wakalah and Wakalah bil Istithmar have also emerged to be widely utilised with a 14.6% share in 1Q14 [2013: 5.37%]. Notable issuers utilising the Wakalah and Wakalah bil Istithmar contracts in 1Q14 include the IDB and IILM, as well as Saudi Electric Company and UAE's DIP Sukuk Limited.

**Sukuk Issuance by Structure (1Q14)**



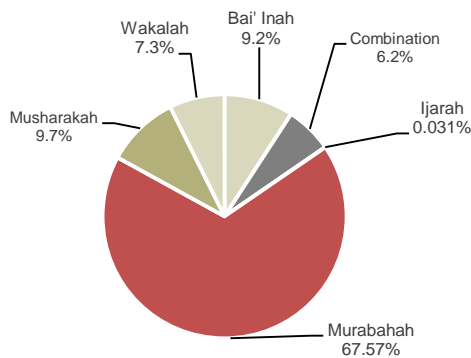
**Sukuk Issuance by Structure (2013)**



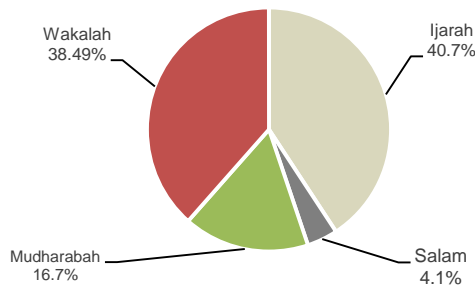
Source: Bloomberg, IFIS, Zawya, KFHR

Between the two major markets of Malaysia and the GCC, Murabahah has a much larger share in Malaysia representing a 67.6% share of the total Malaysian sukuk issuances in 1Q14. In comparison, GCC has widely utilised the ijarah structure with a 40.7% share of the total GCC and the Wakalah and Wakalah bil Istithmar structure follows next with a 38.5% share.

**Sukuk Issuance by Structure - Malaysia (1Q14)**



**Sukuk Issuance by Structure - GCC (1Q14)**



Source: Bloomberg, IFIS, Zawya, KFHR

In terms of individual sukuk issuances, a number of high-profile sukuk were issued in 1Q14. Among selected notable sukuk issuances include the National Commercial Bank (NCB) sukuk worth SAR5bn (USD1.33bn); Dubai Investments Park (DIP) sukuk worth USD300mln; the Turkish Treasury sukuk worth TRY1.33bn sovereign issuance; the Islamic Development Bank's (IDB) sukuk worth USD1.5bn and also Singapore's Bunitama Agri Sukuk worth MYR500mln (USD152.6mln).

**Selected Notable Sukuk Issuance (1Q14)**

Issuer	Structure	Country	Currency	Issue Date	Issue Size (USD mln)	Tenor (Years)	Sector
<b>National Commercial Bank (NCB)</b>	Mudarabah	Saudi Arabia	SAR	20 <sup>th</sup> Feb	1,330	10	Financial Services
<b>DIP Sukuk Limited</b>	Wakalah	UAE	USD	20 <sup>th</sup> Feb	300	5	Real Estate
<b>Hazine Mustersarligi</b>	Ijarah	Turkey	TRY	19 <sup>th</sup> Feb	613.90	2	Government
<b>Islamic Development Bank (IDB)</b>	Wakalah	Multilateral	USD	6 <sup>th</sup> March	1500	5	Financial Services
<b>Bumitama Agri Sukuk</b>	Musharakah	Singapore	MYR	18 <sup>th</sup> March	152.6	5	Agriculture

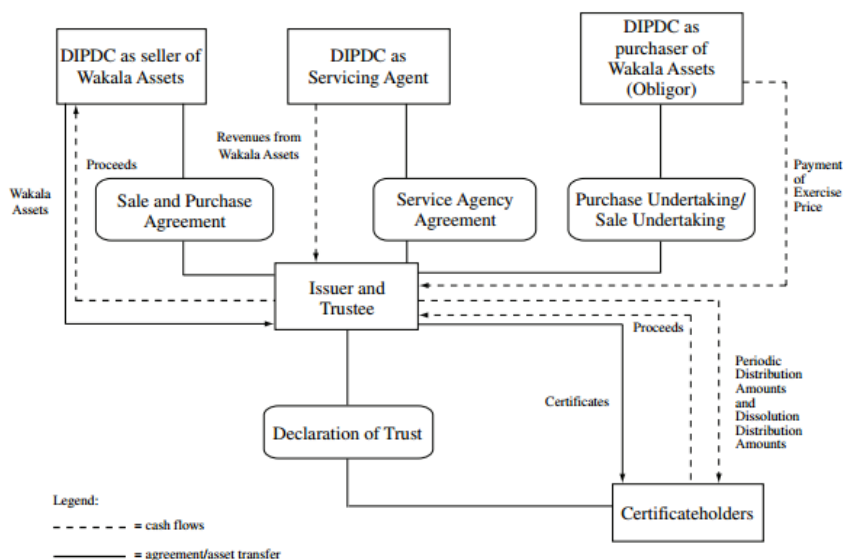
Source: Bloomberg, IFIS, Zawya, KFHR

Brief snapshots on these sukuk issuances are now presented as follows:

- **DIP Sukuk Limited**

Dubai Investments Park (DIP) debuted in the global sukuk market with a USD300mln sukuk on 20<sup>th</sup> February and this sukuk marks the GCC's first USD sukuk issuance for 2014. There was a tremendous response from investors and this offering was oversubscribed by 13 times which represents one of the highest levels of oversubscription achieved by a corporate issuer in the international sukuk and conventional markets in MENA. The oversubscription enabled DIP to price the sukuk at a yield of 4.291% which is lower than the coupon offered on USD-denominated corporate and sovereign sukus in Dubai, issued in 2012. The specifics of the sukuk issuance are presented in the table below:

**DIP Sukuk Limited Structure**



Source: DFSA, KFHR

- **NCB Subordinated Tier II Sukuk**

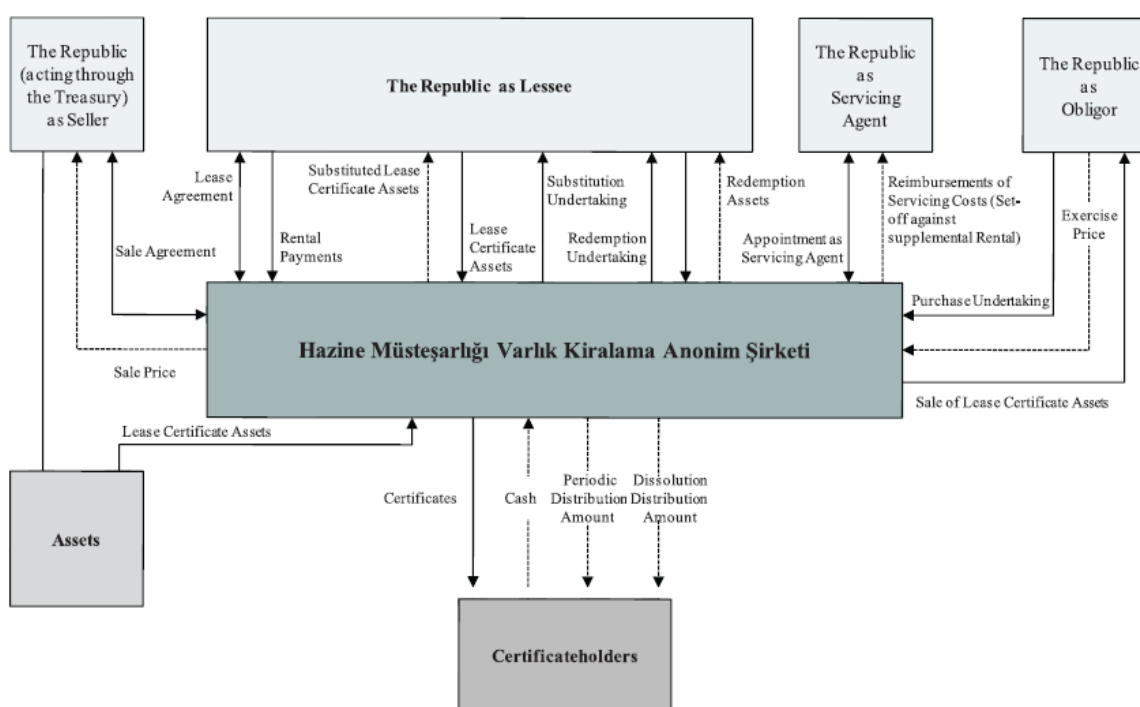
The National Commercial Bank (NCB) of Saudi Arabia issued a 10-year subordinated Tier II capital sukuk raising SAR5bln (USD1.33bln) on 20<sup>th</sup> February. The bank intends to use the proceeds to strengthen its capital base in order to meet Basel III requirements while further supporting its growth plans across various business segments. The issue received an overwhelming interest from investors generating an oversubscription of 2.1 times, and NCB opted for the transaction volume to be upsized to SAR5bln from an initial target issuance of SAR4bln. This sukuk marks the largest issuance by a financial institution in

Saudi Arabia and the largest ever subordinated debt instrument issued by a financial institution in the MENA region. The specifics of the sukuk issuance are presented in the table below:

- **Hazine Mustersarligi Varl 2/16**

The Turkish Treasury tapped the sukuk market with a 2-year Lira sukuk on 19<sup>th</sup> February 2014, marking its sixth sovereign issuance to date. The issue raised TRY1.33bln (USD613.9mln) for the government who intends to utilise the proceeds to diversify the country’s borrowing instruments, broaden the investor base and increase the domestic savings. The sukuk was priced at a yield of 10.6%, which is 490bps higher than a similar sukuk issued by the Treasury on 20<sup>th</sup> February 2013. The notable increase in yields offered is on account of the emerging market funds outflow crisis which have afflicted the Turkish economy severely since 22<sup>nd</sup> May 2013, leading to a depreciating Lira, increasing costs of borrowing in Turkey and a declining equity and debt market.

**Hazine Mustersarligi Varl 2/16 Sukuk Structure**

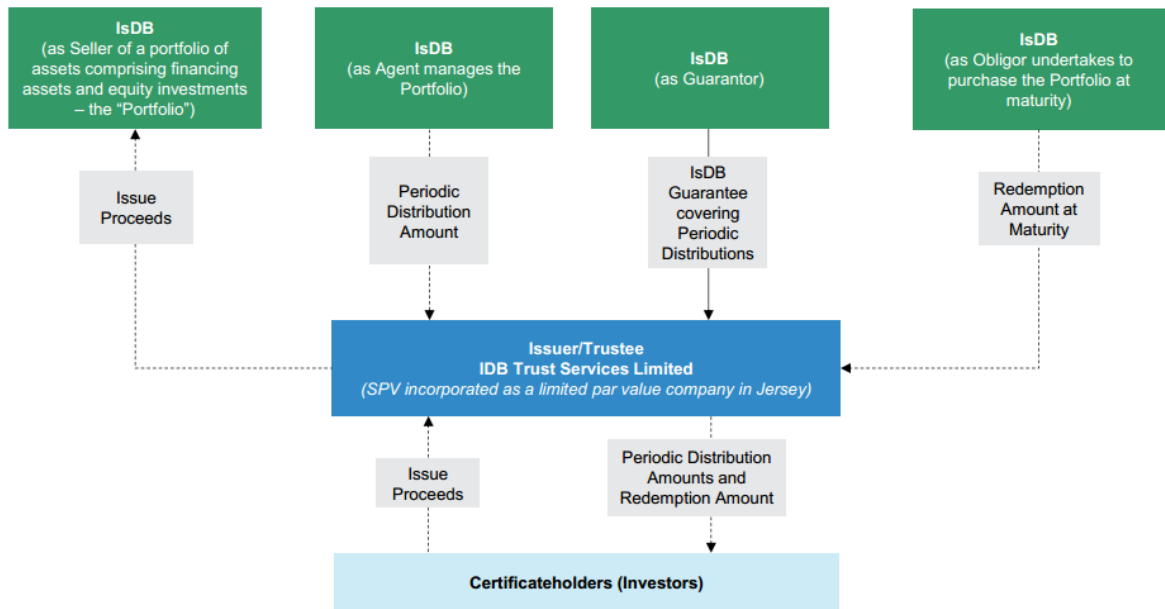


Source: Zawya, KFHR

- **IDB MTN Sukuk**

The AAA-rated Islamic Development Bank (IDB) issued its largest sukuk to date, a USD1.5bln 5-year benchmark sukuk on 6<sup>th</sup> March. The issue received an overwhelming response with over 60 orders in the books enabling IDB to upsize the programme to USD1.5bln from the original planned amount of USD1bln. The strong demand enabled IDB to conclude the transaction at 23bps over mid-swaps which represents IDB’s tightest spread ever. IDB last tapped the sukuk market with a similar USD1bln 5-year issue in May 2013 which was priced at 30bps over mid-swaps.

### IDB MTN Sukuk Structure

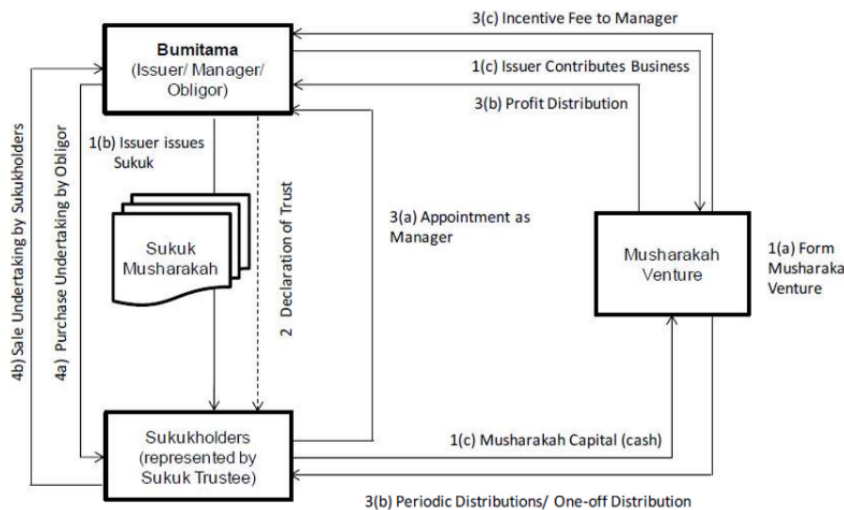


Source: IsDB, KFHR

- Bumitama Agri Sukuk**

Singapore listed palm-oil producer, Bumitama Agri Limited, became the first international jurisdiction for 2014 to tap the Malaysian sukuk market on 18<sup>th</sup> March with a MYR500mln (USD152.6mln) issue. This sukuk marks the Indonesia-based and Singapore-listed company's first sukuk issuance to date and the company intends to use the proceeds towards capital expenditure, investments and debt refinancing. The AA3-rated (by Ratings Agency Malaysia) sukuk provided investors an attractive yield of 5.25%, which is 24bps higher than the benchmark Bloomberg-AIBIM 5 Year AA3-rated Corporate Sukuk Benchmark Indicative Yield on the date of issuance.

### Bumitama Agri Sukuk Structure

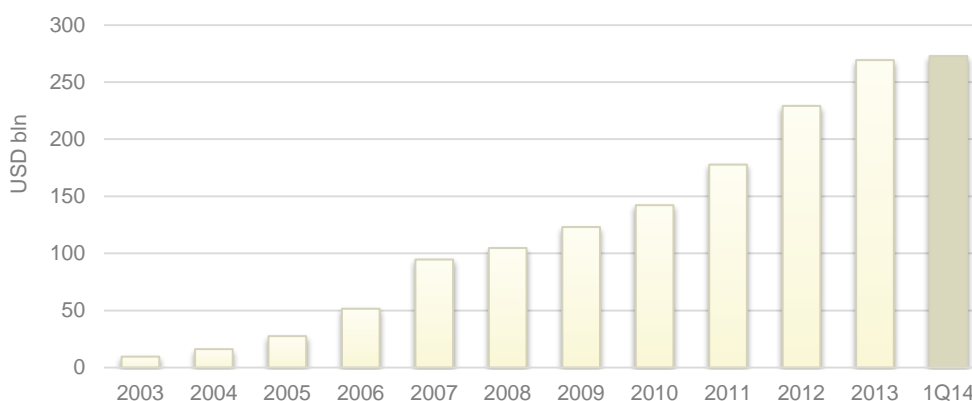


Source: Zawya, KFHR

### Review of Secondary Global Sukuk Market 1Q2014

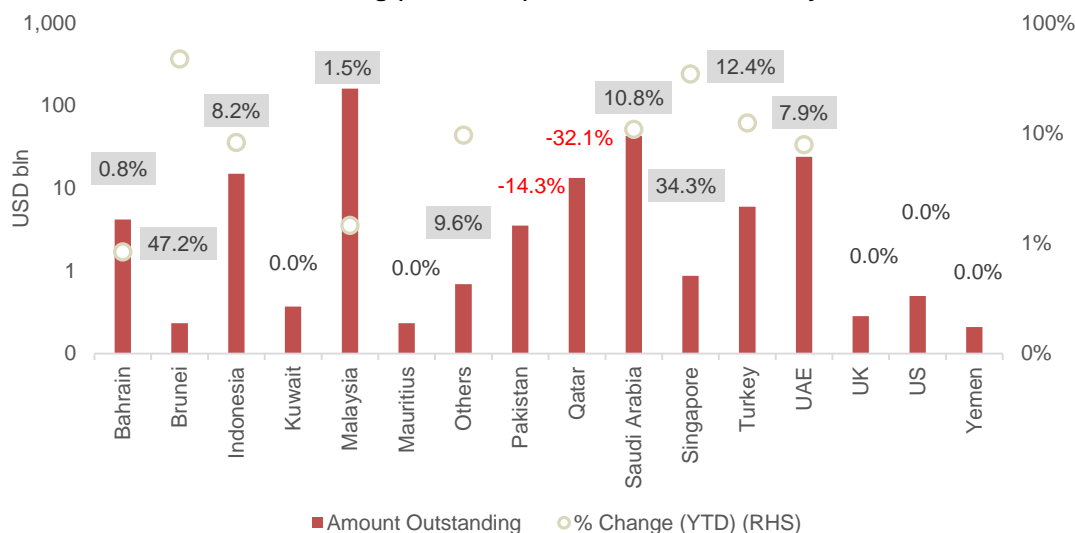
The global sukuk outstanding market reached USD272.96bln as at 1Q14, a very modest 1.3% growth from USD269.4bln as at end-2013 and a 15.96% growth y-o-y since 1Q13. The slow growth in 1Q14 was contributed, in part, by the redemption of a huge USD9.07bln sukuk by the Qatar Central Bank in January 2014. Malaysia continues to be the only secondary sukuk market with over USD100bln in outstanding sukus and as at 1Q14, the sukuk outstanding portfolio for Malaysia amounted to approximately USD160.6bln, a 1.5% increase compared to the USD158.3bln outstanding as at end-2013. The other markets follow significantly behind, with Saudi Arabia having an outstanding portfolio of USD42.8bln as at 1Q14 (end-2013: USD38.63bln); UAE with USD24.11bln (end-2013: USD22.35bln); Indonesia with USD14.97bln (end-2013: USD13.84bln) and Qatar USD13.35bln (end-2013: USD19.67bln). The Qatar sukuk outstanding portfolio experienced a decline of 32.1% on account of the Qatar Central Bank's USD9.07bln sukuk redemption in January 2014. The total GCC (including Oman) sukus outstanding portfolio valued almost USD85bln, a 0.4% decline q-o-q as compared to the USD85.3bln outstanding as at end-2013. In terms of outstanding portfolio growth q-o-q, double digit growth rates in 1Q14 were recorded in Brunei (47.2%); Singapore (34.3%); Turkey (12.4%); and Saudi Arabia (10.8%). During the same period, decline in outstanding portfolio were recorded in Qatar (32.1%) and Pakistan (14.3%). Meanwhile, the other major sukuk markets of Indonesia and the UAE posted growth rates of 8.2% and 7.9% respectively.

Sukuk Outstanding Trend (2003-1Q14)



Source: Bloomberg, IFIS, Zawya, KFHR

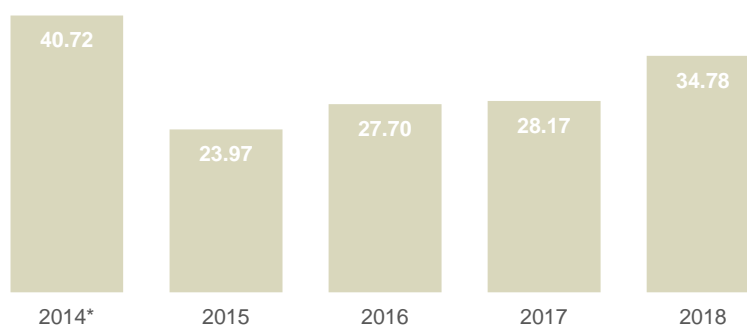
Sukuk Outstanding (as at 1Q14) and 2014 YTD Growth by Domicile



Source: Bloomberg, IFIS, Zawya, KFHR

During the remaining months of 2014, a huge volume of sukuk worth USD40.72bn are maturing, which include sovereign issues from a number of jurisdictions including Malaysia, Turkey, Indonesia, Pakistan, United Arab Emirates, Bahrain and short-term sovereign sukuk by Brunei, Gambia, Bahrain and Malaysia. Notably, the International Finance Corporation's (IFC) first sukuk, Al-Hilal Sukuk worth USD100mln issued in 2009, is also scheduled to mature in November this year. Other supranational sukuk maturing this year include IDB's 5-Year sukuk worth USD850mln issued September 2009 as well as IILM's USD860mln and USD490mln tranches issued in January and February respectively this year. The amounts set to mature over the next few years ranges between USD23.97bn and USD34.78bn. However, this volume is expected to increase moving forward as more new issues penetrate the market in the coming months including regular supply of short-term liquidity management sukuk issues.

**Sukuk Maturing 2014\*- 2018, as at end-1Q14**

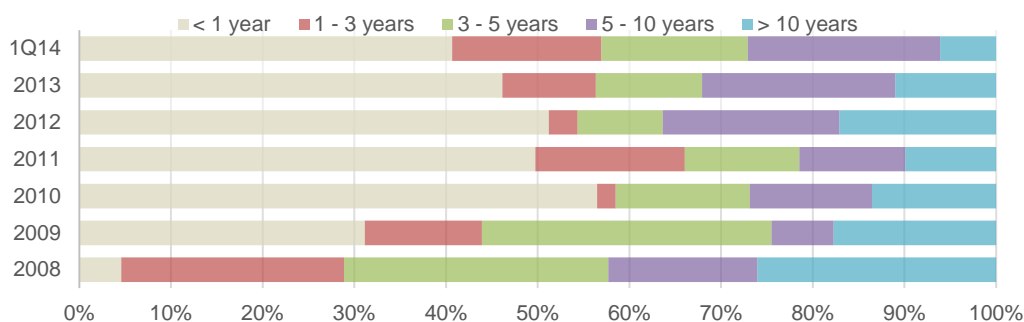


\* From 1 April until year end

Source: Bloomberg, IFIS, Zawya, KFHR

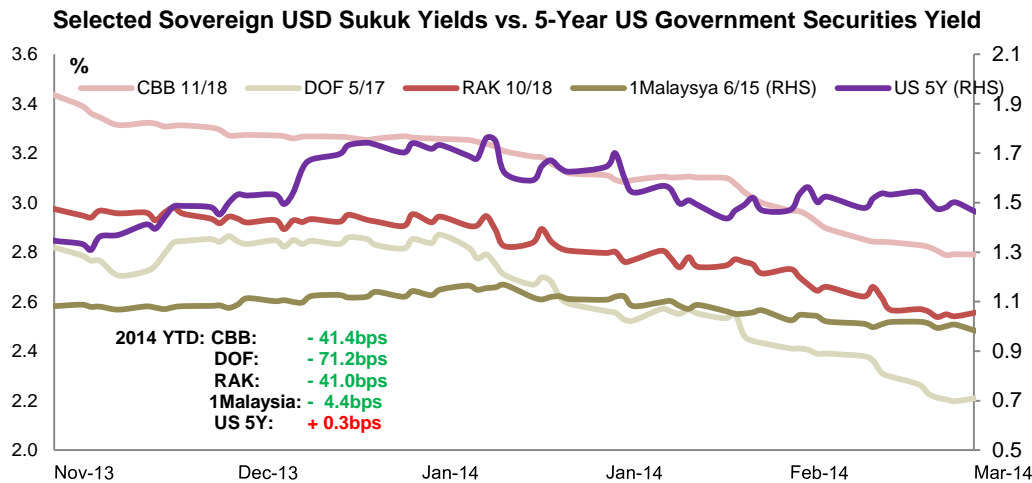
Consistent with the trend since 2010, the short-term maturity sukuk represented bulk of the issuances with over 41% share in 1Q14 led by sovereign liquidity management issuers from Malaysia, Bahrain, Brunei and Gambia. A few corporate entities from Malaysia and Turkey also tapped the short-term sukuk market to raise proceeds to support working capital needs. A notable change in 1Q14 is the 1-3 years maturity sukuk bracket which had an over 16% share as compared to fewer than 10% shares in 2013 and 2012. This bracket has been led by a diverse group of issuers including a 2-year sovereign sukuk by Turkey, a 1-year quasi-sovereign sukuk by Petronas Dagangan Berhad (Malaysia) and 3-year issues by Qatar Central Bank, Republic of Indonesia and Karachi Electricity Supply Corporation in Pakistan. In general, medium-to-longer term maturity sukuk (1-10 years) have been tapped in a greater proportion by the issuers in 1Q14, representing over 50% share. The long term maturity sukuk of over 10 years have declined in proportion with a less than 7% share of total issuances.

**Sukuk by Maturity Trend (2008-1Q14)**



Source: Bloomberg, IFIS, Zawya, KFHR

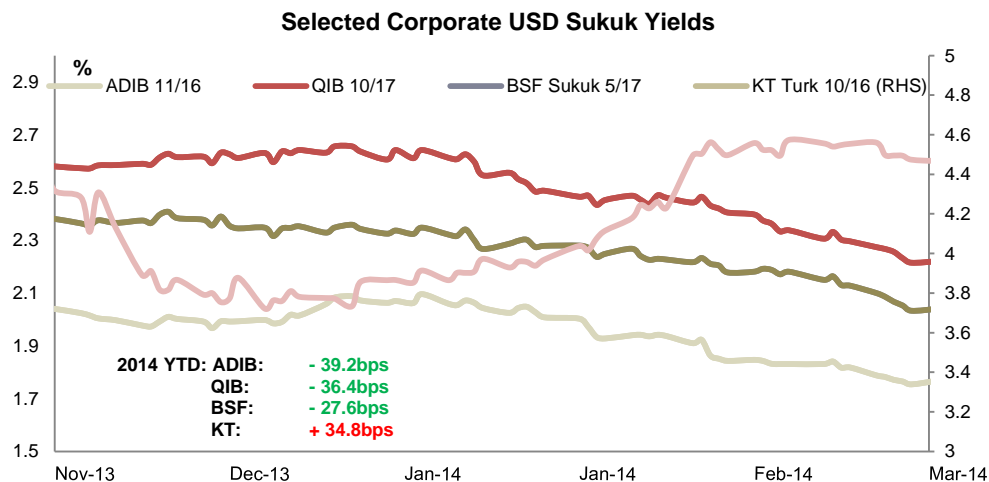
In terms of returns on sukuk papers in 1Q14, there has been a considerable heterogeneity in yields between various jurisdictions. Markets have generally reflected upon the macroeconomic fundamentals and characteristics of the issuing economies when pricing sukuk instruments. The yields on sukuk instruments in the GCC markets have performed most favourably in the first quarter of 2014, reflecting increased investor confidence in the region. Except for a brief period during the first two weeks of March, the yields on the GCC sukuk instruments have generally eased (See charts below). For instance, in the sovereign/quasi-sovereign sector, the Dubai Department of Finance 5/17 Sukuk yields lowered by 71.2bps since 2nd January to close at 2.135% as at 31st March. Similarly, the yields on the Central Bank of Bahrain Sukuk 11/18 lowered by 41.4bps to close at 3.267% as at 31st March. In the GCC corporate sector, the yields on the Qatar Islamic Bank Sukuk 10/17 and the Banque Saudi Fransi 5/17 declined 36.4bps and 27.6bps respectively during the 1Q14.



Note: Numbers in Sukuk name indicate maturity

CBB = Central Bank of Bahrain; DOF = Department of Finance, Dubai; RAK = Government of Ras Al-Khaimah

Source: Bloomberg, KFHR

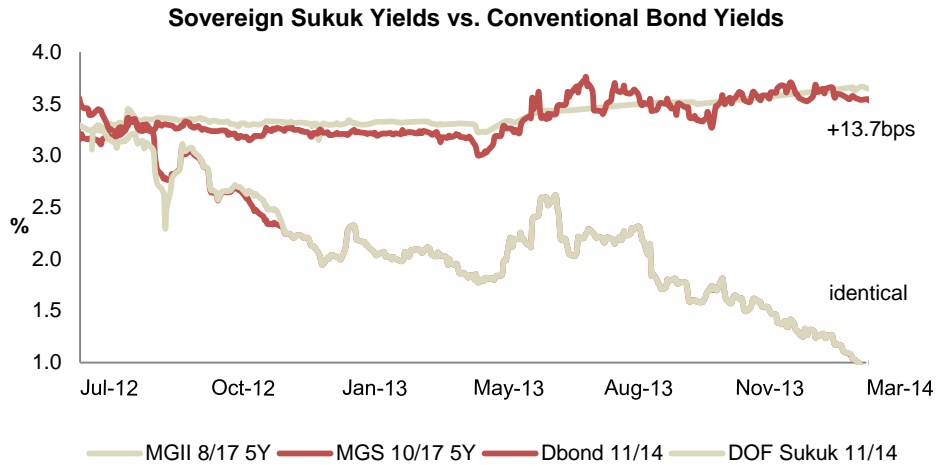


Note: Numbers in Sukuk name indicate maturity

ADIB = Abu Dhabi Islamic Bank; QIB = Qatar Islamic Bank; BSF = Banque Saudi Fransi; KT: Kuveyt Turk

Source: Bloomberg, KFHR

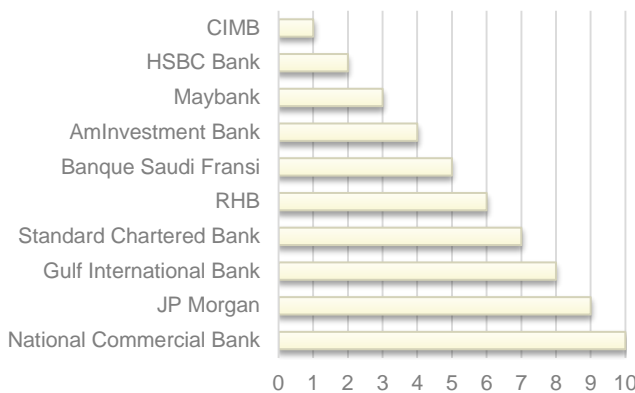
A yields comparison between Sukuk and comparable conventional bond instruments indicates that yields on sukuk instruments generally provide investors slightly higher or similar returns. For example, a 5Y Malaysian Government Investment Issue Sukuk had a slightly higher yield of 13.7 basis points (bps) as compared to the conventional Malaysian government bond as at 31<sup>st</sup> March 2014.



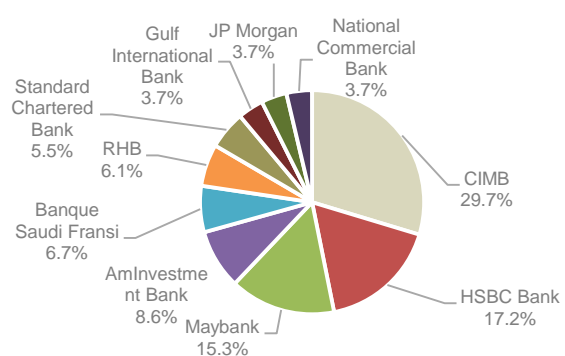
*Note: Numbers in Sukuk name indicate maturity*  
 MGII = Malaysian Government Investment Issue Sukuk; MGS = Malaysian Government Sovereign Bond  
 Dbond = Dubai Government Bond; DOF = Department of Finance, Dubai  
 Source: Bloomberg, KFHR

In the sukuk arranging league, 2013's second-placed CIMB ranked first during 1Q14 with 46 deals generating a volume of USD2.65bln as per data compiled by Bloomberg. Last year's leader, HSBC bank, ranked second during 1Q14 having underwritten 11 deals amounting to USD1.53bln. 2013's 3<sup>rd</sup> placed Standard Chartered Bank slips to 7<sup>th</sup> position during 1Q14 with 18 deals and a volume of USD492mln. Maybank and AmInvestment bank continue to be in the Top 5 since last year with Maybank at 3<sup>rd</sup> place having 33 deals worth USD1.36bln and AmInvestment Bank at 4<sup>th</sup> place with 8 deals worth USD768mln in 1Q14. The fifth position this year to date goes to Banque Saudi Fransi which generated a volume of USD600mln with its sole deal in 2014.

**Top 10 by Ranking (1Q14)**

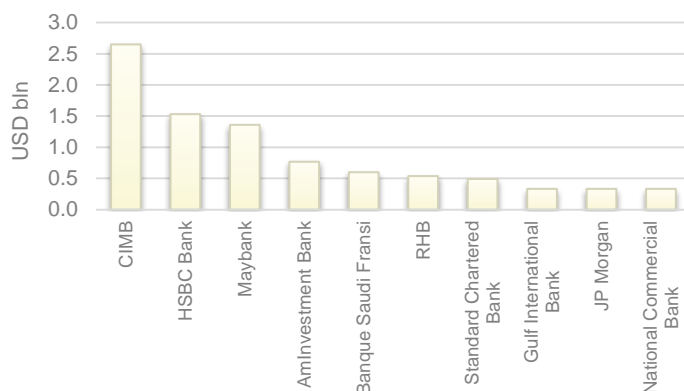


**Top 10 by Market Share (1Q14)**

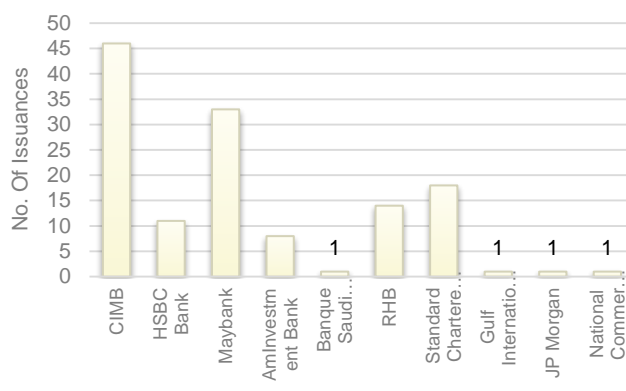


Source: Bloomberg, KFHR

**Top 10 by Amount Underwritten (1Q14)**



**Number of Deals Underwritten (1Q14)**



Source: Bloomberg, KFHR

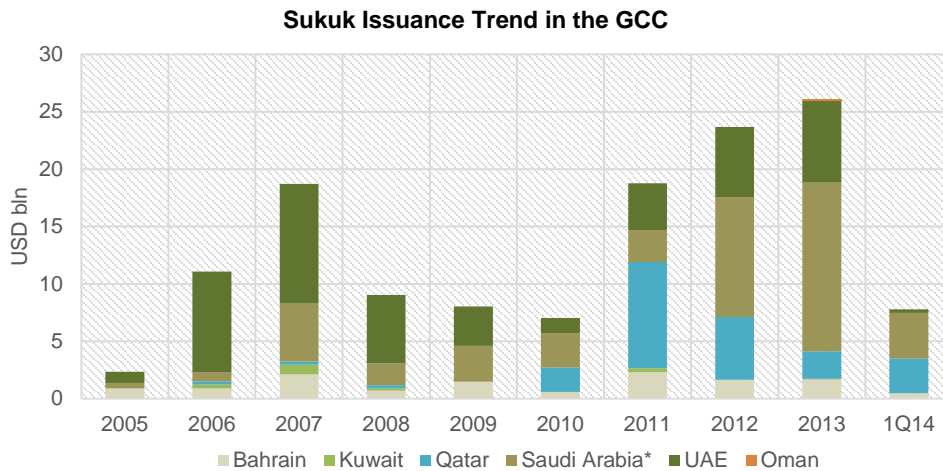
**Sukuk Arranging League Tables**

Name	1Q14			
	Rank	Market Share (%)	Volume (USD mIn)	Deal Count
CIMB	1	24.9	2,651	46
HSBC Bank	2	14.4	1,532	11
Maybank	3	12.8	1,360	33
AmInvestment Bank	4	7.2	768	8
Banque Saudi Fransi	5	5.6	600	1
RHB	6	5.1	538	14
Standard Chartered Bank	7	4.6	492	18
Gulf International Bank	8	3.1	333	1
JP Morgan	9	3.1	333	1
National Commercial Bank	10	3.1	333	1
Commerzbank	11	1.8	188	1
First Gulf Bank	12	1.8	188	1
National Bank of Abu Dhabi	13	1.8	188	1
Natixis	14	1.8	188	1
Kenanga Investment Bank	15	1.4	152	2
Kuwait Finance House	16	1.0	102	2
Bank Islamic Malaysia	17	0.8	90	2
United Overseas Bank	18	0.7	77	1
Al Hilal Bank	19	0.7	75	1
BNP Paribas Group	19	0.7	75	1

Source: Bloomberg, KFHR

### GCC Sukuk Market 1Q2014

Saudi Arabia continued to be the largest market of the GCC states for issuances in 1Q14 with a total of almost USD4.0bln placed, although notable USD1.5bln to this volume was contributed by the Islamic Development Bank. Qatar has been rapidly emerging as a major domicile for sukuk issuances in the GCC and in 1Q14 was the second largest domicile led by a USD3.02bln sukuk issuance by the Central Bank of Qatar. Kuwait and Oman remained absent from the sukuk market in 1Q14 while Bahrain generated a volume of USD476.8mln driven by short-term liquidity management Al-Salam sukuks issued by the Central Bank of Bahrain. The UAE had a volume of USD300mln contributed by the sole sukuk issuance of the country by Dubai Investments Park (DIP). Overall GCC issuances valued USD7.8bln in 1Q14, an increase of 6.0% y-o-y as compared to the USD7.36bln issuance in 1Q13.

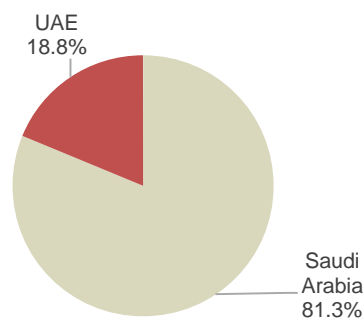


\*Note: Saudi Arabia includes IDB's issuances

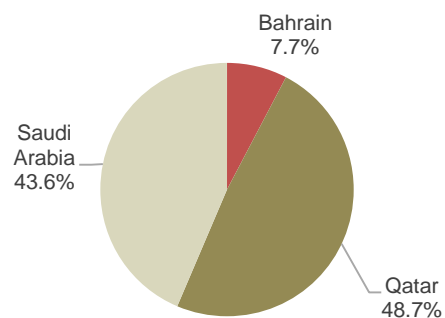
Source: Bloomberg, IFIS, Zawya, KFHR

By type of issuance, there were two corporate sukuks issued in the GCC during 1Q14 generating USD1.6bln in proceeds (1Q13: 4 sukuks and USD2.01bln) with the SAR5bln NCB sukuk in Saudi Arabia and the USD300mln DIP sukuk in UAE. In the category of sovereign and quasi-sovereign issuers, four issuers from the GCC (including the Jeddah-based IDB) tapped the market raising nearly USD6.2bln in proceeds (1Q13: USD5.34bln).

**Corporate Sukuk by GCC Domicile (1Q14)**



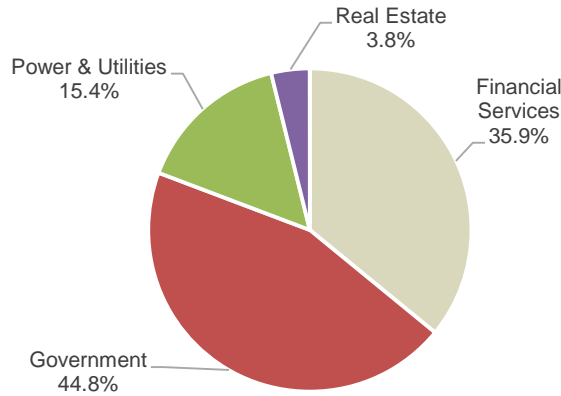
**Sovereign and Quasi-Sovereign Sukuk by GCC Domicile (1Q14)**



Source: Bloomberg, IFIS, Zawya, KFHR

By sector of issuance, the government sector generated the most volume led by Qatar's USD3.02bn sukuk followed by the financial services sector contributed by the USD1.5bn IDB sukuk and the USD1.33bn NCB sukuk. The UAE's USD300mln DIP sukuk contributed to the Real Estate sector while the Saudi Electric Company contributed towards the power and utilities sukuk.

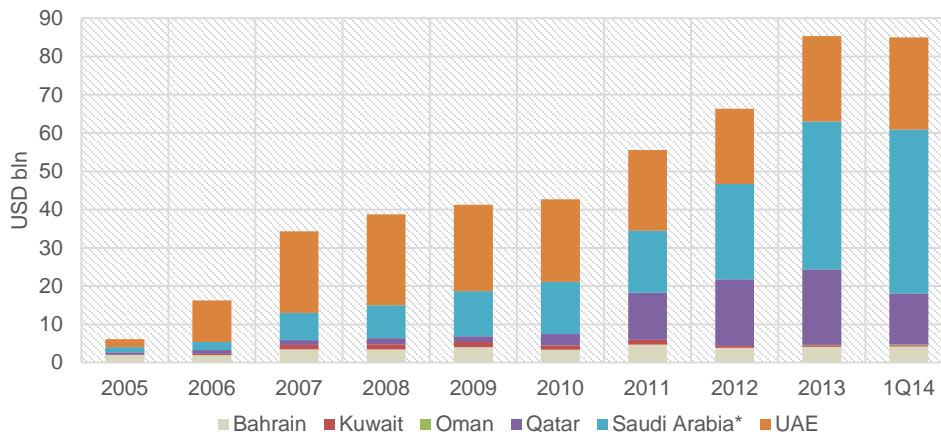
**GCC Sukuk Issuances by Sector (1Q14)**



Source: Bloomberg, IFIS, Zawya, KFHR

The GCC's secondary sukuk market has actually experienced a decline in value as the total GCC sukuk outstanding portfolio valued almost USD85bn as at end-1Q14, a 0.4% decline q-o-q as compared to the USD85.3bn outstanding as at end-2013. The decline has been largely contributed by the redemption of a huge USD9.07bn sukuk by the Qatar Central Bank in January 2014. The Qatar's outstanding portfolio experienced a decline of 32.1% between end-2013 and 1Q14 while the growths in the other markets were as follows: Saudi Arabia (10.8%); UAE (7.9%); and Bahrain (0.8%).

**Sukuk Outstanding Trend in the GCC**



Source: Bloomberg, IFIS, Zawya, KFHR

The GCC sukuk market is anticipated to have strong prospects moving forward given the substantial amounts of infrastructure spending and other developments in the pipeline across the region. The GCC market has a number of notable issuances in the pipeline including as follows:

#### Notable GCC Sukuk in the Pipeline as at 31<sup>st</sup> March 2014

Issuer	Country	Currency	Issue Date (E)	Issue Size (USD mln)
Flydubai	UAE	USD	1Q15	500
Saudi Electricity	Saudi Arabia	USD	2Q14	2500
Gulf Finance House	Bahrain	USD	2Q14	500
Bank Muscat	Oman	OMR	2H14	1300
Sultanate of Oman	Oman	OMR	2H14	521.04
ACWA Power International	Saudi Arabia	USD	2Q14	800
Qatar International Islamic Bank	Qatar	USD	2Q14	2000
Alpha Star Holding Limited	UAE	USD	2Q14	650
Albaraka Banking Group	Bahrain	USD	2H14	200
Arcapita Bank	Bahrain	USD	2H14	550

Source: Zawya, IFIS, KFHR

## GCC Islamic Securitisation

### Islamic Securitisation

In principle, as most Islamic financial products are based on an asset-backed concept, securitisation is a perfect match with Shari'a principles and there is little impediment to a successful Islamic securitisation. However, the underlying asset pool or portfolio of receivables in a securitisation must nevertheless match Shari'a compliance standards, for example, interest-bearing financing such as mortgages and credit cards should theoretically not be eligible for an Islamic securitisation.

However, there are a number of elements that the structure must comply with in order to be considered Shari'a compliant. For example, a degree of ownership is necessary and must be physically transferred to the investor; while investors must also participate in the profits and losses generated by the underlying assets. Securities representing a loan or debt also cannot theoretically be used because they cannot be sold or purchased in the secondary market. This is because if they are sold at a price higher or lower than their face value this represents Riba for one party or the other, while if they are purchased at their face value it can represent Gharar, or speculation.

The implementation of a Shari'a compliant securitisation requires a two-stage verification process which assesses its Shari'a compliance (i.e. the type of underlying assets and the generation of returns) and the transaction structure and Ownership conveyance (the physical transfer of ownership rights). Shari'a law also requires that all documents are conveyed together, and any assignment of any document, contract, note or instrument must be accompanied by all the documents. Therefore for an Islamic securitisation, the key requirement to the structure is ownership of a pool of assets that are convertible to cash within a prescribed time period, with the cash flow proceeds within this period distributed to the holders of the security.

### Islamic securitisation from a credit rating perspective

- **Without credit-enhancement features**

This sukuk structure bears resemblance to an asset-backed security in a securitisation. The pool of underlying assets underpins the source for coupon and principal payment. The ratings on these sukuk are typically based on the ability of the identified assets to generate sufficient cash flow to service the special-purpose vehicle's (SPV) financial obligations in a timely manner. Credit ratings in this case are based on the performance of the underlying assets under different stress scenarios along with the expected value of these assets at maturity.

In addition to the rating of this type of sukuk, focus is on:

1. the ability of the underlying assets to generate enough cash to meet the SPV's sukuk payment obligations;
2. the capacity of the managing agent to act as servicer and transfer payment from the obligors to the investors; and
3. the expected value of the reinvested cash flows, compared with the principal amount of the sukuk.

On the whole, thorough analysis would be done based on modelling the behaviour of the underlying assets and liquid instruments under different possible stress scenarios, as well as on documented assumptions about the recovery rates of the securitised asset classes. In addition, assessment will include examining the supportiveness of the underlying legal framework, especially legal isolation of the assets from the originator's insolvency.

- **With limited credit-enhancement features**

This structure includes features with a third-party guarantee absorbing limited shortfalls from an otherwise asset-backed transaction. In this instance the rating approach depends on the estimate of the capacity of the underlying assets to meet the SPV's financial obligations as well as the terms of the guarantee and the creditworthiness of the guarantor. Partially credit-enhanced sukuk benefits from a third-party guarantee with respect to either periodic profit distributions or the principal amount but not both. The partial guarantee is viewed as a mechanism enhancing the creditworthiness of the sukuk, but as such might not provide enough for the sukuk to be equalised to the rating of the guarantor.

Under these circumstances, an assessment of the overall creditworthiness of the sukuk on a stand-alone basis will be done, which means an evaluation of the ability of the underlying assets to generate sufficient cash flow to allow the issuing SPV to meet its financial obligations. This assessment incorporates the consideration of the position of the managing agent in relation to the extent to which non-performance of its functions would affect the sukuk's credit quality.

Subsequently, the stand-alone rating could then be notched up, depending on the nature of the guarantee and the implied enhancement to the sukuk's overall creditworthiness. There will also be an assessment on the capacity of the guarantor to provide timely support to the SPV in case of need, as well as enforceability of the guarantee. Furthermore, there could be some emphasis on recovery analysis, whenever feasible.

- **Legal considerations**

On the credit assessment of these sukuk, evaluation also takes into account the relevant legal and jurisdictional aspects of the transaction in rating a sukuk regardless of its type. The assessment could encompass legal issues such as enforceability, recognition of choice of law, and, particularly in the context of nonguaranteed sukuk, insolvency and security-related matters. Also, the distinction between law of jurisdictions with recognition on Shari'a laws 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.

### The Islamic securitisation market in GCC

As GCC's economic outlook looks positive, we anticipate the frequency of issuance of sukuk to follow suit to fuel the growth in development. This growth is also partially due to the development of many capital markets converging towards a single global market. As all segments of the economy now compete for the same capital, the need for efficient and innovative financing have become more necessary. To achieve this, it is now beyond the number of issued structured finance product and emphasis is focused on the structural innovation that will continue to contribute to the further development and refinement of traditional sukuk structures and similar Islamic structured finance products that will be offered at a level competitive with conventional investments.

Despite considerable, and growing, demand for Shari'a-compliant assets, the further development of sukuk depends on crucial economic, regulatory and infrastructural environment/infrastructures. Amid weak reliance on capital market financing in many Islamic countries, issuers of sukuk are faced with several economic impediments i.e. the ability to identify assets that meet shari'a requirements.

Nevertheless, supporting market efficiency and product development, the work of Shari'a regulatory authorities adds consistency to shari'a interpretations by religious boards and enhances market practices which, together with the development of Islamic finance documentation standards and the continued evolution of banking and corporation law, capital market guidelines and regulatory framework should lead to the further global growth of Islamic structured finance transactions.

In view of the gradual development experienced within the Islamic securitisation space in the GCC, there are 7 Islamic securitisation transactions from 2003 until 2013. Thus far, Islamic securitisation in GCC in the past decade has garnered seven transactions, from four different countries worth USD2.5bln. Nevertheless the single Islamic securitisation transacted in 2013 was evidently a milestone in the history of Islamic securitisation and now sets the benchmark for future possible transactions. We reiterate that as the Islamic securitisation space continuously introduce notable milestone and sets new benchmark for future Islamic securitisation deals, the number of deals emanating out of GCC is anticipated to increase backed by the need of capital funding against a thriving economic background.



Source: KFHR

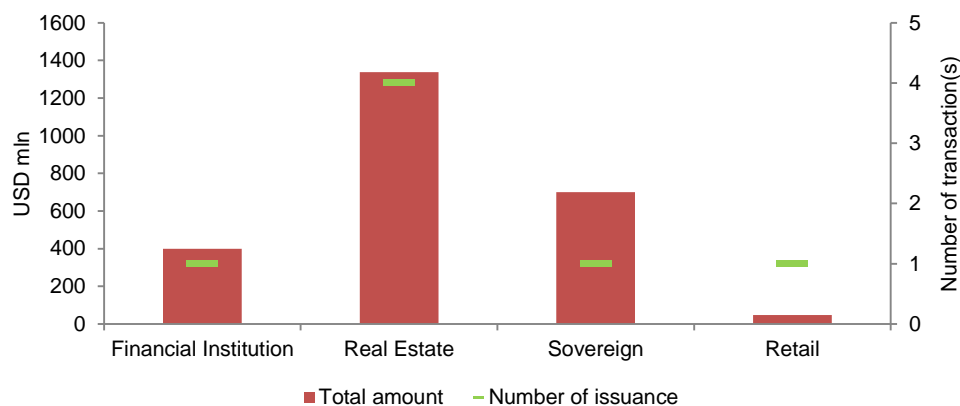
### Islamic securitisation transaction profile: Economic sector

Last year, the single Islamic securitised transaction originated from the retail market. This is clearly a first as with regards to the Islamic securitisation deals compared by economic purposes in the past, it was evidenced that most Islamic securitised transactions originated from the real estate market, which accounted for 4 out of the total 7 Islamic securitisation deals in GCC to date. These real-estate backed transactions were transacted in the UAE, KSA and Qatar. Meanwhile, the single sovereign Islamic securitisation was among the early securitisation deals which were structured in Qatar in 2003.

Kuwait emerged in the Islamic securitisation market in 2013 with its first innovative Islamic transaction from the retail industry. Being the latest addition to the economic sectors, this most recent Islamic securitised transaction (YAAS sukuk I) was completed in 1H2013. This transaction itself is milestone in Kuwait and across the whole Islamic securitisation space.

Meanwhile, the single Islamic securitisation by a financial institution was completed in 2003 by the Islamic Development Bank (IDB) in Saudi Arabia. Being the only bank to issue an Islamic securitised instrument, there could be potential for other issuances particularly with IDB's role to fund a growing number of countries within MENA. To add, as financial institutions raise capital for regulatory compliance purposes, an Islamic securitised transaction could be one potential avenue to venture into.

Islamic securitisation transactions by economic sector (2003-2013)



Source: KFHR

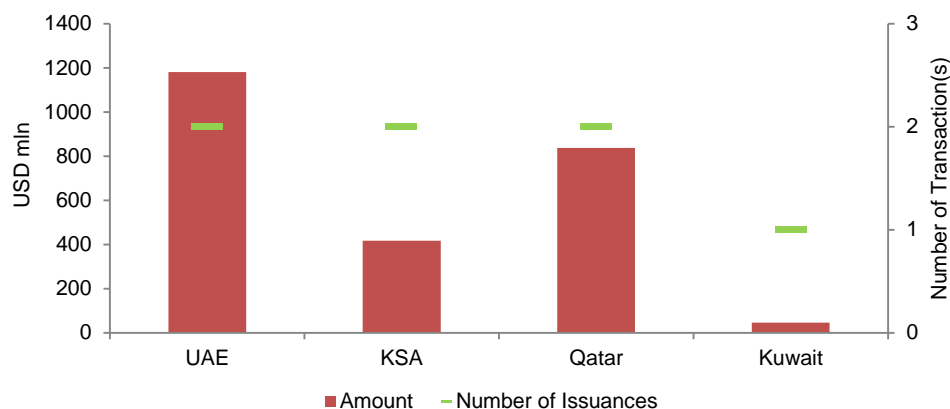
### Islamic securitisation transaction profile: Geographic location

The GCC is composed of countries with strong economic fundamentals. This can potentially facilitate the issuance of Islamic securitised assets from countries sound credit fundamentals which are undertaking heavy infrastructure developments. The number of Islamic securitised transaction from among the GCC countries between 2003 and 2013 has been dominated by such countries, which among them are the Kingdom of Saudi Arabia (KSA), the United UAE and Qatar with 2 transactions each.

As highlighted earlier, the recent country to join with its inaugural Islamic securitisation transaction is Kuwait. The country emerged with its first Islamic securitisation in 2013. Going forward, there could be more Islamic securitised transactions from countries with the likes of Saudi Arabia, UAE and Qatar given the huge economic development within these countries.

These accomplishments are a demonstration of the evolution and innovation which is currently emerging in the GCC. Not only is this due to the maturing of investor base demanding for new asset class to diversify their portfolio but also the development in human capital talent within the market to become pioneers of newly structured instrument and further setting new precedence for future products.

**Total value and number of securitisation transactions,  
By country (2003-2013)**



Source: KFHR

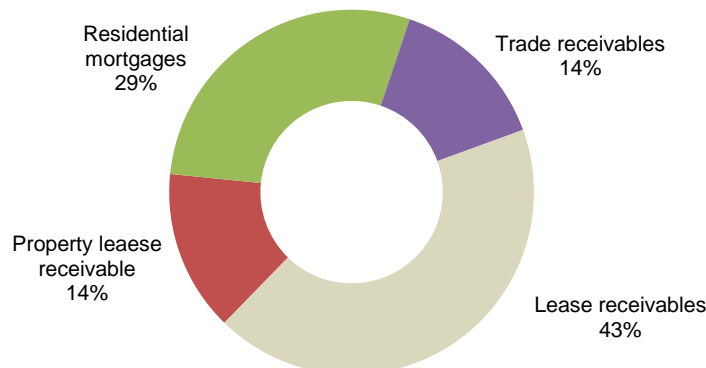
#### Islamic securitisation transaction profile: Underlying collateral class

Perhaps the distinction for every Islamic securitised transaction is the underlying collateral itself which drives the cash flow generation of the sukuk. If compared among the seven Islamic securitised transactions, the most favoured type of by collateral class would be those related to the real estate sector. That said, the two most commonly used collaterals were the lease receivables and residential mortgages.

This indicated the most common structure used in most real estate-backed transactions. While the lease receivables account for three of the seven Islamic securitisation collaterals, residential mortgages comprised two of the Islamic securitisation deals. The remaining two collaterals i.e. property lease receivables and trade receivables, which accounted for the remaining collateral types.

The amount of each Islamic securitisation varied with the residential mortgages and lease receivables backed transactions in total amounted to USD1.7bln. These lease receivables related transactions originated equally from the UAE, Qatar and KSA. Meanwhile, Kuwait with its first Islamic securitisation transaction is collateralised by trade receivables. Residential mortgages on the other hand, were mainly collaterals for securitised deals from the UAE and KSA. Moving forward, these two main collaterals are expected to be featured further especially in UAE given the current revival within its residential and commercial market.

### Proportion of Islamic securitisation transactions by collateral type (2003-2013)



Source: KFHR

### Islamic securitisation outlook

Market participants are predicting an increase in sukuk issuance in the Gulf region over the next two years, as innovative structures expand the range of assets that can be used as underlying sources of profit. The venture to use an intangible asset may serve to widen the base of borrowers that could access the market. Rather than paying a coupon, sukuk offer investors a share of the profit generated by an asset held by the issuer.

In the GCC market, massive economic developments have been assigned and are well underway. While these economies are strongly supported by hydrocarbon income, they could alternatively issue specific infrastructure sukuk with underlying securitised structures or assets. This will most importantly help to create and support the development of the domestic capital market and the development of further innovative securitisation structures.

The fact that distinguished companies issued innovative deals will spur others to take the same path. Generally in the sukuk market, anything innovative tends to be backed by very good credits of reputable names. In this instance, when such high profile names transact a deal, it paves the way for others to venture down the innovation path.

Market players are convinced that some innovation is returning to the market especially after considering the innovative sukuk issued in 2013. It now shows that there is potentially a wider scope to tap into the broader market, and issuers are becoming flexible with the type of assets they are using as underlying securities. In view of this, it will open the potential pool of issuers coming into market.

However, some quarter within the market expressed some caution, highlighting that a balance has to be determined between innovations and divergence from the Islamic principles that govern the asset class. Generally in the GCC, certain countries are aggressively striving towards initiating more things in Islamic finance. While there is more innovation it has to be met with a balance, as Shari'a compliance is very important and the Islamic scholars are conscious not to let the market push the boundaries too far.

## Outlook for 2014

Despite 1Q14 producing a modest volume of USD31.14bln worth of issuances, the global sukuk market is expected to once again surpass the USD100bln market in the primary market in 2014. It is foreseen that as the market gets clarity on the US QE policies and as the investors' write-off the short-lived political risks in the GCC, sukuk issuances are likely to trend upwards on the back of a number of high profile issuances in the pipeline for this year.

The sovereign sukuk sector is to be of much stakeholder interest in 2014 as sovereigns to the likes of United Kingdom, Luxembourg, South Africa, Tunisia, Mauritania, Senegal and Oman, among others, are expected to debut with sovereign issuances in 2014. In the supranational/multilaterals sector, the IILM continues to expand its short-term sukuk programme with a current outstanding portfolio of USD1.35bln. Further issuances by IILM in 2014 will be healthy contributions to the primary market. Expectations are also build up on a debut sukuk issuance from the multilateral Asian Development Bank (ADB) that is reported to be considering issuing sukuk in 2014.

In the corporate sukuk sector, debut corporate sukuk issuances in 2014 are expected in Australia, Ireland, Russia and Thailand which will expand the total number of jurisdictions that have tapped the sukuk market to date to well over 30 (excluding offshore jurisdictions). Based on the announced pipelines, 2014 will also witness the return of France into the corporate sukuk sector after its inaugural and only issuance in 2012. Meanwhile, the more established markets of Indonesia, Pakistan, Turkey and Singapore also have corporate sukuk announced in the pipeline for issuances in 2014.

Among jurisdictions, Malaysia will continue to be the global leader for sukuk issuances in 2014 (although its share has been on a declining trend) as a number of infrastructural development projects stream in under the Malaysian government's economic transformation programme. The GCC region is another critical driver for sukuk issuances on the back of vast infrastructure and capital expenditure plans in the region over the next ten years. Key Islamic finance markets of Saudi Arabia, Kuwait and Qatar already have in place infrastructural development projects that run in excess of over USD100bln. Saudi Arabian government-related entities including General Authority of Civil Aviation (GACA) and Saudi Electric Company have issued massive sukuk worth several USD billions in the past and are expected to continue leading Saudi sukuk issuances in 2014. United Arab Emirates continues to improve its profile as the regional centre of the GCC with various ambitious development plans involving infrastructure, tourism and other monumental development projects. The successful bid by Dubai for the Expo 2020 alone is estimated to see the Dubai government investing USD9bln to prepare for the event. In addition, government related entities in the GCC, such as Emirates Airlines and Kuwait Airways have also announced fleet expansion plans and the financing for such would be partly covered by sukuk to be issued in 2014.

Notwithstanding the above, a critical factor to observe closely in 2014 would be the US Federal Reserve's interest rates policy. The new Fed Chairman Janet Yellen has recently indicated that the US could start raising interest rates as early as 2015. An increase in US interest rates will be followed by identical rates increase in the rest of the world leading to higher funding costs for issuers. In such a scenario, higher fund costs may deter potential issuers from the sukuk market and any early rates increase prior to 2015 is likely to dent the global primary market sukuk issuances this year. Nonetheless, as the number of jurisdictions tapping the sukuk market expands (including debut issuances from non-OIC countries), the global sukuk market has firmly established itself as an alternative source of liquidity to support the various financing needs of global issuers.

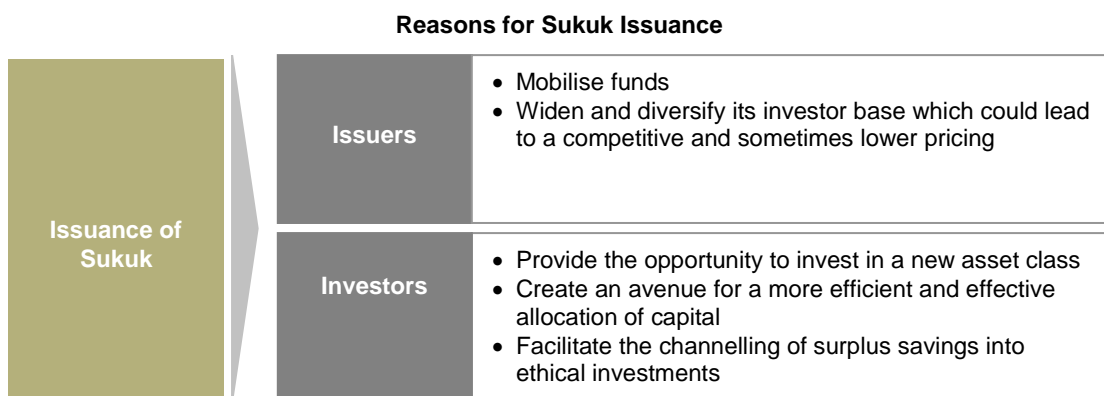
Selected Announced Sukuk in the Pipeline as at 31<sup>st</sup> March 2014

Issuer	Country	Size (USD mln)
Maybank Islamic Berhad	Malaysia	458.30
WOM Finance	Indonesia	26.27
Government of Senegal	Senegal	200.00
Unique Wealth Management	Malaysia	307.08
ACWA Power International	Saudi Arabia	800.00
Gulf Finance House	Bahrain	500.00
PT Citra Marga Nusaphala Persada	Indonesia	41.25
Flydubai	UAE	500
Bank Muscat	Oman	1300
Ministry of Finance – Egypt	Egypt	2,000.00
Central Bank of Yemen	Yemen	233.12
Meezan Bank Limited	Pakistan	-
UK Sovereign Sukuk	UK	334.24
SGI-Mitabu	Australia	147.87
Government of South Africa	South Africa	500
Alpha Star Holding Limited	UAE	650
Emirates Airline	UAE	-
B&N Bank	Russia	25.00
FGB Sukuk Company Limited II	UAE	1,074.77
QIIB Sukuk Funding Limited	Qatar	2,000.00
Government of Ireland	Ireland	-
Bank Centrale de Tunisie	Tunisia	635.28
Arcapita Bank	Bahrain	550.00
Bereket Varlik Kiralama Anonim Sirketi	Turkey	200.00
Société Générale	France	300.04
Alghanim Industries	Kuwait	50.00
Bank Asya Sukuk Limited	Turkey	55.32
Tamweel Residential RMBS	UAE	235.00
Al Baraka Sukuk Al Wakala Co.	Bahrain	200.00
Republic of Tatarstan	Russia	100.00
Islamic Bank of Thailand	Thailand	159.97

Source: IFIS, Zawya, KFHR

## Appendix 1: Sukuk Defined

Sukuk are defined by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) as certificates of ownership in a pool of underlying assets, in which the certificates are of equal value. Sukuk are issued with the aim of using the mobilised funds for establishing a new project, developing an existing project, or financing a business activity as per the respective shares.



Source: KFHR

Initially, Islamic securities (sukuk) were introduced as an Islamic alternative to the conventional bonds which function more as fixed-income instruments. However, as the sukuk market develops, it becomes increasingly distinct from conventional bond instruments. Under the mechanics of sukuk, returns to investors or sukukholders represent rights to receive payments from a trade transaction, ownership of a particular asset, or a business venture. In contrast, the returns to conventional bondholders represent the right to receive indebtedness for borrowed money. In addition, a sukuk does not pay interest but generates a return through actual economic transactions in the form of sharing or leasing assets.

### Sukuk vs. Conventional Bond

Parameter	Sukuk	Conventional bond
<b>Issuer</b>	<ul style="list-style-type: none"> <li>• A sukuk issuer shall be engaged in Shariah-compliant business activities</li> </ul>	<ul style="list-style-type: none"> <li>• An issuer of conventional bonds is not limited in its business activities</li> </ul>
<b>Investor base</b>	<ul style="list-style-type: none"> <li>• Enjoys a wider investor base from both Islamic and conventional investors</li> </ul>	<ul style="list-style-type: none"> <li>• Conventional bonds can only tap the conventional investors</li> </ul>
<b>Ownership</b>	<ul style="list-style-type: none"> <li>• Investors take direct ownership of an underlying asset or pool of assets</li> </ul>	<ul style="list-style-type: none"> <li>• A conventional bond is purely the financial debt of the issuer</li> </ul>
<b>Administrative cost</b>	<ul style="list-style-type: none"> <li>• Additional fees in terms of legal and Shariah advisory fee</li> </ul>	<ul style="list-style-type: none"> <li>• No additional administrative costs associated with conventional bond issues</li> </ul>
<b>Financing cost</b>	<ul style="list-style-type: none"> <li>• A larger pool of sukuk investors creates more demand, hence may help to achieve slightly more competitive pricing</li> </ul>	<ul style="list-style-type: none"> <li>• A comparatively smaller pool of conventional bond investors suggests that there is less demand for the paper</li> </ul>

Source: KFHR

To investors, sukuk provide the opportunity to invest in a new asset class, create an avenue for a more efficient and effective allocation of capital, and facilitate the channelling of surplus savings into ethical investments. Concurrently, the issuer is able to widen and diversify its investor base which could lead to a competitive and sometimes lower pricing.

Sukuk are now being issued in many regions of the world which have very different legal systems. The growth in demand over recent years raises challenges to the sukuk market which has led to slight differences in certain aspects of sukuk issuance among the range of jurisdictions. A prime example of this is allowable underlying assets in a sukuk transaction. Under the Malaysian jurisdiction, debt receivables are considered a permissible asset class for securitisation according to the Shariah Advisory Council (SAC) of Securities Commission (SC) Malaysia.

**AAOIFI: Characteristics of an Investment Sukuk**

Sukuk defined	<ul style="list-style-type: none"> <li>Investment sukuk are certificates of equal value issued in the name of the owner or bearer in order to establish the claim of the certificate owner over the financial rights and obligations represented by the certificate</li> </ul>
What do they represent	<ul style="list-style-type: none"> <li>Investment sukuk represent the common share in the ownership of the assets made available for investment, whether these are non-monetary assets, usufructs, services or a mixture of all of these plus intangible rights, debts and monetary assets</li> <li>These sukuk do not represent a debt owed to the issuer by the certificate holder</li> </ul>
Issuance	<ul style="list-style-type: none"> <li>Investment sukuk are issued on the basis of a Shariah-nominated contract in accordance with the rules of Shariah that govern their issuance and trading</li> </ul>
Trading	<ul style="list-style-type: none"> <li>The trading of investment sukuk is subject to the terms that govern the trading of the rights they represent</li> </ul>
Return	<ul style="list-style-type: none"> <li>The owners of these certificates share the return as stated in the subscription prospectus and bear the losses in proportion to the certificates owned (held) by them</li> </ul>

Source: AAOIFI, KFHR

Note: Missing from the AAOIFI standards are financial assets and debts as possible underlying assets. This means jurisdictions adopting the AAOIFI standards will inevitably be utilising different sukuk structures and thus different methods of raising investor’s funds, than jurisdictions which rely on local law.

## Appendix 2: Types and Definitions of Selected Sukuk

Type of sukuk	Definition
<b>Ijarah</b> (Certificate of ownership in leased asset)	<ul style="list-style-type: none"> <li>These are certificates that carry equal value and are issued either by the owner of a leased asset or an asset to be leased by promise, or by his financial agent, the aim of which is to sell the asset and recover its value from subscription, in which case the holders of the certificates become owners of the assets.</li> <li>These securities would suit the classification of asset-based because the leased asset will be transformed into units of proportionate ownership to be subscribed by the investors</li> </ul>
<b>Manfaah</b> (Certificate of ownership of usufructs of existing assets)	<ul style="list-style-type: none"> <li>Certificates of equal value issued by the owner of an existing asset either on his own or through a financial intermediary with the aim of subleasing the usufruct and receiving the rental from the revenue of subscription so that the holders of the certificates become owners of the usufruct.</li> <li>These are also part of asset-based securitisation though the asset is in the form of usufruct and services.</li> </ul>
<b>Intifa'</b> (Certificates of ownership of usufructs of described future assets)	<ul style="list-style-type: none"> <li>These are documents of equal value issued for the purpose of leasing out tangible future assets and for collecting the rental from the subscription revenue so that the usufruct of the described future asset passes into the ownership of the holders of the certificates.</li> <li>These are deemed to be part of asset-based securitisation though the underlying asset is the future services that are to be performed in the future.</li> </ul>
<b>Milkiyyat Al-Khadamat</b> (Certificates of ownership of services of a specified supplier)	<ul style="list-style-type: none"> <li>These are documents of equal value issued for the sake of providing or selling services through a specified supplier (such as educational programmes in a nominated university) and obtaining the value in the form of subscription income, in which case the holders of the certificates become owners of the services.</li> <li>Similar to the other Ijarah-based securities, these securities come under the purview of asset-based securitisation.</li> </ul>
<b>Al-Khadamat Al-Mawsufah fi Al-Zimmah</b> (Certificates of ownership of services to be made available in the future as per description)	<ul style="list-style-type: none"> <li>These are documents of equal value issued for the purpose of providing future services through described provider (such as certain prescribed educational benefits from university without naming the educational institution) and obtaining the fee in the form of subscription income so that the holders of the holders of the certificates become owners of the services.</li> <li>Services, though to be provided in the future are deemed as an asset thus making this security a type of asset-based securitisation.</li> </ul>
<b>Salam</b> (Salam Certificate)	<ul style="list-style-type: none"> <li>These are documents of equal value issued for the purpose of mobilising Salam capital so that the goods to be delivered on the basis of Salam basis come to be owned by the certificate holders.</li> <li>The Salam sukuk represent the ownership of the investors in the asset to be delivered in the future.</li> <li>These Salam sukuk can be issued but are not traded even on the basis of par value because the Salam asset which is represented by the Salam sukuk cannot be sold to another party without the initial buyer taking possession of the asset.</li> </ul>

<b>Istisna'</b> (Isitsna' Certificates)	<ul style="list-style-type: none"> <li>• These are certificates of equal value issued with the aim of mobilising funds to be employed for the production of goods so that the goods produced come to be owned by the certificate holders.</li> <li>• This definition refers to the sukuk that represents the proportionate ownership in the asset to be constructed. This is an asset-based structure until the asset is delivered to the buyer.</li> <li>• As practiced in some jurisdictions like in Malaysia, Istisna' sukuk refers to debt securitisation that is the receivables owing to the contractor. This type of issuance, from an international Shariah standpoint, cannot be traded freely as it reflects debt trading instead of asset-trading.</li> </ul>
<b>Murabahah</b> (Murabahah Certificates)	<ul style="list-style-type: none"> <li>• These are certificates of equal value issued for the purpose of financing the purchase of goods through Murabahah so that the certificate holders become the owners of the Murabahah commodity.</li> <li>• Similar to Istisna' sukuk, this definition refers to an activity of pooling monies to purchase a commodity to resell the same to another party under Murabahah sale. This sukuk if issued is an asset-based securitisation.</li> <li>• However, as practiced in Malaysia, Murabahah sukuk may refer to the securitisation of the seller's receivables. This issuance cannot be traded except on face value principle in accordance with AAOIFI Shariah standards because Murabahah receivables connote debt or financial obligation which is deemed to be money in character.</li> </ul>
<b>Musharakah Certificate</b>	<ul style="list-style-type: none"> <li>• These are certificates of equal value issued with the aim of using the mobilised funds for establishing a new project, developing an existing project or financing a business activity on the basis of any of partnership contracts so that the certificate holders become the owners of the project or the assets of the activity as per their respective shares.</li> <li>• There are three modes of issuing securities based on Musharakah concept:           <ol style="list-style-type: none"> <li>(i) <b>Musharakah sukuk</b> (Participation Certificates). These are certificates representing projects or activities managed on the basis of Musharakah by appointing either one of the partners or another person to manage the operation.</li> <li>(ii) <b>Mudharabah sukuk</b> (Issuer is the mudharib or manager). These are certificates that represent projects or activities that are managed on the basis of Mudharabah by appointing the mudharib for the management of the operation.</li> <li>(iii) <b>Wakalah sukuk</b> (Investment agency sukuk). These are certificates that represent projects or activities that are managed on the basis of investment agency by appointing an agent to manage the operation on behalf of the certificate holders.</li> </ol> </li> </ul>
<b>Istithmar</b>	<ul style="list-style-type: none"> <li>• These are the sukuk which are hybrid in nature. They combine both financial assets such as Murabahah receivables and tangible assets such as Ijarah leased asset according to a proportion of 70:30 respectively.</li> <li>• The issuance of these securities which was initiated by the Islamic Development Bank was a breakthrough in addressing the issue of receivables securitisation.</li> <li>• These securities have been deemed as asset-based securitisation and therefore are tradable in the secondary market without any Shariah constraint in trading these securities.</li> </ul>

Source: INCEIF

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