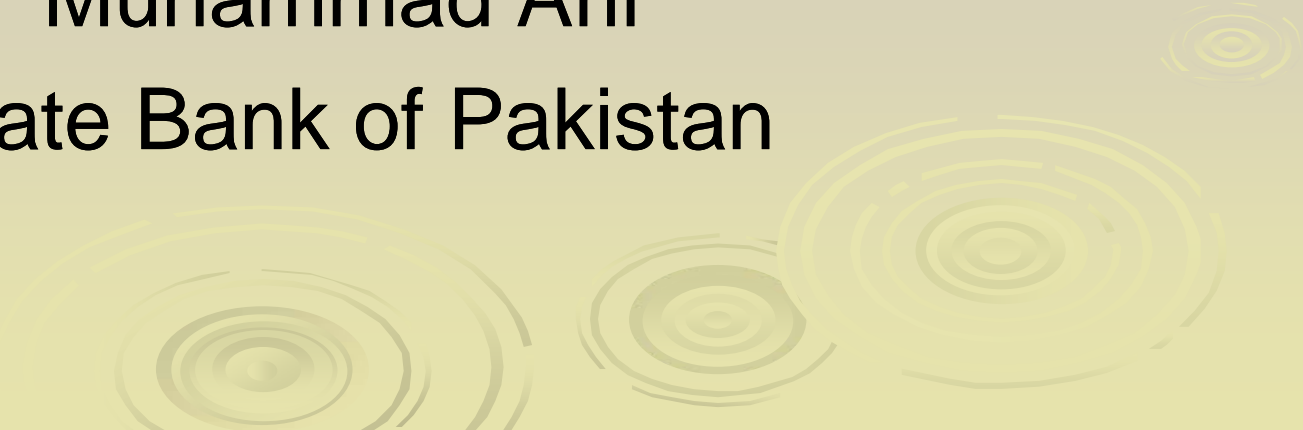


Corporate Sukuk Issuance and Prospects

(Utility and State Owned Enterprises)

Presented by
Muhammad Arif
State Bank of Pakistan



SUKUK

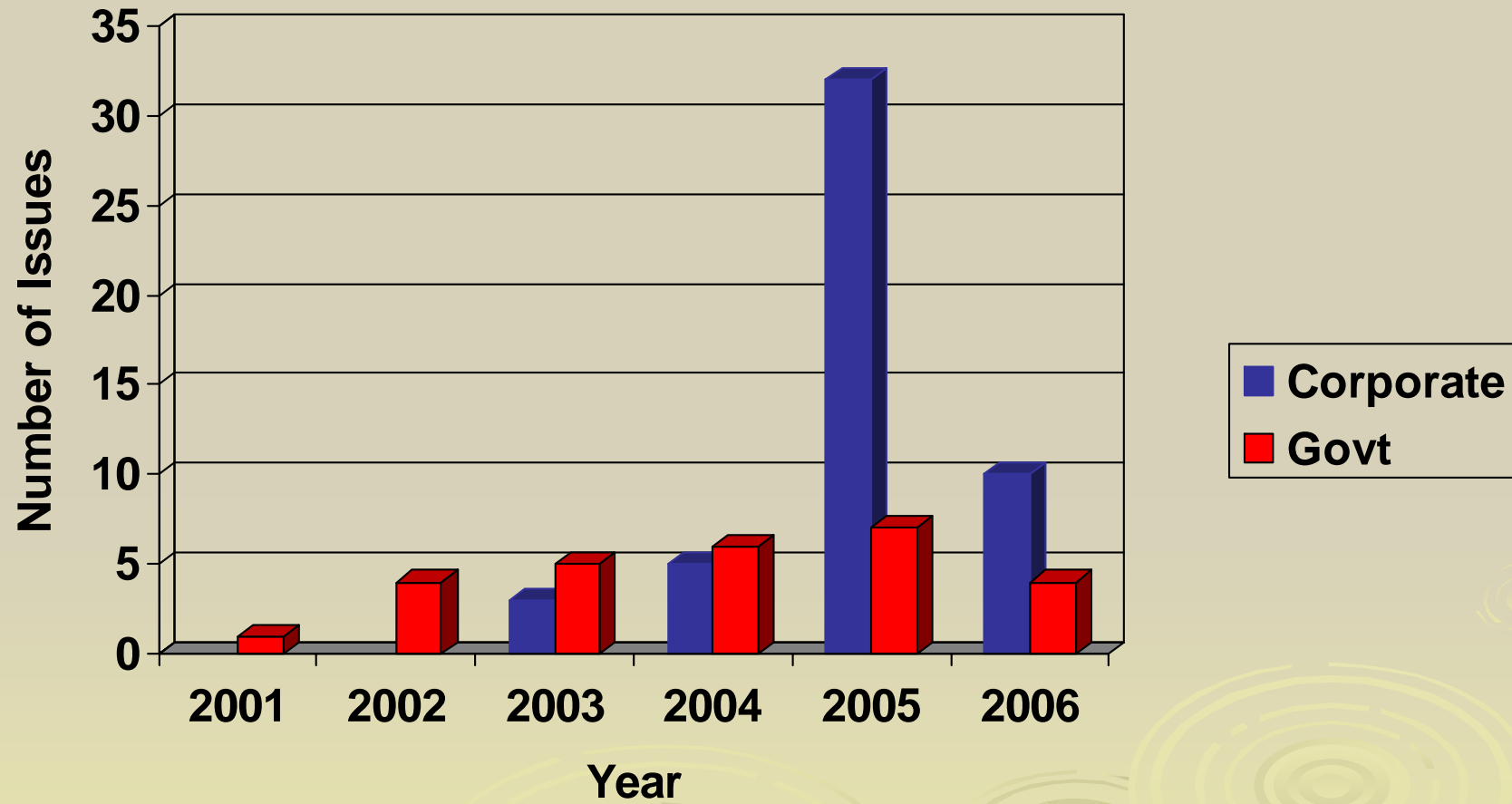
Definition

- ❑ Sukuk Certificates represent proportionate beneficial ownership and may be described as an Islamic Bond for a defined period the risk and return on which is associated with cash flows generated by a particular asset belonging to the investors i.e. Sukuk holders.

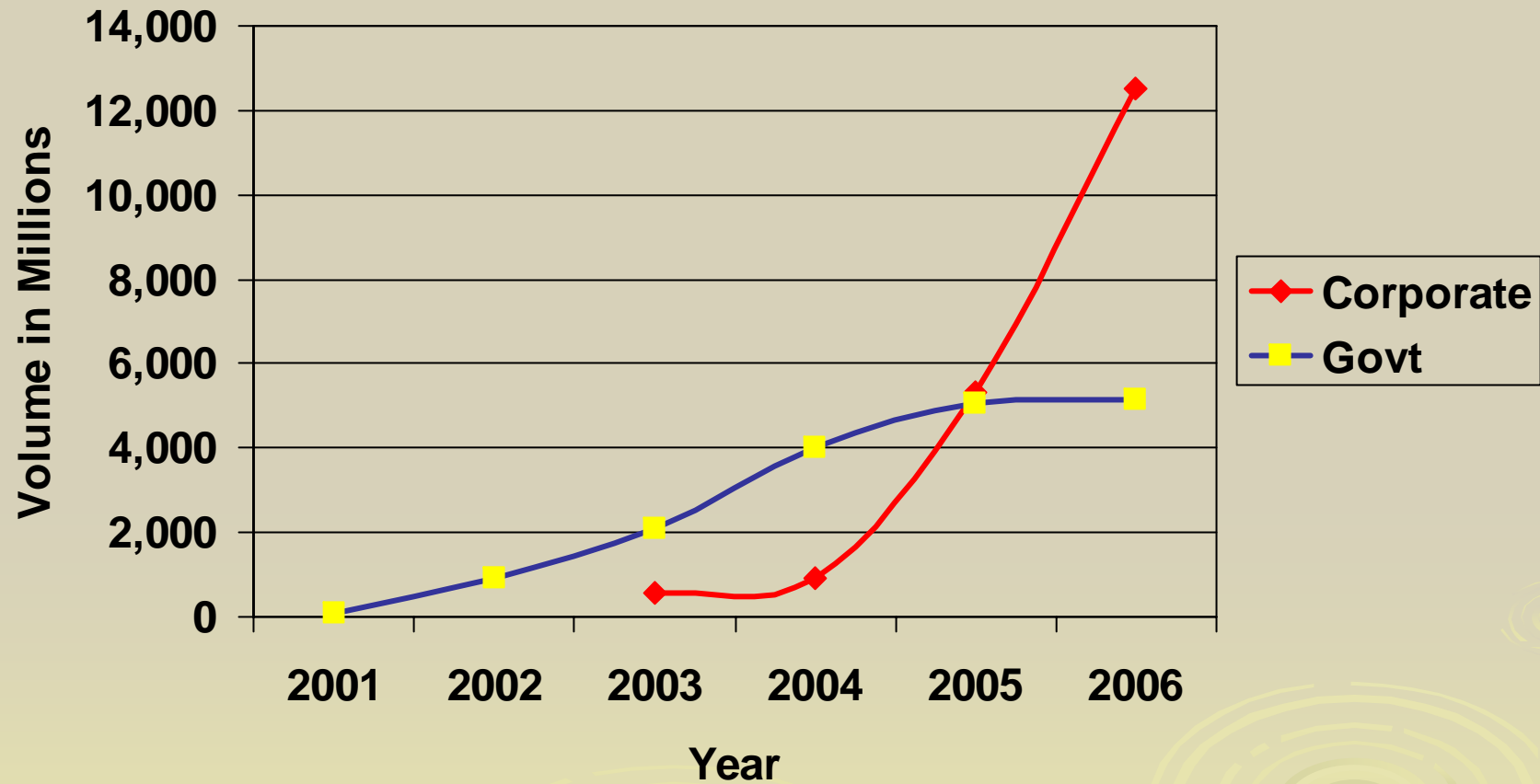
Structure

- ❑ Sukuks must be asset linked.
- ❑ Backing by real assets make it tradable.
- ❑ linking to pure receivables encounter it with prohibition for secondary market trading. However this can be overcome by mixing it with mode having its backing by real assets.
- ❑ The periodic payments and scheduled amortization of the principle due to investors are structured matching with the income and capital returns arising out of the underlying assets.
- ❑ The profit payment can be fixed or benchmarked to the inter-bank offered rate plus a margin

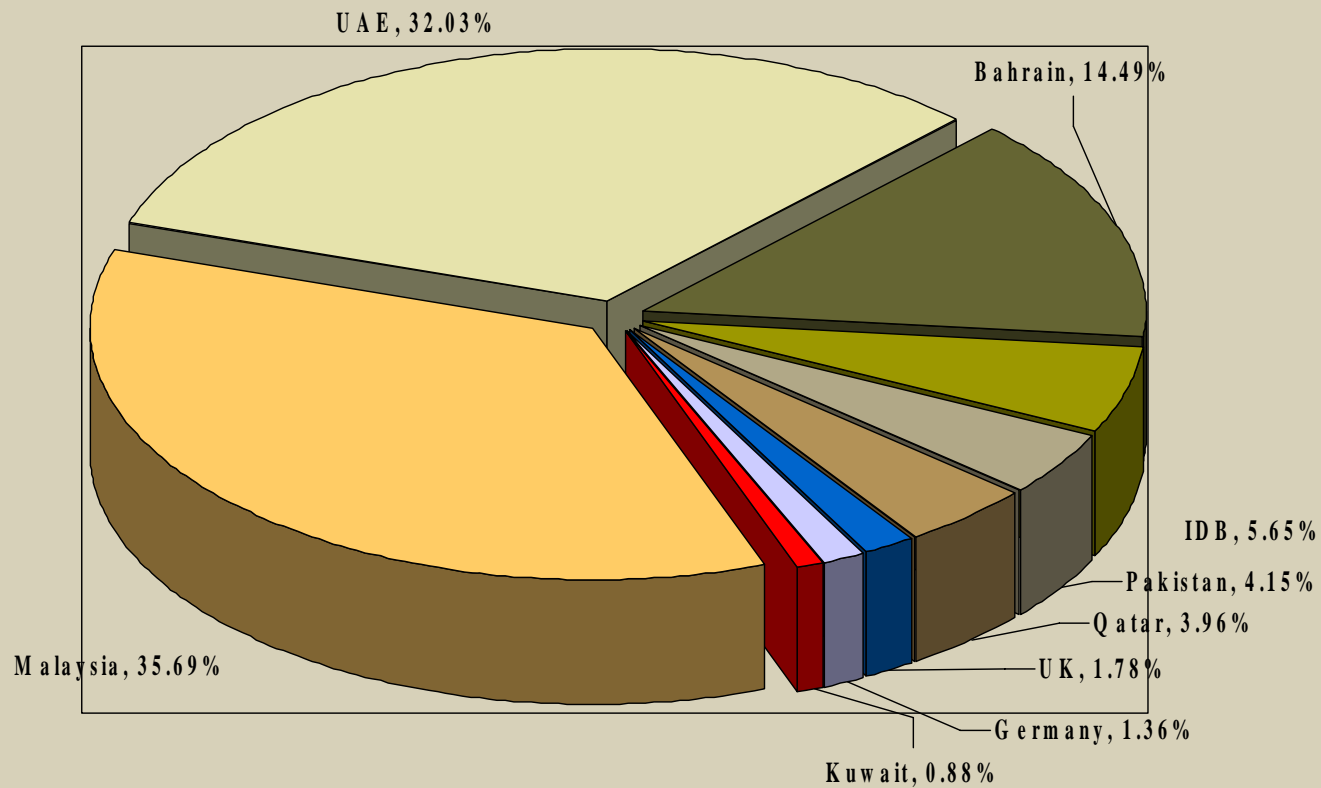
Global Sukuk Issuance



Global Sukuk Volume



Global Sukuk- Countries Share



Need

Sukuks are required for:-

- Investors to place their funds in accordance with Shariah compliant principles.
- Govts/Corporates to raise funds for their working capital/Project financing under Shariah Compliant framework.
- Financial institutions undertaking shariah compliant business for their liquidity management

Driving Force

Three main driving forces behind the development of the Sukuk market are :-

- Growing demand by the investors for shariah compliant instruments (competitive yields provide better results).
- Desire of the Corporates to raise shariah compliant funds cost effectively.
- Features of Sukuks as such that they can be used as liquidity management instrument by the Financial institutions undertaking Shariah Compliant business and for their use as monetary policy tool.
- innovations are required to match these all extremes

International Experience-Malaysia

Share of Malaysia in Global Sukuk Market is 36%.

Steps taken on Supply side include:-

1. Government and regulatory support for bringing Shariah compliant legal framework.
2. Consistent supply of Sovereign as well Corporate Sukuks.
3. Innovations like offering new sukuku i.e. Khazana Exchangeable , Mukah Mudarabaha and plus Musharakha sukuku etc.
4. Sukuku in any currency and by offering both to residents and non-residents.

Steps taken on Demand side include:-

1. Developing Islamic Interbank Market with ample number of Islamic Financial institutions.
2. Facilitating entry of foreign fund managers/Tax exemptions to non residents.
3. Developing Islamic Funds/ REITs/ Infrastructure financing sector.

International Experience-UAE

Share in Global Sukuk Market is 32%.

Steps taken on Supply include:-

- Government and Regulatory support with consistent supply of Sukuks.
- Innovations like introduction of convertibles and issuance of large size Sukuks.

Steps taken on demand side include:-

- Developing Islamic Interbank market and listing of Sukuks at Stock Exchanges.
- Focusing Onshore/offshore investors.
- All sectoral Financing viz: Infrastructure financing, Construction, Trade, Oil, Industrial investment are now being raised through Islamic mode.

International Experience-Bahrain

Share in Global Sukuk Market is 15%.

Steps taken on Supply side:-

1. Short-term as well long term, tradable, asset-backed sukuk have been provided by the Government in collaboration with BMA consistently since 2001.

Steps taken on Demand side

1. The Sukuks were listed on the Bahrain Stock Exchange to enable their trading in the secondary market for its investors.
2. LMC was established to facilitate the creation of an interbank money market.
3. Government projects/Infrastructure financing projects carried out by Private/Public entities being financed by Islamic mode.
4. Focusing onshore/offshore investors.

KEY CONSIDERATIONS FOR SUCCESS

- Proper Shriah, legal and Regulatory framework.
- Islamic Interbank market with ample number of participants.
- innovation in Sukuk products by focusing on its pricing and risk characteristics (The success in this respect is evident from the fact that in Sukuks 40-50% investment have come from conventional investors) .
- Presence of short term as well long term Sovereign sukuk with consistent supply.
- interbank market infrastructure.
- Tradability factor of Sukuk for its use by market participants as well Central Bank for its monetary policy operations.
- Developing investor base i.e. Islamic Funds/REIT/Infrastructure financing and providing incentives like tax exemptions.
- Developing Domestic Capital market.

PAKISTAN



Growth of Islamic Banking in Pakistan

Islamic Banking Players	2003	2004	2005	2006
Number of Islamic Banks	1	1	2	4
a) Number of branches of Islamic Banks	8	10	32	48
Number of Conventional banks operating Islamic Banking Branches	0	5	9	11
b) Total Number of Standalone Islamic Banking Branches of Conventional Banks	0	10	30	39
Total Islamic Banking Branches (a+b)	8	20	62	87

Growth Trends

Rs. in Millions

Description	June 2003	June 2004	% Growth	June 2005	% Growth	June 2006	% Growth
Deposits	6,517	13,158	102%	37,835	188%	59,657	58%
Financing & Investments	5,421	13,102	142%	37,171	184%	57,936	56%
Total Assets	8,821	18,830	113%	54,017	187%	87,603	62%

Status of Sukuk Issuance in Pakistan

- No GOP Sukuk issued.
- The Sukuk issued in Corporate market are:-

Sukuk	Tenor	Amount	Return
Sitara Chemicals	5 Years	360 million	Variable
Al Zamin Lease-II	5 Years	275 million	P&L sharing
Wapda Sukuk	7 Years	8 Billion	6-month KIBOR+35bps

Prospects

- Potential of Capital market growth is enormous in Pakistan due to its geographical location/natural requirements
- PSEs / Utility services / Sub national authorities require huge financing for carrying out developments in their respective areas.
- To mitigate moral hazard/agency problem Securitization / Islamic Financing are the most appropriate techniques.
- Apart from Federal Government support, Infrastructure financing requirements estimated in the respective areas in next 10-15 years are as under.
 - Ports = Rs 104 billion
 - Aviation= Rs 133.9 billion
 - Energy = Rs 1,102 billion from Private/Federal Government
 - KESC = Rs 58 billion
 - Water Resources = Rs 219 billion
 - Fuel Sector = Public Sector Rs 219 billion + private sector Rs 174 billion

Issues

- Sovereign Sukuk market not existing.
- Islamic Interbank market is at infancy.
- Sub National/Infrastructure/mortgage instruments markets yet to emerge.
- Islamic financial/Takaful Industry is at early stage of development.
- Primary Sovereign/Corporate Sukuk market has yet to take shape. So obviously Secondary Market that follows Primary market is altogether non existing.
- Islamic Financing activities not yet part of Monetary Policy Operations.

Recent Domestic Sukuk Issuances

2006 has proved good for Sukuk market in Pakistan and following Sukuks have been issued in the 2nd H/Y 2006 or are in the pipeline. They all represent Public Utilities/PSEs/Private Sector.

- Sitara Chemical Industries Limited : Standard Chartered Bank
1,100,000,000 June-06
- Sitara Chemical Industries Limited : Meezan Bank Limited
625,000,000 December-06
- Wateen Telecom : Standard Chartered Bank
1,200,000,000 December-06
- Sui Southern Gas Company Ltd : Standard Chartered Bank/Dubai Islamic
1,000,000,000 in Process
- Karachi Shipyards & Eng Work : Dubai Islamic Bank /Jahangir Siddiqui
3,500,000,000 in Process
- Pakistan International Airline : Citi Bank
2,000,000,000 in Process

Way forward

- ❑ Creation of Primary Sovereign Sukuk Market first.
- ❑ Creation of critical mass in Sovereign market to the level of Rs 30 billion. This would enable Islamic banks to meet their reserve requirements leaving some mass for secondary market trading.
- ❑ Creation of Repo market by innovating some model in accordance with our Shariah requirements and devising documentatation/ master Repo agreement.
- ❑ Making Islamic financing activities part of Monetary policy Operations. This can be done through introduction of short term Islamic MM instrument mimicking features of T.Bills/legislative changes/providing infrastructure.
- ❑ Install Price dissemination mechanism.
- ❑ Sequencing these developments

Conclusion

- SBP is coordinating with IFSB/IIFM in developing Islamic MM and Sukuk Market.
- In house SBP has also formed a Task Force to develop Islamic MM and suggest GOP regarding structure/Issuance of Sovereign domestic Sukuk.
- SBP is also coordinating with SECP to develop Corporate Bond Market by making them cost effective and by providing requisite market infrastructure. This would facilitate Corporate Sukuk issuance as well.

Thanks

