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IIFM's Sukuk Documentation & Market Guidelines Standardization Initiative

Thursday, 29th March 2018, Crowne Plaza Hotel, Ankara, Turkey
10th Meeting of the COMCEC Financial Cooperation Working Group
“The Role of Sukuk In Islamic Capital Markets”

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(Senior Unsecured & Perpetual)

Background Information on IIFM Sukuk Standardization Initiatives



➤ Comprehensive Industry Consultative Process

- Two Consultative Meetings & Several rounds of consultation with major institutions, regulators, law firms and other market participants

➤ Standardization Objectives

- Ensuring that market standardization requirements are addressed and buy-in of key stakeholders is in place
- Creation of transparent, robust and deep Sukuk market



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General Sukuk Market Guidelines

Sukuk Market Guidelines



1	Develop Standard Terms & Conditions that would apply to all <i>Sukuk</i> irrespective of the structures.
2	Develop general guidance notes for market participants such as process flow on developments and performance of the underlying assets, build- in provisions to make an exchange program in the event of default i.e. convert a capital market issue into a debt (can it be mandatory for all <i>Sukuk</i> .)
3	Follow one <i>Sukuk</i> Structure at a time and establish priority.
4	Develop Guidance notes specific to the selected <i>Sukuk</i> structure.
5	To improve transparency, provide disclosure guidance notes on implication on Balance sheet, Capital, <i>Shari'ah</i> and risk disclosures.
6	Naming of <i>Sukuk</i> SPV correctly and clearly (in order to help identify the credit risk and the issuer. Names like Wings, Danga etc does not provide any immediate indication of the actual credit risk). Standard or guidelines to be provided. (Should <i>Sukuk</i> name also identify the <i>Shari'ah</i> Structure?).
7	SPV ownership - Independence of SPV- (Should the issuing Corporate control the SPV or it must have independence? Should the purpose of establishing SPV to be logistical purpose only or it should have a greater role
8	Condition on Use of Funds and type of Asset or Business that would comply for <i>Sukuk</i> .

Sukuk Market Guidelines (Continued)

9	Purchase Undertaking (need to address, clarify, define Purchase undertaking by the issuer of a <i>Sukuk</i> , especially in terms of buying back at Initial price, market price, or by a formula agreed at inception.
10	What exceptions if any can be considered when Sovereign is issuing a <i>Sukuk</i> .
11	Continuous <i>Shari'ah</i> monitoring of <i>Sukuk</i> terms for Non compliance. Should each <i>Sukuk</i> have a <i>Shari'ah</i> monitoring till maturity, either by a <i>Shari'ah</i> scholar, a panel of <i>Shari'ah</i> Scholars or by the Lead Managers <i>Shari'ah</i> team.
12	Role of trustee – In <i>Sukuk</i> , Should Trustee be involved in <i>Sukuk</i> offering documentation, its role with ongoing processes / Redemption and Event of Default.
13	The role of trust and does the trustee need to be empowered to protect the certificate holders on certain issues such as indemnities required by the lead bank third party guarantee – Should there be fee payment. What about Guarantee by Parent or by another sister Company?
14	Secondary market trading of <i>Sukuk</i> at discount or at par when tangible assets are either not there or has fallen below an agreed threshold.
15	Late payment of Periodic payment or late payment at maturity.
16	Methodology for dealing with minority creditors

Sukuk Market Guidelines *(Continued)*

17	Information flow between the lead manager and paying agent in special circumstances
18	Asset Based <i>Sukuk</i> versus Asset Backed <i>Sukuk</i> (obstacles and ways to promote issuance of Asset Backed <i>Sukuk</i>)
19	To assist due diligence process particularly for private deals the transaction document to be more informative
20	In case of restructured <i>Sukuk</i> perhaps requirement of new assets as a replacement could be explored
21	Framework that support securitization and risk transfer mechanism
22	The restructuring of <i>Sukuk</i> and how differences, if any, in the case of restructured/renegotiated <i>Sukuk</i> are to be treated. Question will be when renegotiated amounts are lower than the original <i>Sukuk</i> issue amount then how should the difference be treated in the books of the issuer? Would the difference be income or an item of equity? What level of disclosure should be provided by the issuer in these circumstances?
23	The proportion of tangible and intangible assets related to Istithmar <i>Sukuk</i> in general
24	Enforceability of foreign judgments or awards in the local jurisdictions and suggestions for better enhancement to the reciprocal enforcement treaties

Other related issues

Documentation

- **Accounting Assessment**
- ***Shari 'ah* elements disclosures**
- **Legal Opinion**
- **Rating Mechanism**



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Sukuk Market Guidelines (Default & Restructuring)

Market Guidelines on Critical Issues – Sukuk Default & Restructuring



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- Information in Sukuk prospectus on which investors' relied upon is generally incomplete or not transparent.
- Sukuk are mostly “Asset-Based” incorporating income and capital guarantees into Sukuk.
- Head Lease and Sub-Lease were not registered; hence, legal title remained with the obligor.
- The rights of the Sukukholders are at times not clear.
- The “true” asset valuation.
- Leverage level of corporate need to be assessed and monitored; additional debt made it more risky.
- Obligor may have a rating while Sukuk could be unrated.
- Less regulatory surveillance if Issuer's choice of jurisdiction is off shore.
- Different legal regimes used to structure Sukuk that will effect Shari'ah interpretation.
- Weakness in the legal and regulator system both for conventional and Islamic.
- Auditors who did not object to a rather narrow views of the activities of group activities.
- Sukukholders generally rely on the reputation of the Arrangers and Trustee's (conduct proper due diligence).
- Mode of restructuring / liquidation in the event of default is not clearly defined in Sukuks.
- Asset-Based Sukuks are structured as debt instrument on the grounds that **“this is what investors were looking for and this is what market wants”**



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Sukuk Al Ijarah Documentation Standard

Sukuk Al Ijarah Structure Diagram (SEC SUKUK)

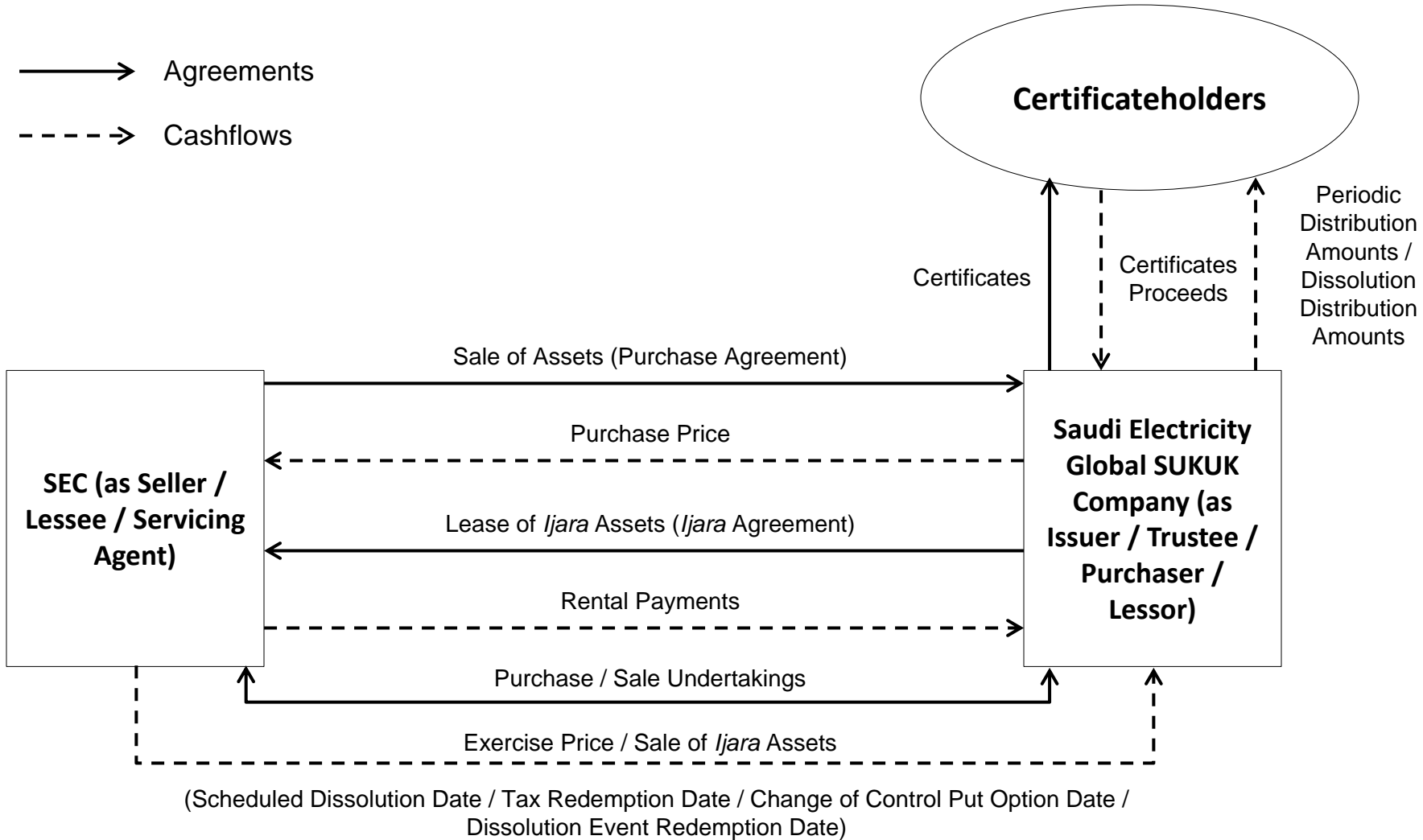


Diagram explanation

- I. SEGSC (as the Issuer/Trustee/Purchaser) will purchase power generation assets (*Ijarah* Assets) from SEC (as Seller/Lessee/Servicing Agent) pursuant to a Purchase Agreement.
- II. SEGSC (as the Lessor) will lease the relevant *Ijarah* Assets to SEC (as the Lessee) pursuant through an *Ijarah* Agreement.
- III. SEC will pay rental payments which are intended to be sufficient to fund the periodic distribution amounts to SEGSC.
- IV. The Trustee may, on the dissolution date, or prior thereto following the occurrence of a dissolution event, exercise its rights under the relevant Purchase Undertaking and require SEC to purchase the relevant *Ijarah* Assets as well as repay any unpaid and accrued periodic distribution amount.
- V. SEC may also, in the event that it wishes to cancel any certificate, exercise its rights under the Sale Undertaking, to require the Trustee to transfer the relevant *Ijarah* Assets to it.
- VI. The consideration payable by SEC upon, exercise of a Purchase Undertaking or a Sale Undertaking shall be the relevant Exercise Price.

Issues related to Sukuk Al Ijarah structure



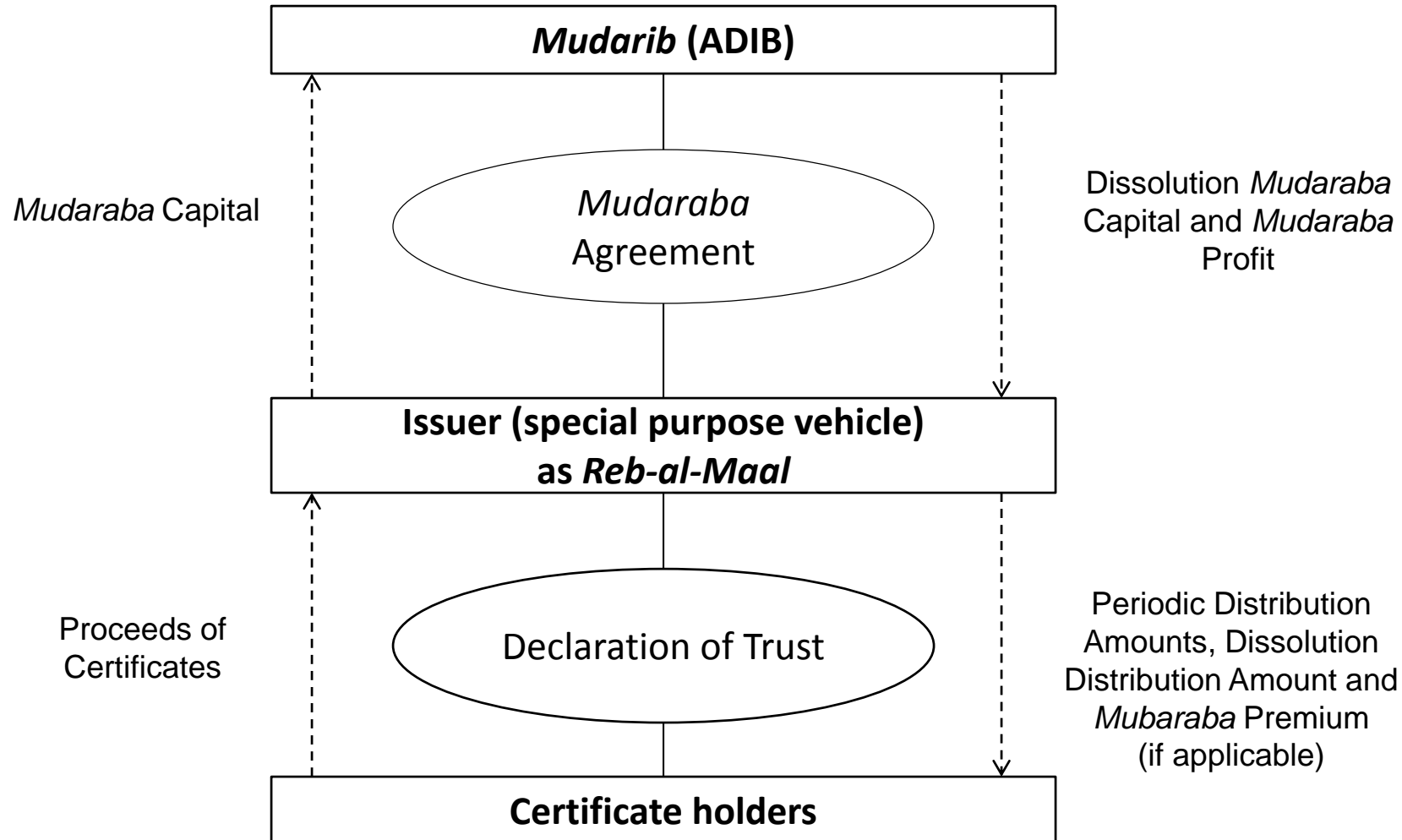
- Majority of *Sukuk* are Asset Based i.e. only beneficial transfer of ownership
- Obstacles in Asset Backed *Sukuk* issuance and ways to improve very low level of Asset Backed *Sukuk* issuances.
- Common *Ijarah Sukuk* Structure needs clearer understanding. Head Lease & sub Lease, requires some form of legal and *Shari 'ah* clarification and understanding. This could be part of disclosures or guidance notes
- Asset Valuation- Market price, Book Value, OR What?
- Maintenance of Leased Asset and ensuring the Assets are free and encumbered.
- Assets can be “sold” does the constitution or Articles of Association allows disposal of Assets.
- Assets can be transferred legally. Suppose a building or land is sold and leased backed and the Asset are not transferred at the Land Registry. Its implication from *Shari 'ah*, legal and accounting perspective.
- Takaful or Insurance. Use of Asset loss cover, unavailability of Takaful and who is responsible to arrange cover and who pays.
- Supplementary Rentals *Shari 'ah* guidance required.
- Forward lease – *Shari 'ah* guidance required



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Sukuk Al Mudarabah Documentation Standard

Sukuk Al Mudarabah Structure Diagram (ADIB Sukuk)



Analysis of Structure and Cash flows

- I. On the Issue Date, ADIB Capital Invest 1 Ltd. (a special purpose vehicle) will issue the Certificates, and the Certificate holders will pay the issue price in respect of the Certificates to it (as Issuer/Trustee).
- II. ADIB Capital Invest 1 Ltd. will apply the proceeds of the issuance of the Certificates towards the capital of the *Mudaraba* pursuant to the *Mudaraba* Agreement (the “***Mudaraba* Capital**”).
- III. ADIB (as *Mudareb*) will invest the *Mudaraba* Capital in the business activities of ADIB in accordance with an agreed Investment Plan prepared by the *Mudareb*.
- IV. Unless a Non-Payment Event or a Non-Payment Election has occurred, prior to each Periodic Distribution Date, the *Mudareb* shall distribute the profit generated by the *Mudaraba* to both the Issuer and the *Mudareb* in accordance with an agreed percentage split (90 per cent. to the Issuer (as *Rab-al-Maal*) and 10 per cent. to the *Mudareb*). Payments of *Mudaraba* Profit by ADIB (as *Mudareb*) are at the sole discretion of ADIB (as *Mudareb*) and may only be made in circumstances where ADIB will not be in breach of certain conditions as a result of making such payment. The *Mudareb* shall not have any obligation to make any subsequent payment in respect of such unpaid profit (whether from its own cash resources, from the *Mudaraba* Reserve or otherwise).
- V. The Issuer shall apply its share of the profit (if any) generated by the *Mudaraba* on each Periodic Distribution Date to pay the Periodic Distribution Amounts due to the Certificate holders on such date.
- VI. The Certificates are perpetual securities in respect of which there is no fixed redemption date. Accordingly the *Mudaraba* is a perpetual arrangement with no fixed end date.

Analysis of Structure and Cash flows

(Continued)

VII. Subject to certain conditions, ADIB (as *Mudareb*) may at its option liquidate the *Mudaraba* in whole, but not in part, on the basis of an actual liquidation of the *Mudaraba* in the following circumstances:

- a) at its option on the First Call Date (being 16 October 2018) or any Periodic Distribution Date after the First Call Date; or
- b) on any date on or after the Issue Date (whether or not a Periodic Distribution Date):
 - A. upon the occurrence of a Tax Event (being circumstances where the *Mudareb* or the Issuer would be required to pay tax on amounts due under the *Mudaraba* Agreement or the Certificates, as applicable, due to a change in law); or
 - B. upon the occurrence of a Capital Event (being circumstances where ADIB is notified in writing by the UAE Central Bank to the effect that the notional amount of the Certificates which qualifies as regulatory capital would cease to qualify for inclusion in full in the consolidated Tier 1 capital of ADIB).

VIII. Upon the occurrence of the circumstances set out in paragraph (vii) above, the Trustee shall (only upon the instructions of ADIB) redeem the Certificates. Alternatively, upon the occurrence of a Tax Event or a Capital Event, ADIB (as *Mudareb*) may require the Trustee to make such variations to the terms of the Certificates and the *Mudaraba* Agreement as may be required to ensure that the Certificates become or, as appropriate, remain qualifying Tier 1 capital instruments. ADIB (as *Mudareb*) agrees in the transaction documents that such variation will not be materially prejudicial to the interests of Certificate holders.



Issues related Mudarabah Structure

- How liquidity is covered, what percentage of liquid asset to fixed asset in the pool.
- What's the maximum percentage of cash assets that can be acceptable
- Should there be an onus on someone to advice when breaching Asset ratio
- What form of Guarantees if any can be used
- Asset Ration Monitoring responsibility or leave to Issuers



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Thank You

***Shukran
Wassalamu 'Alaikum***

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