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GLOBAL

New Sukuk rules set to boost bond market

Last year, the market saw many Sukuk scheduled for issuance being held back following a statement by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) that 85% of the Sukuk issued in the GCC last year were non-Shariah compliant.

After many deliberations, AAOIFI issued a new set of rules early this month on the sale of Islamic bonds, which, among others, demand that investors become the legal owners of those assets rather than nominal holders.

The new ruling also does not permit tradable Sukuk to represent either revenue streams or debt, save in the case of a trading or financial entity that is selling all of its assets, or a

portfolio that includes a standing financial obligation such as that the debt was incurred indirectly.

While the new guideline will probably help investors sleep better at night, safe in the knowledge that their money is "parked" within the limits of Islamic law, industry players believe that the new rules will be tougher to comply with, especially with the current structure.

AAOIFI hopes that the new guideline, which takes effect immediately, will promote more profit sharing and losses between issuers and investors.

(Also see IFN Reports on page 12)

UAE

ADIA's wealth fund top the chart

The Abu Dhabi Investment Authority (ADIA) is the world's largest sovereign wealth fund (SWF), reveals Deutsche Bank research. It stated that ADIA has a total of US\$900 billion worth of assets under management.

Some of the wealth is expected to trickle into the Islamic finance sector. Earlier, ADIA had announced it may invest more into Islamic bonds mainly in Kazakhstan and Turkey.

Meanwhile, in the No.2 spot is the Singapore Investment Corporation with assets worth

US\$330 billion, while Norway's Government Pension Fund-Global (GPF) came in third with US\$322 billion in assets.

SWFs worldwide are managing assets worth US\$3.2 trillion, according to the research. In the Middle East, Saudi Arabia's various funds have assets worth US\$300 billion under management; Kuwait Investment Authority, US\$250 billion; Libya Oil Reserve Fund, US\$100 billion; Qatar Investment Authority, US\$60 billion; and Iran's Foreign Exchange Reserve Fund, US\$15 billion.

BAHRAIN

Abaad reveals financial results

Abaad Real Estate Company, the real estate subsidiary of Bahrain Islamic Bank, has announced the financial results for the year ended the 31st December 2007. In its first full year of operation, Abaad recorded total revenue of BHD2.1 million (US\$5.57 million)

and a net income of BHD1.5 million (US\$4 million), representing a return on capital of 14.7%. Abaad CEO Ahmed Yusuf said it is working closely with strategic partners to finish the master plans for several upcoming projects.

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GLOBAL

AAOIFI spells out dos and don'ts in Sukuk

Last November, as billions of oil money continued to pour into the Sukuk (which remains the most popular investment tool in Islamic finance) market, Sheikh Muhammad Taqi Usmani dropped a bombshell – something that drew the instant attention of issuers, investors and rating agencies all over the world.

The renowned and much respected Shariah scholar, who chairs the board of scholars at the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), announced that as much as 85% of Sukuk in the market might be non-Shariah compliant, basically since they violate the risk-sharing aspects of this Islamic compliant investment tool.

His statement led to a flurry of discussions, debates and questions. Early this month, AAOIFI then released the much awaited fatwa on tradable Sukuk.

From the three-page text, which is posted on the organization's official website, we believe that these guidelines sought to update and clarify traditions and consensus that had already been agreed upon.

Although the guidelines were technically not “new”, it is good to remind ourselves to always be aware of the basic requirements that can be misinterpreted when we consider other elements like tax and legal jurisdiction in structuring the products.

Reading the text hereunder, it should be pointed out that all observations are subjected to the already existing AAOIFI standards that are applicable. The new advisory had discussed the following:

> **Transfer of title** – The tradable Sukuk must represent ownership for Sukuk holders, with all of the rights and obligations that accompany ownership, in real assets, whether tangible or usufructs or services, that may be possessed and disposed of legally and in accordance with the Shariah. The manager of a Sukuk issuance must establish the transfer of ownership of such assets in its books, and must not retain them as its own assets.

> **No debt or revenue streams permitted** – It is not permissible for tradable Sukuk to represent either revenue streams or debt. Such is only permitted when in the case of a trading or financial entity that is selling all of its assets, or a portfolio that includes a standing financial obligation such as that debt was incurred indirectly, incidental to a physical asset or a usufruct.

> **(Profit Equalization) Reserve** – It is not permissible for the manager of Sukuk, regardless of whether the manager acts as a Mudarib (investment manager), Sharik (partner) or a Wakeel (investment agent), to undertake to offer loans to Sukuk holders when actual earnings fall short of expected earnings.

It is permissible, however, to establish a reserve for the purpose of covering such shortfalls to the extent possible, on condition that the same be mentioned in the prospectus. There is no impediment to the distribution of expected earnings on account of or to obtaining project financing on the account of the Sukuk holders.

> **End of Sukuk term relating to the promise to acquire assets from the Sukuk holders** – It should be understood that the Sukuk manager

acts as guarantor of [investor] capital at its nominal value in cases of negligence or mala fides or non-compliance with stated conditions, regardless of whether the manager is a Sharik, Wakeel or Mudarib.

It is not permissible for the Mudarib, Sharik or Wakeel to agree to purchase assets from Sukuk holders, or from whoever represents them, for a nominal value of those assets at the time the Sukuk are extinguished at the end of their tenors.

It is permissible, however, to agree to purchase the assets for their net value, or market value, or fair market value, or for a price agreed to at the time of their purchase.

“Although (AAOIFI) guidelines were technically not ‘new’, it is good to remind ourselves to always be aware of the basic requirements that can be misinterpreted...in structuring the products”

If, however, the assets of a Sukuk Musharakah, Mudarabah or Wakalah are of lesser value than assets leased by means of a lease ending in possession (Ijarah muntahiya bittamlik), then it will be permissible for the Sukuk manager to agree to purchase those assets at the time the Sukuk are extinguished for the remaining lease payments on the assets, by considering these payments to be the net value of those assets.

It is permissible for the lessee in a Sukuk Ijarah to agree to purchase the leased assets when the Sukuk are extinguished for their nominal value, as long as the lessee is not also an investment partner, manager or agent.

> **Shariah Supervisory Board responsibilities** – Shariah supervisory boards must not consider their responsibility to be over when they issue a fatwa on the structure of Sukuk.

Rather, they must review all contracts and documentation related to the actual transaction, and then oversee the ways that these are implemented in order to be certain that the operation complies at every stage with Shariah guidelines and requirements as specified in the Shariah standards, and that the investment of Sukuk proceeds and what those proceeds are converted to takes place in accordance with one [or another] of the approved Shariah methods of investment.

The advisory ends with a friendly but urgent reminder to all Islamic financial institutions to decrease their exposure to debt-related operations and to increase their operations on true partnerships and the sharing of profit and loss. (2)

By Paul Wouters, adviser to Bener Law Office, Istanbul