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Investigating Shari'ah and Liquidity Risk Factors in Special Purpose Company and its Role in Structuring Contemporary Waqf Sukuk

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Presentation Outline

1. **WHAT? RESEARCH TOPIC**
2. **WHY? THIS RESEARCH TOPIC / KNOWLEDGE GAP**
3. **HOW? METHODOLOGY**
4. **RESULTS / CONCLUSIONS** (Compared to Previous Studies)
5. **POTENTIAL APPLICATION FOR FINDINGS**
6. **QUESTIONS**



INTRODUCTION

- Diversity and flexibility in Islamic law (juristic views) has contributed to rapid growth of Islamic finance.
- SPC/SPV based SUKUK...the most important product for Islamic Banking by volume (tens of billions USD issued) – mostly by corporations.
- SPC based SUKUK...combines both characteristics of shares (represent ownership of assets, usufruct, and rights) and debt instrument (lower risk profile + non-profit-sharing)





Who really owns the sukuk assets?

(This simple maxim stresses the ownership of assets by the Sukuk holders)

(لا يَعلَقُ الرَهْنُ مِنْ صَاحِبِهِ الَّذِي رَهَنَهُ ، لَهُ غُنْمُهُ وَعَلَيْهِ غُرْمُهُ) رَوَاهُ

الذَّارِقُطْنِيُّ وَالْحَاكِمُ ، وَرَجَّاهُ ثِقَاتٌ ، فَقَدْ اكد هذا الحديث الشريف استقرار الملك مع صاحب الغنم

والغرم . مقتبس من تعليق الدكتور محمد أنس الزرقاء في سياق حديثه عن متطلبات السيولة في الصكوك القائمة على الأصول، ومخالفتها المباشرة للنصوص الصريحة، ندوة الصكوك، جدة 2010

The answer to this controversial question depends on your considerations (of form or substance). The above hadith simply and directly says that once the return “*ghunm*” and liability “*ghurm*” falls in anyone’s hand; then it automatically means he really owns the asset



Contd...

- Islamic Banks are holding lots of deposits, but their Shari'ah-compliant options are limited.
- Some Islamic banks are playing a dangerous game, which is essentially to match short-term liabilities with investments in Sukuk, which have longer maturities.
- **Total global *Sukuk* issuance increased from a size of just over US\$ 1 billion towards the end of 2001 to US\$ 179 billion as of 30th June 2010, a compounded annual average growth rate or CAGR of 88%. (IIFM, 2010)**



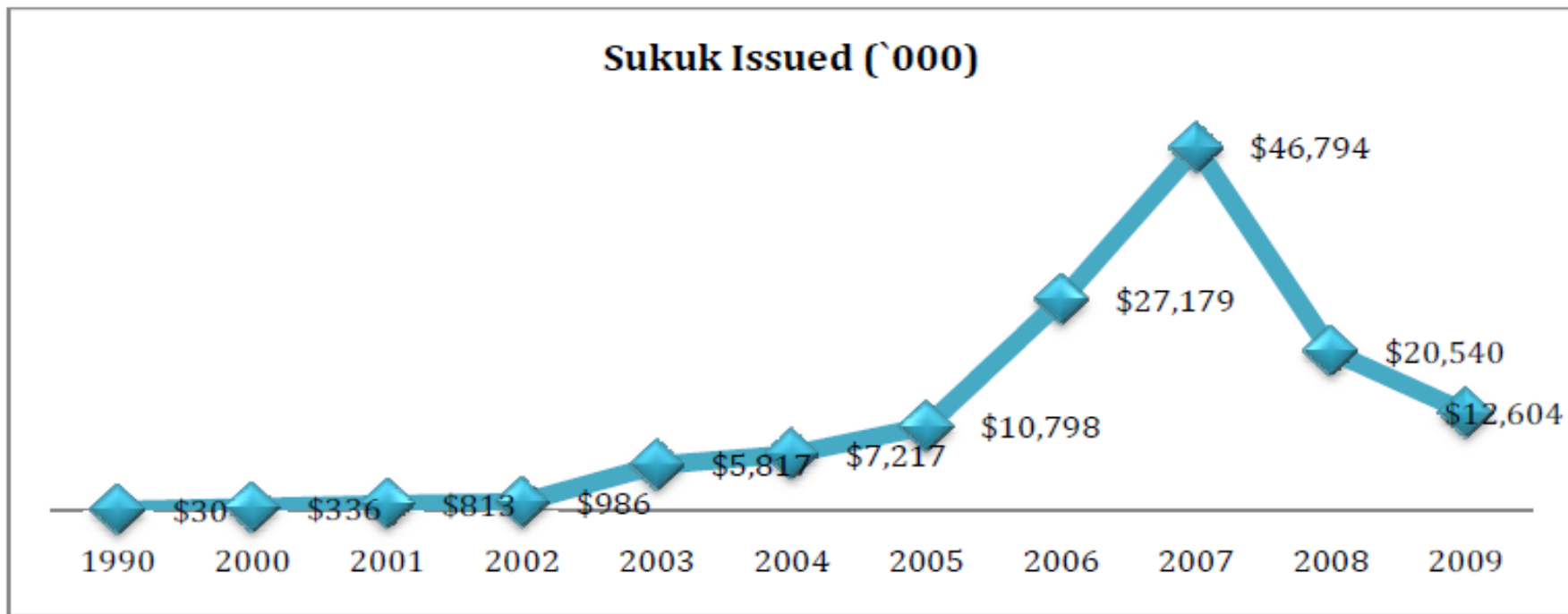
Contd...

- Global sales of sukuk fell 23% to \$6.5bn so far this year (2013), according to data compiled by Bloomberg. Issuance totaled \$20.2bn last year, up from \$14.1bn in 2011.
- *Comparative Shari'ah interpretations of Bai al-Dayn or debt trading (Saudi Arabia)*
- IFIS (i.e. IIFM) , ZAWYA, Bloomberg, Security Commission, Investment banks (95% CI, Bayesian Stat.): Issued Sukuk (pending and matured) = Approx. 690 issues until May 2012, **85% not listed**



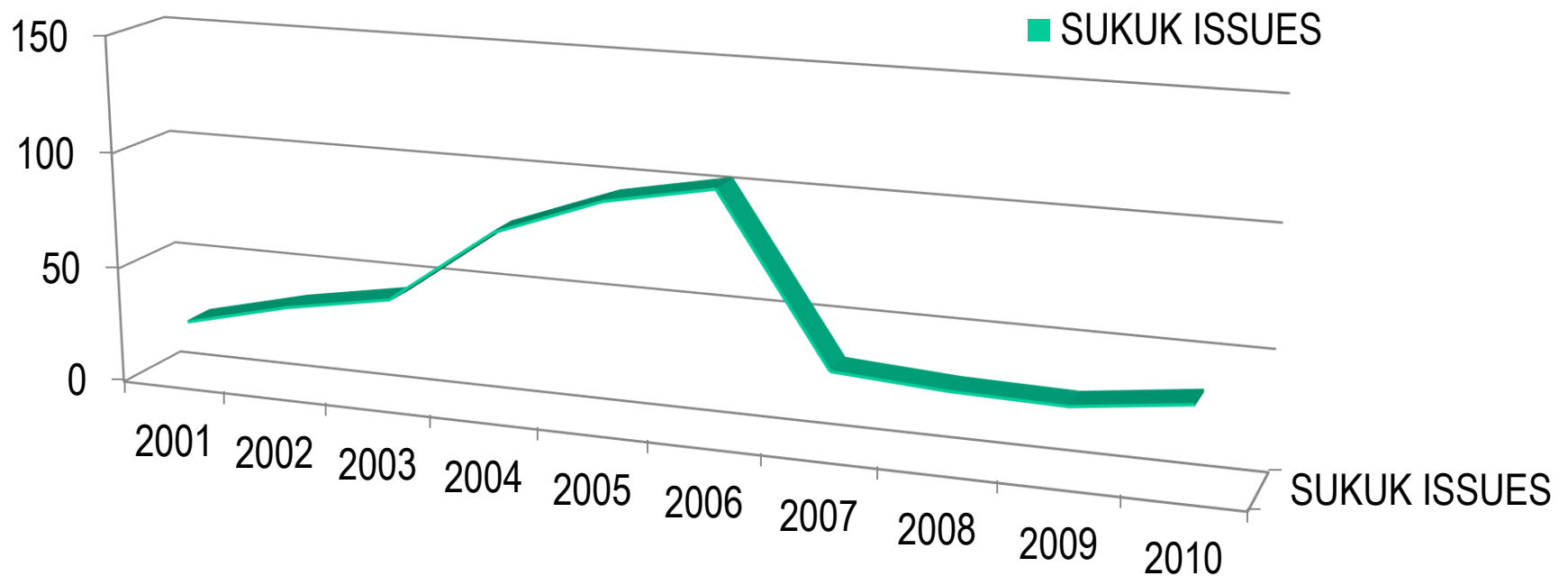
Research study Done ISRA.my

Chart 1: Growth of the *Ṣukūk* Market³



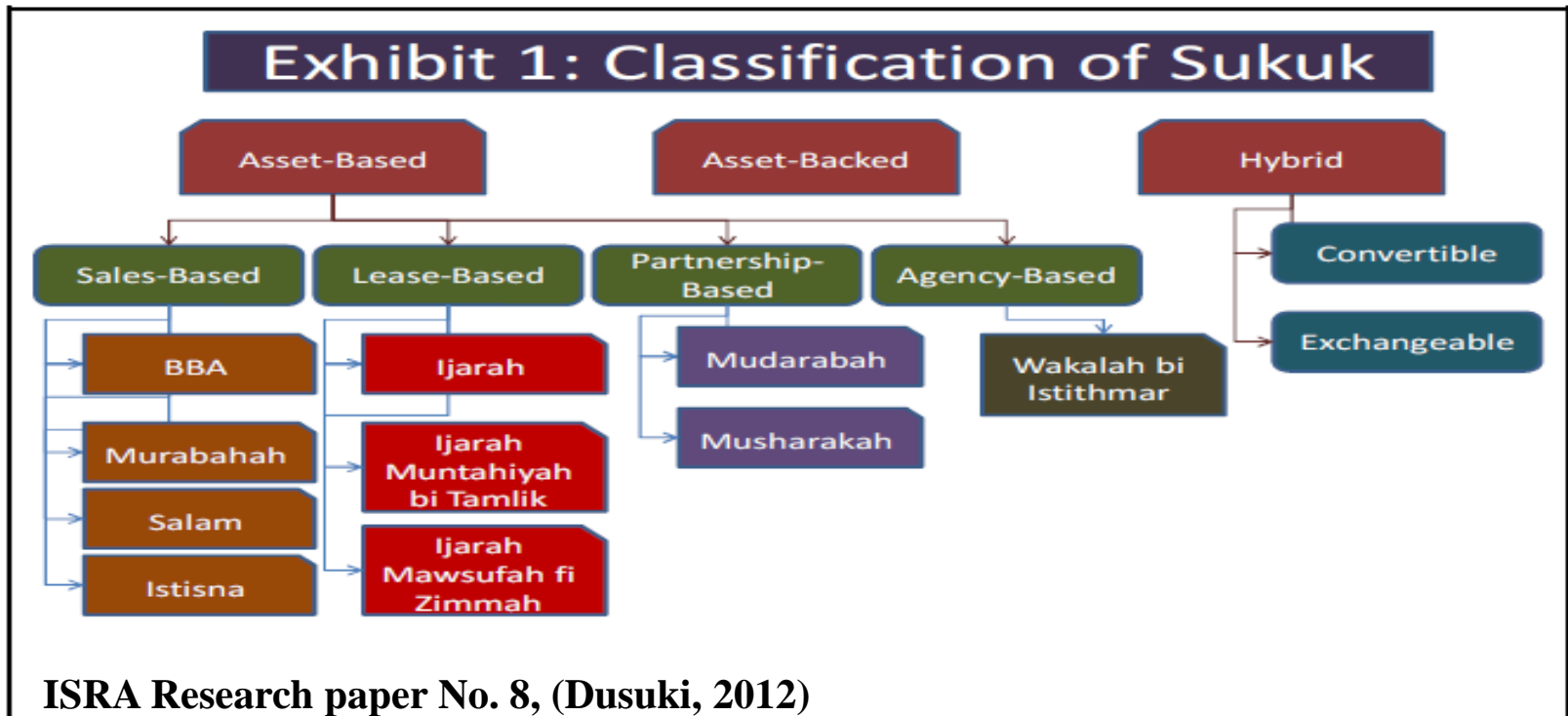


Growth of SPC based Sukuk Market (No. Issued per year- IIFM/ DIFX)





Classification of Sukuk

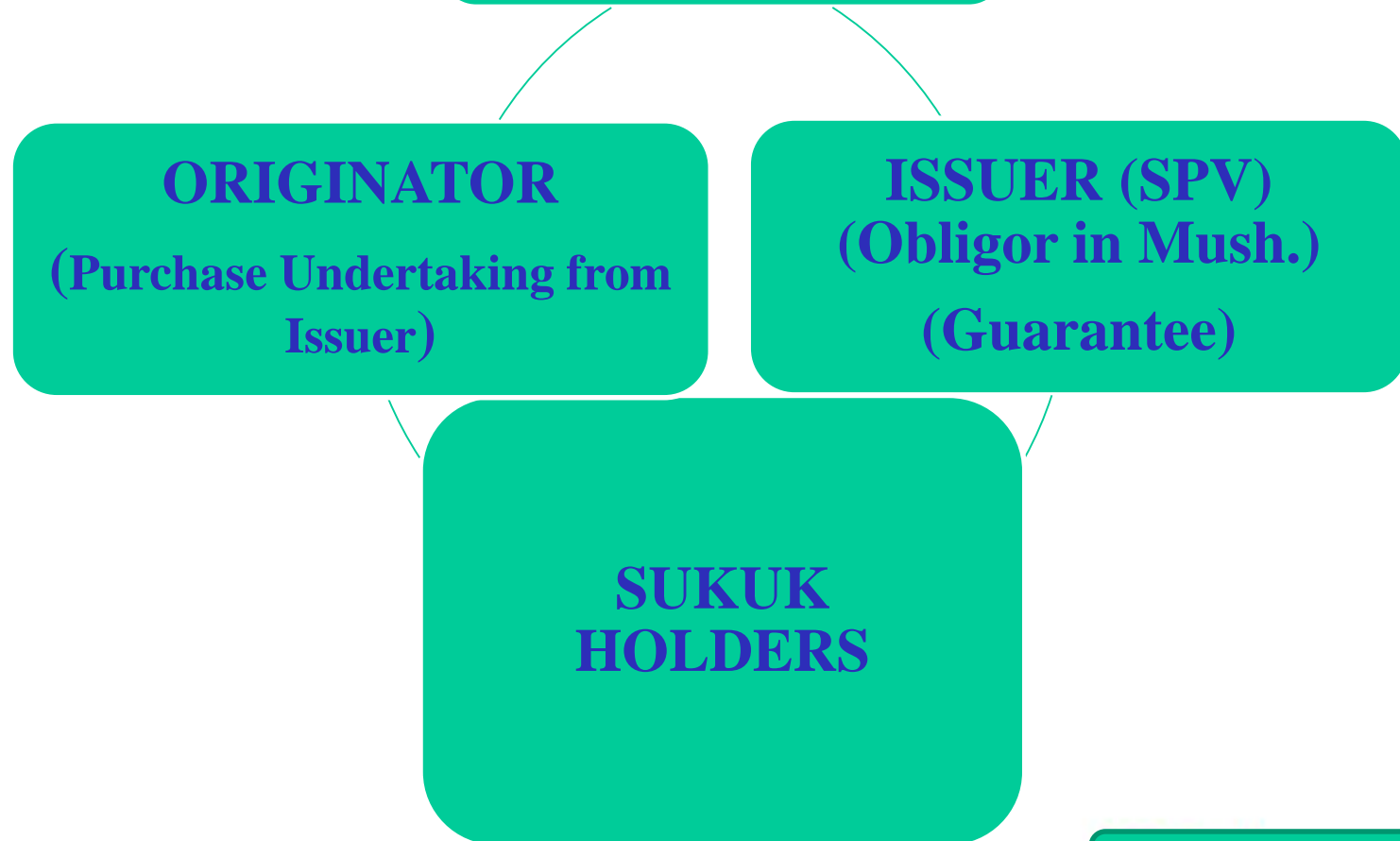


ISRA Research paper No. 8, (Dusuki, 2012)

Source: (Securities Commission, 2009)



Sukuk Parties





Sukuk vs. SPC

“Sukuk = Investment Certificates”; are securities representing ownership of income-generating assets, or shares of partnership (i.e. Musharakah) in any business activity characterized by fixed income, short term, and guaranteed debt on the originator or obligor.

Sukuk Liquidity concerns

How can we beat or avoid liquidity issues in Sukuk relative to other financial products floated in developed and emerging markets?



Equity-based Sukuk

“Equity-based Sukuk”: Sukuk where the returns to sukuk holders are determined on the basis of profit-and-loss sharing in the underlying investment (e.g. Musharakah or Mudarabah) or via any Shari’ah-compliant instrument where debt creation is as a result of a deferred sale (i.e. sales-based, Istisn’aa).





Islamic Securitization (Sukukization)

- Differences (Juristic & legal) between Malaysia and GCC. How do we weigh (Masaleh & Mafasid) (Shariah objectives in today's Islamic Finance)?
- How does it impact classification of Sukuk Issuances in GCC and Malaysia and affect Sukuk Liquidity?





Why GCC and Malaysia?

- **GCC:** Besides being the leader in the overall global *Islamic market in terms of both volume and value*, with a total credit worth approximately over US\$ 168 billion, GCC has also pioneered a whole lot of innovations in the domestic as well as international market.
- **Malaysia:** The largest Sukuk issuance market by volume in the world.
- **Hallmark Equity-based Sukuk Issues from GCC & Malaysia:**
- Khazanah, Bin Ladin group, Electricity SA



Contd...

- **Dubai:**

DIFX is the Middle East region's International Exchange (proclaimed as having the highest international regulatory standards in the region) and first-class listing of all sukuk issued in the region.

- **Hallmark Equity-Based Sukuk Issues from Dubai:**

Dana Gas, DP World, DIFC, Aldar Properties, PJSC





Research Questions

- **First:** What is the special purpose company, and what are the reasons behind its appearance?
- **Second:** What are the characteristics of the special purpose company, and what are its types?
- **Third:** What is securitization, its pillars and importance?
- **Fourth:** What is the importance of the special purpose company in the securitization process?
- **Fifth:** What function does the special purpose company play in the securitization process and the structuring of Islamic Financial products?
- **Sixth:** What is the legal jurisprudence and Shari'ah objective position on the special purpose company?



OBJECTIVES OF THE STUDY

- To show the concept of the special purpose company and the reasons behind its emergence.
- To expose the characteristics of the special purpose company and its types. To exert best effort to research the concept of the securitization process, and show its importance and major financing components
- To show the importance of the special purpose company in the securitization process.



Sukuk Relevant Standards & Rulings

AAOIFI (Dubai): Shariah Sukuk Standard 17 (2, 5/1/12, 5/1/8/5), Reserve Standard 13 (8/8/3), PU Standard 12 (3/1/6/2), Guarantee 5 (2/2/1/- 2/2/2)

IFSB: IFSB 2, IFSB 7

OIC: (7/2)64 (Installment sale provisions), (11/4)101 (sale of shares and bonds), (17/7) 158 (Sale of Debt), Decision No. 1-2 (16th Circular) on Securitization



COMPANY LITERATURE REVIEW





Recent Related Studies (2007 – 2013)

- *Al-Tawreeq wa Mada Ahmmiyatahu fi Dhil Qanoon Al-Rahn Al-Aqari* [Translated as: Securitization and its importance in relation to the real estate mortgage] (Al-Hijazi, Obaid Ali Ahmad 2001)
- *Dawr Al-Sukuk Al-Islamiyah Fi Tamweel Al-Mashroo'at Al-Tanmawiyah* [Translated as: The role of Islamic Sukuk in financing development projects] (Mohammed Saleh and Fath- Al-Rahman Ali, 2008)
- *Al-Tawriq wa Baqiyat Adawat Al-Suyoolah li-sook Al-Islamiyah* [Securitization and the rest of liquidity instruments for Islamic market] (Mala'ekah, Saleh 2005)





Elements of SPC Equity-based Sukuk Securitization

True Sale
(Accounting and legal)

Profit Sharing

Bankruptcy Remoteness

Loss Sharing (Not. Applied)

Enforceability of Security

Islamic Securitization



RESEARCH METHODOLOGY





QUANTITATIVE (30%)
(Data Collection various
sukuk...) GCC and Malaysia

(GCC and Malaysia)

**RESEARCH
METHODOLOGY**

QUALITATIVE (70%)

(The main focus in this methodology is to collect and analyze materials or data in respect to SPC based equity Sukuk issuance. This includes the types of structures used, legal and Shari'ah issues.

Growth trends data has been extrapolated for the latter part of 2010 and the year 2013 (Size over USD\$ 900million)

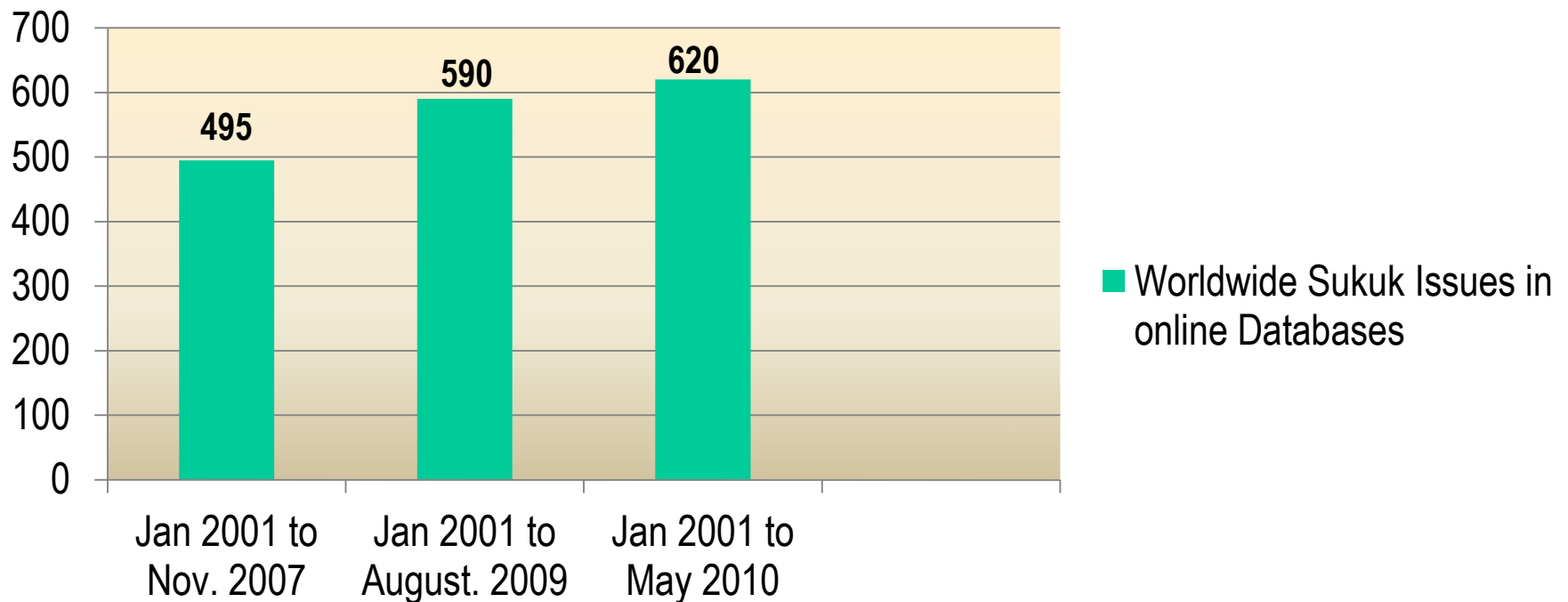


- All issues reported are issued Sukuk and already matured.
- If part of the same term sheet, all tranches are grouped as one issue (even if of different maturity and yields)
- The USD\$ value of Sukuk denominated in local currency was calculated based on the average monthly exchange rate at which it was issued.





Number of SPC based Sukuk Issues Worldwide (IFIS & ZAWYA databases)





LAYOUT OF CHAPTERS





- The dissertation is arranged and divided into six chapters:
- **Chapter (1) INTRODUCTION:** consists of scope, objectives, Problem Statement, Research Questions, methodology, Literature review, and outline of the chapters.
- **Chapter (2) "THE COMPANY" LITERATURE**





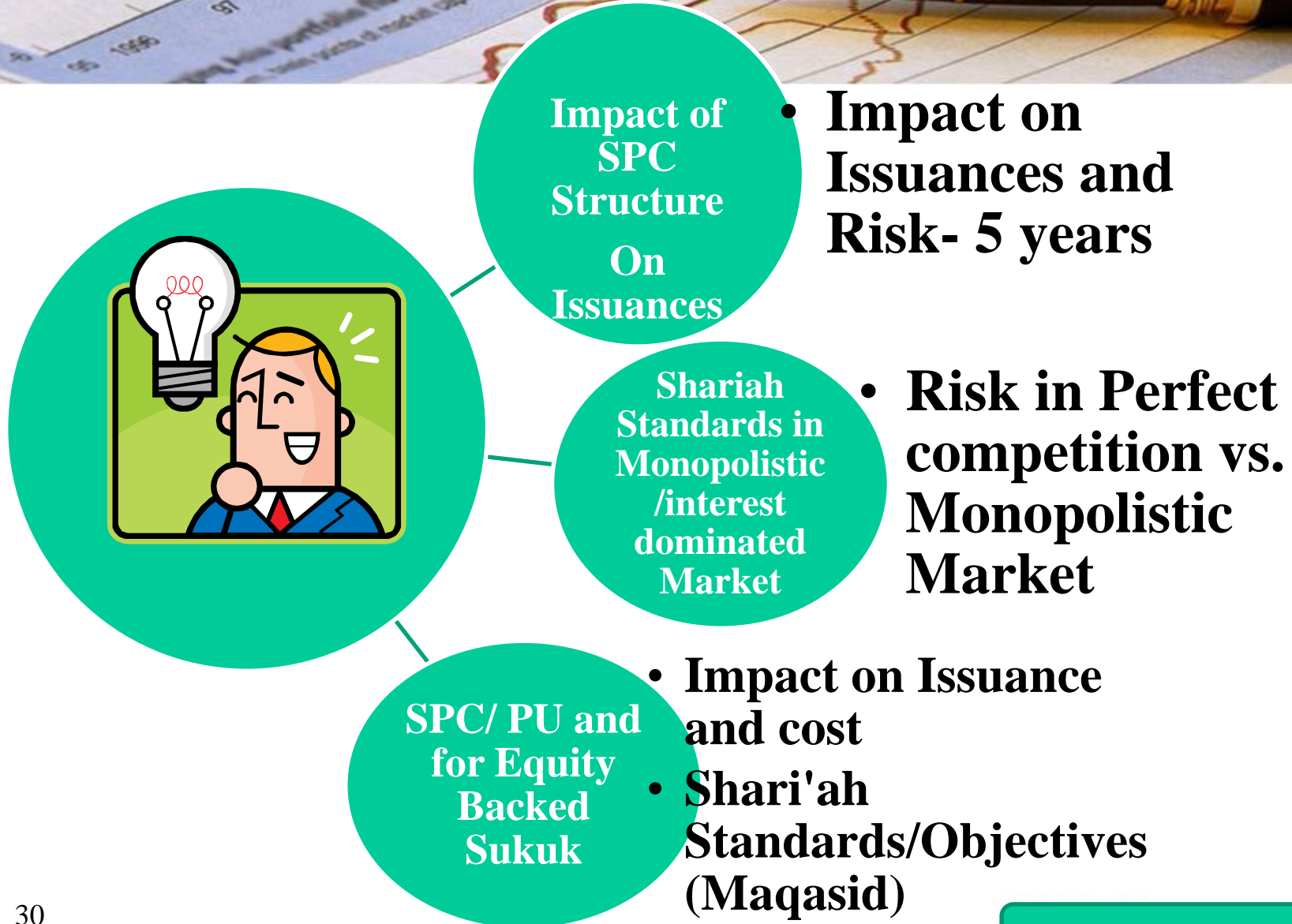
- **Chapter (3) SPECIAL PURPOSE COMPANY (SPC) ROLE IN FINANCE**
- **Chapter (4): LEGAL AND SHARI'AH FRAMEWORK FOR SPECIAL PURPOSE COMPANY IN ISLAMIC FINANCE**
- **Chapter (5): SPECIAL PURPOSE COMPANY (SPC) IN SUKUK STRUCTURING**
- **Chapter (6): CONCLUSIONS, RECOMMENDATIONS, AND FUTURE OUTLOOK**





CONCLUSIONS







Potential Applications for Findings





POTENTIAL APPLICATIONS OF FINDINGS

A Government Securities Market

- Helpful in decision making and policy formulation .
- Gain some basic/practical knowledge and background on the level of research in the SPC based Equity Sukuk field.

Explore Equity-based Structure that fulfill MaqÉÊid

- Provide Shari'ah Solution to Islamic debt-based instruments which use LIBOR



CHALLENGES

**Uniformity of
rules between
regulators
and
practioners.**

**Lack of
Sukuk data and
Solution's
parameters
Calibration**

Transparency

THANK YOU

INVAH

ISLAMIC FINANCE

Research Institute