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Sovereign Finance Corporation

An Institutional Framework for Regular Issuance of Sovereign Sukuk

Financial Product Development Center
Islamic Development Bank Group

COMCEC Financial Working Group
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Sovereign Sukuk: Challenges

- Pledging sovereign assets
- Limited number of eligible assets
- Disconnection of finance from real activities
- Ad-hoc structures
- Reputational risks

What Do We Need?

- No pre-existing assets are required
- Ability to match the government financial plan with more granularly using regular issuances
- Ability to meet the needs of different classes of investors
- Economically efficient and sustainable structure

Sovereign Finance Corporation

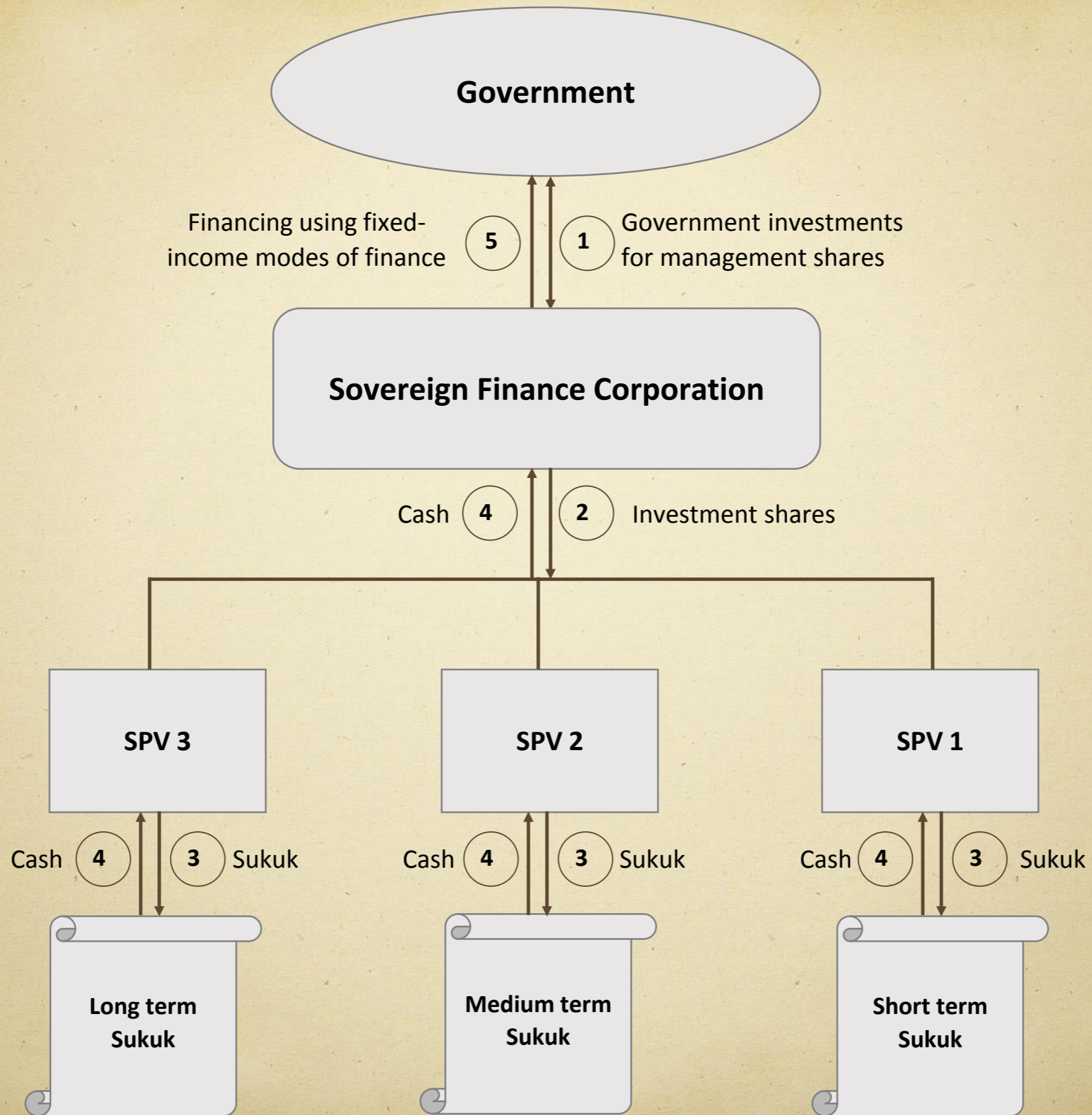
- A dedicated institution for issuing Sukuk to finance sovereign activities
- SFC finances the government using fixed-income modes (e.g. murabaha, leasing, istisna', ...)
- An institutional approach to Sukuk

Flexibility

- Sukuk are not constrained by tangible assets—only the real economic capacity
- Any Islamic fixed-income mode of finance can be used
- Serves both to securitize existing assets and to finance future activities (ex ante and ex post)

Sustainability

- Sukuk volume is scalable
- Sukuk can be issued on regular basis
- Various maturities can be issued to meet needs of different investor classes
- An institutional-based rather transaction-based approach



Issuing Shares

- ❧ SFC issues two classes of shares:
 - ❧ management shares (10-15%) to be held by the government in exchange for in-kind investments or assets
 - ❧ Investment shares (85-90%) to be held by SPV issuing the Sukuk for cash

Tradability

- Sukuk are backed by shares (asset-backed Sukuk)
- Shares of Islamic banks are tradable (OIC Fiqh Academy)
- Sukuk are tradable regardless of the composition of the assets of the SFC

Risk Profile

- SFC issues a conditional undertaking to buy Sukuk at nominal value subject to performance of underlying sovereign assets
- No guarantee: underlying assets fail only if the government fails—risk is sovereign risk
- Management risk is held by the government

Reserves

- Net returns are not distributed to Sukuk holders
- They are used to build reserves of the SFC
- Overtime, these reserves provide additional protection to Sukuk investors

Conclusion

- Preparations are underway for a pilot for the SFC
- How such a model may enhance public debt management?

Thank you!