



# ISLAMIC FINANCE GATEWAY

THE PULSE OF THE ISLAMIC FINANCIAL MARKETS

## SUKUK IN TAKAFUL INVESTMENT

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ITS 2013

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CAIRO – EGYPT



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## SUKUK PERCEPTIONS AND FORECAST FOR 2013

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### AGENDA



WHAT IS SUKUK?

SUKUK INSTRUMENTS IN  
TAKAFUL

SUKUK INVESTMENT  
OPPORTUNITY FOR 2013



REUTERS/Jose Gomez

# FROM CONECEPT TO PRACTICE

## SUKUK OVERVIEW



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## WHAT IS SUKUK?

- Sukuk (Islamic investment instruments, comes from the word “Sak”) are always linked to underlying assets (tangible / intangible), which represents a partial ownership in the assets. Islamic financing contracts representing ownership can be bought and sold, hence can be monetized in the form of tradable securities
- A Sukuk Represents:
  - An undivided proportionate beneficial ownership interest in an asset or portfolio.
  - The right to the Islamically acceptable income streams generated by the asset/portfolio
- Sukuk Structure:
  - Sukuk can be structured in a number of ways, depending on the underlying assets and the business purpose
  - While majority of the sukuk issued to date have utilized “Ijara” or “Musharaka” structures based on real estate as the underlying asset, the sukuk issued by Islamic banks and Finance Companies have used financial contracts as the underlying asset
- It works similar to a conventional bond in most characteristics such as trading, listing, rating etc. however, structured in a Sharia-compliant manner
- Sukuk provide access to a vast and growing Islamic liquidity pool, in addition to the conventional debt capital market investor base



## TYPES OF SUKUK

Short  
Term

SALAM

STRUCTURE BASED ON SPOT PAYMENT WITH FUTURE DELIVERY OF ASSET

MURABAHA

SUKUK STRUCTURE BASED ON A COST PLUS FINANCING CONTRACT , ASSET DELIVERED NOW WITH DEFERRED PAYMENT

Long  
Term

IJARA

SUKUK STRUCTURE INVOLVING THE SALE AND LEASE-BACK OF ASSETS IN EXISTENCE E.G REAL ESTATE, PLANT & MACHINERY, AIRCRAFT, SHIPS, OTHER TANGIBLE ASSETS. CAN ALSO BE STRUCTURED AS A MASTER LEASE/SUB LEASE STRUCTURE

MUSHARAKA

SUKUK STRUCTURE INVOLVING A PARTNERSHIP BETWEEN THE SPV AND OBLIGOR TO JOINTLY OWN EITHER READY ASSETS OR TO CONSTRUCT/MANUFACTURE ASSETS (REAL ESTATE/PROJECT FINANCING)

ISTISNAA

SUKUK STRUCTURE FOR CONSTRUCTION FINANCING (PROGRESS PAYMENT FOR ASSETS / PROJECTS UNDER CONSTRUCTION)

MUDARABA

A PARTNERSHIP / FUND MANAGEMENT CONTRACT BETWEEN AN INVESTOR (RAB-UL-MAL) AND A MANAGER (MUDARIB)





REUTERS/Aly Song

# NEED TO KNOW WHAT IS THE BENEFIT?

## SUKUK IN TAKAFUL INVESTMENT

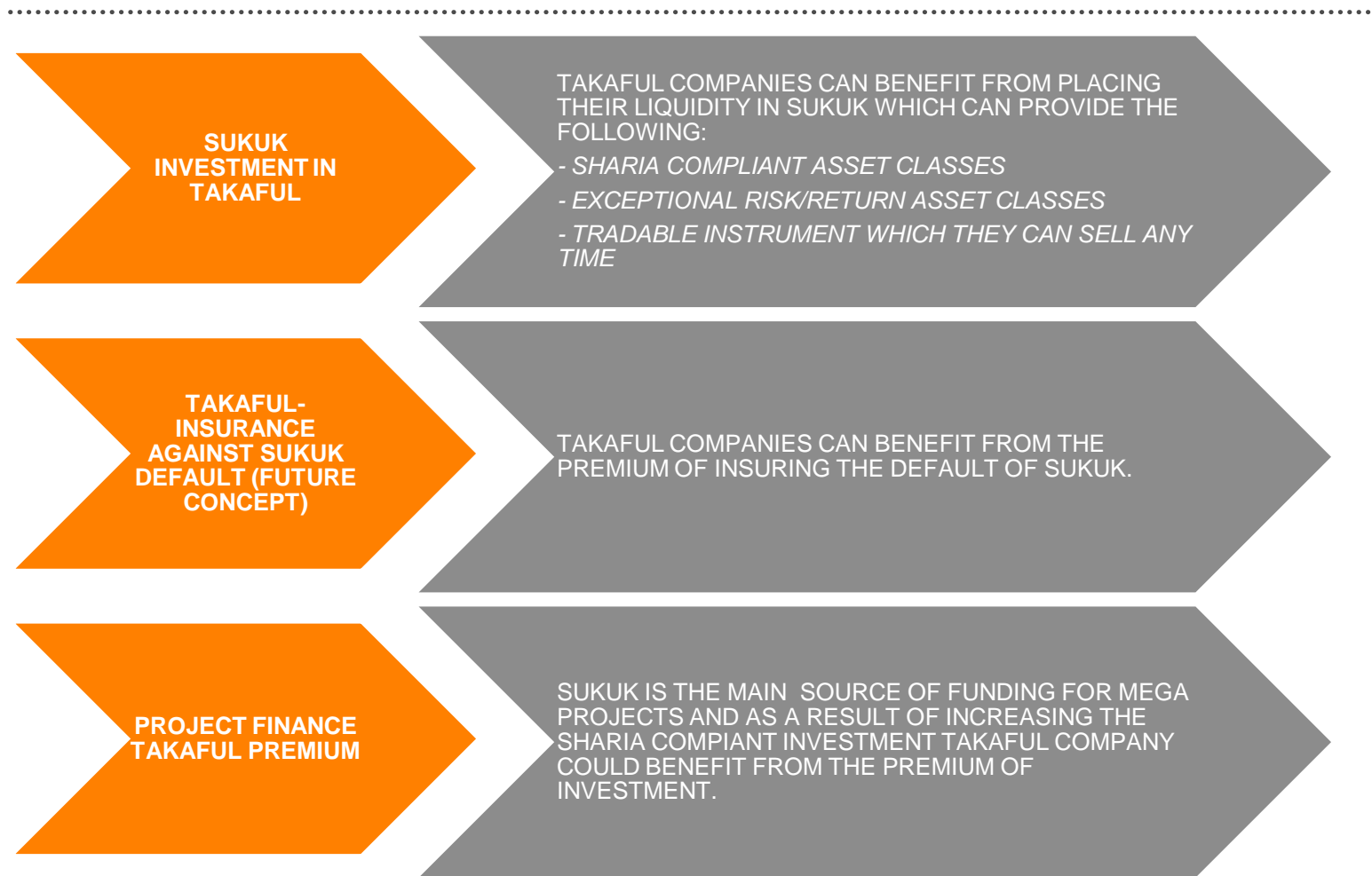


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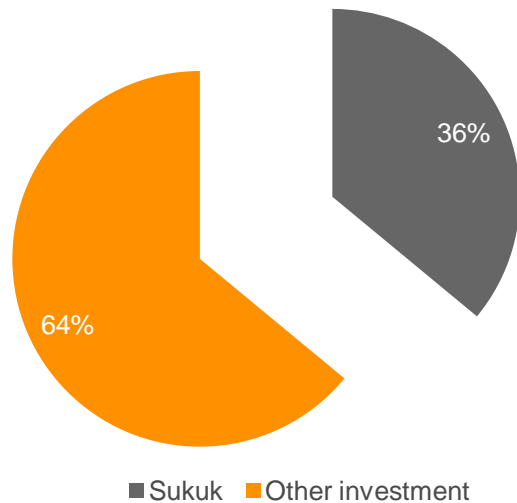


## SUKUK INVESTMENT IN TAKAFUL

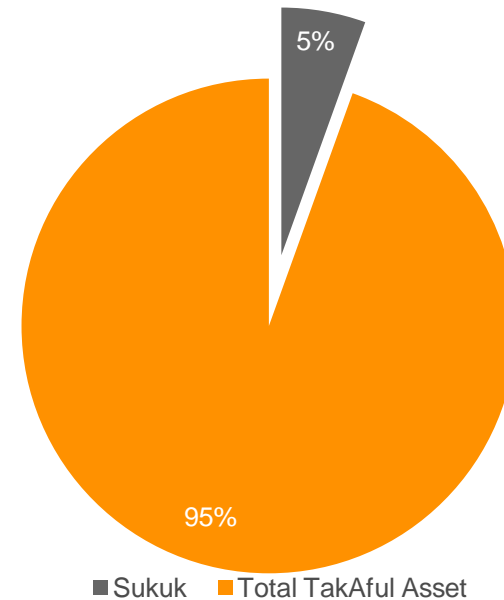


## HOW MUCH DOES THE TAKAFUL COMPANIES INVEST IN THE SUKUK MARKET? ...

SUKUK INVESTMENT IN THE TAKAFUL COMPANIES PORTFOLIO



SUKUK AS PERCENTAGE OF TOTAL ASSET



Source: Thomson Reuters EIKON





REUTERS/Vijay Mathur

# 360° ABOUT MOST PROMISING ASSET CLASSES

HISTORICAL TREND – RISK ASSOCIATE – FUTURE OUTLOOK



THOMSON REUTERS

zawya



REUTERS/Carlos Barria

# LOOKING BACK, WE FIND...

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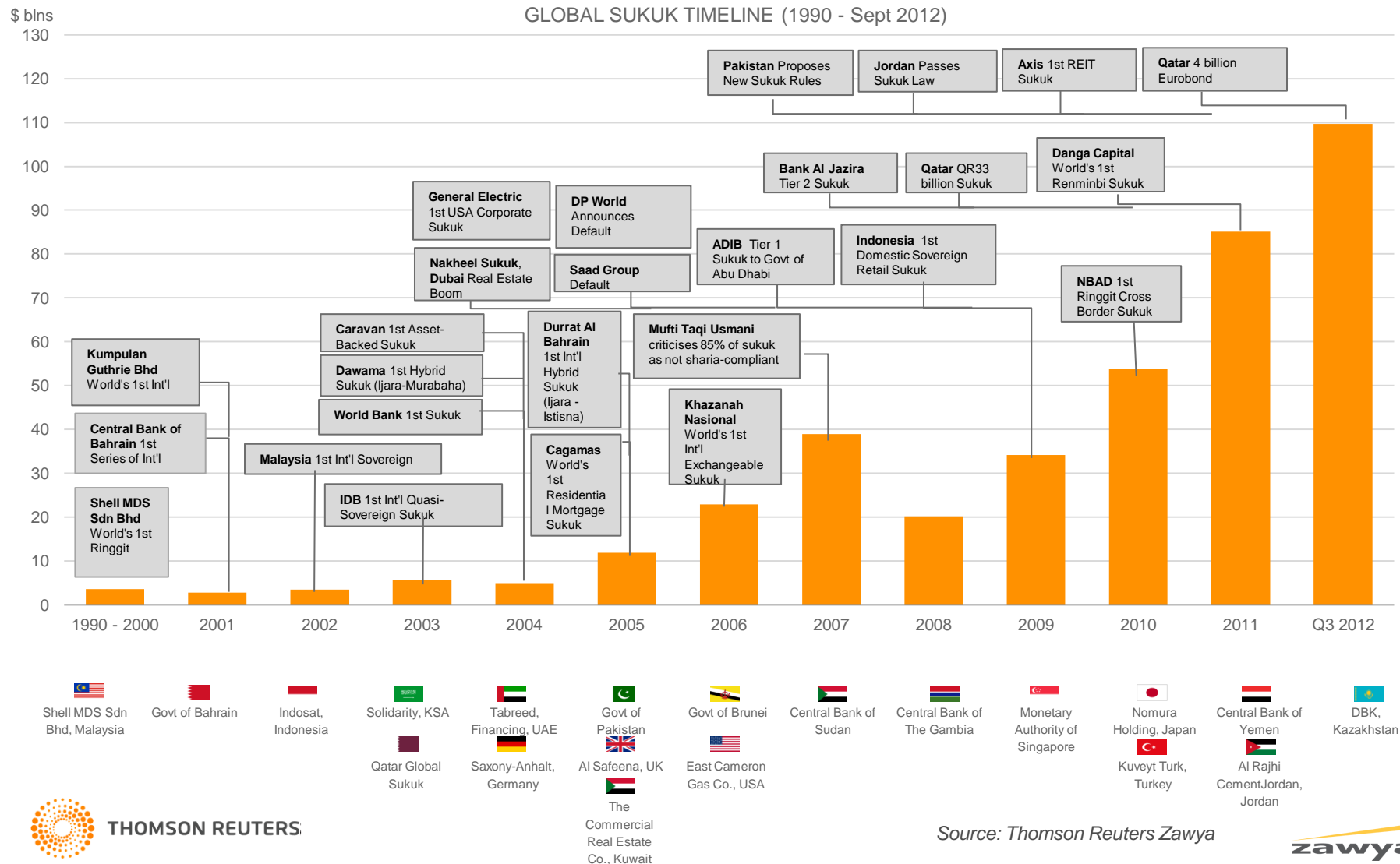
## KEY HISTORICAL TRENDS



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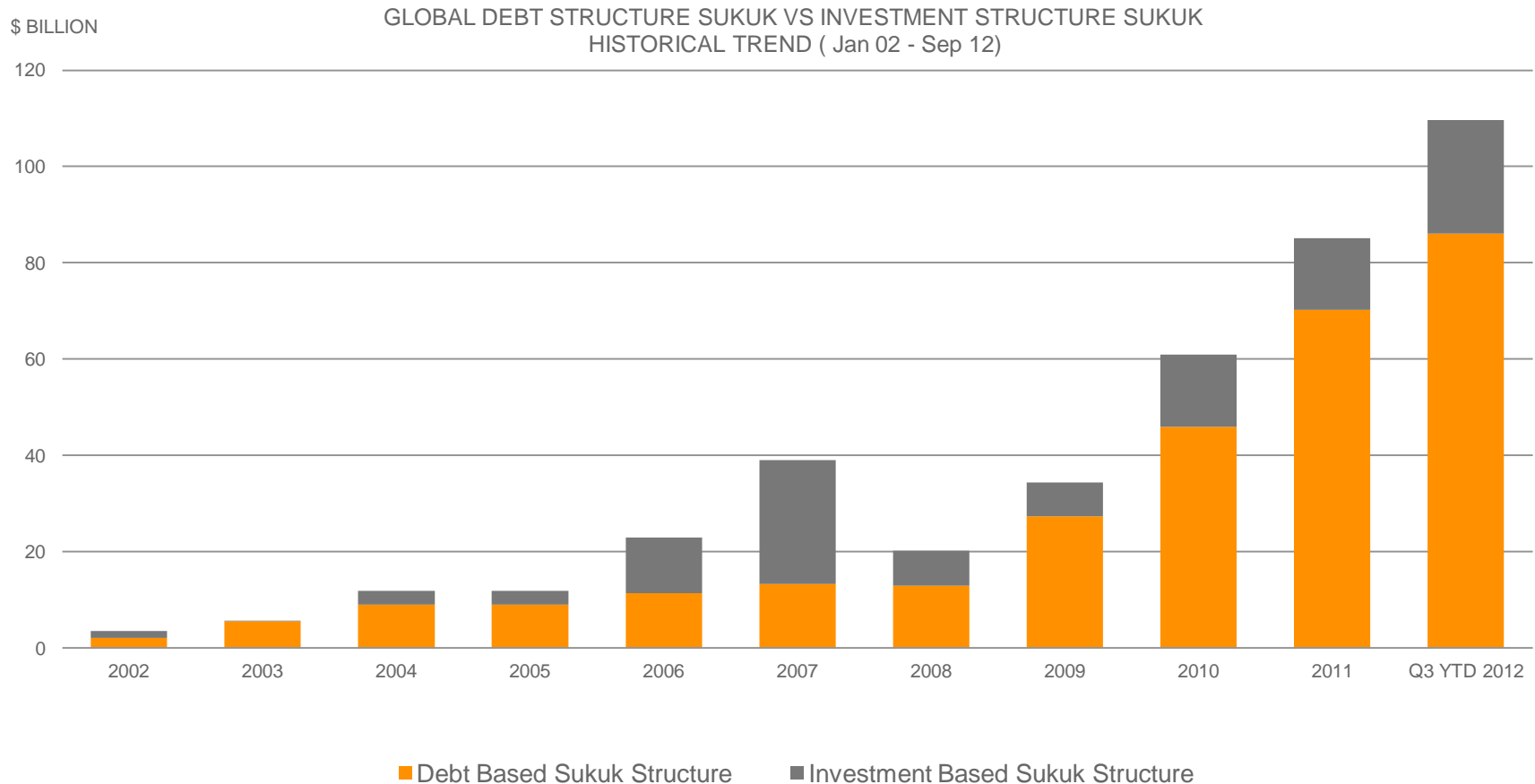


# SUKUK ISSUANCE HAS GROWN BOTH IN TERMS OF VOLUME AND ISSUER AND INSTRUMENT DIVERSITY...





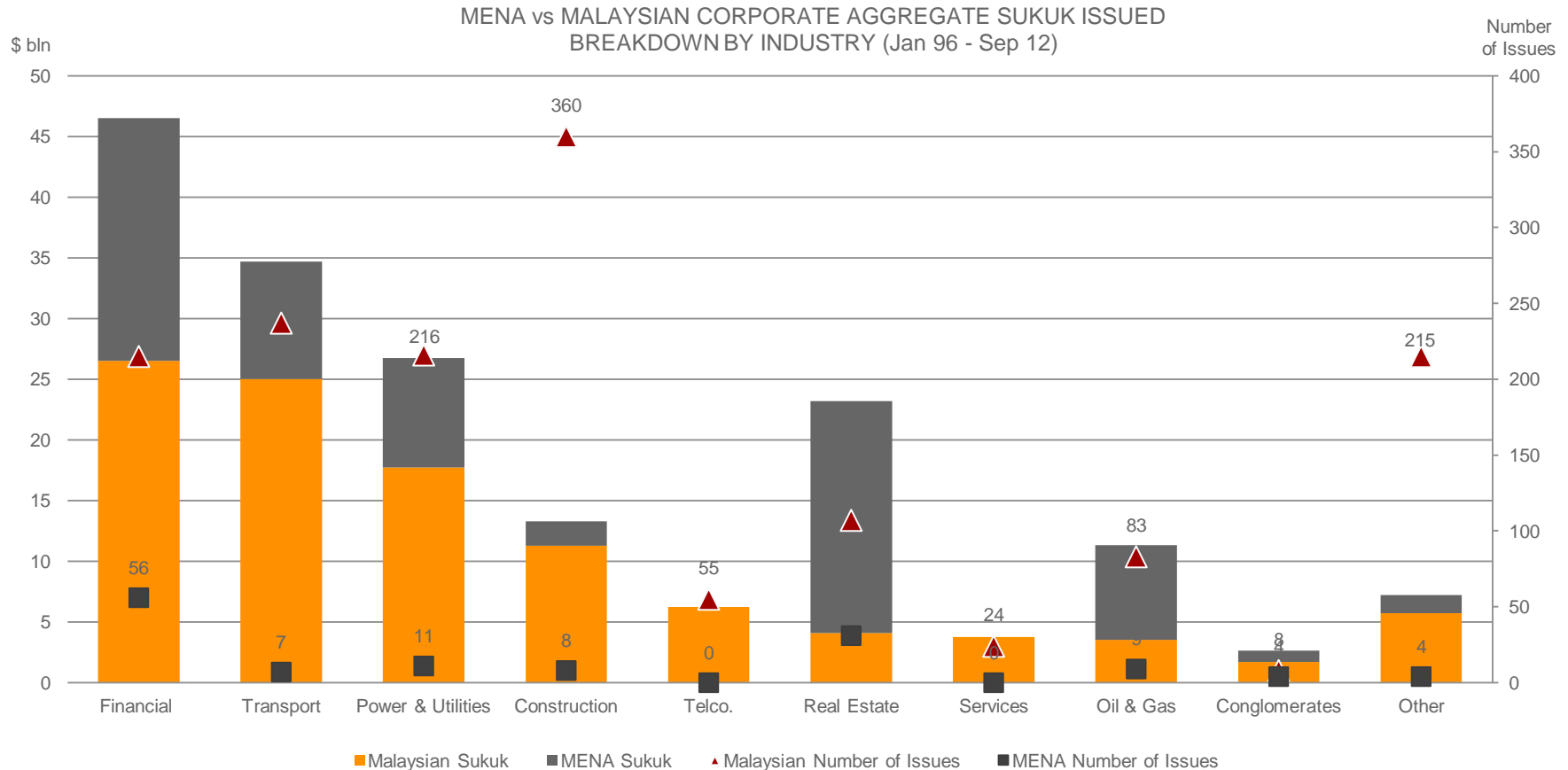
## ...MOST SUKUK HAVE BEEN DEBT BASED AS MAJORITY ORIGINATED IN MALAYSIA.. HOWEVER, INVESTMENT BASED SUKUK SLOWLY CATCHING UP...



Source: Thomson Reuters Zawya

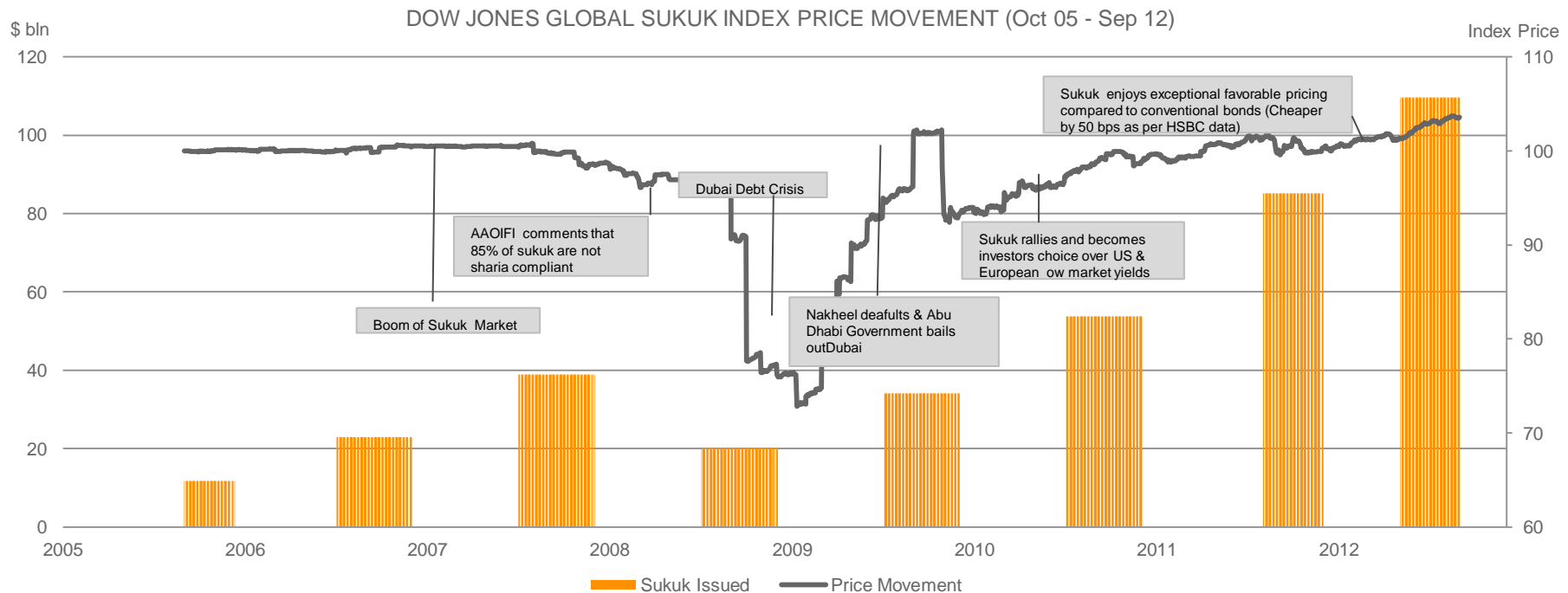


## ...INTUITIVELY, REAL ESTATE, FINANCIALS AND OIL AND GAS COMMAND A DISPROPORTIONATE SHARE OF ISSUANCES IN THE MENA REGION...



Source: Thomson Reuters Zawya

...WHILE PERFORMANCE AND ISSUANCE DIPPED DURING THE FINANCIAL CRISIS, SUKUK LARGELY REBOUNDED TO PROVIDE EXCEPTIONAL PERFORMANCE GOING FORWARD...

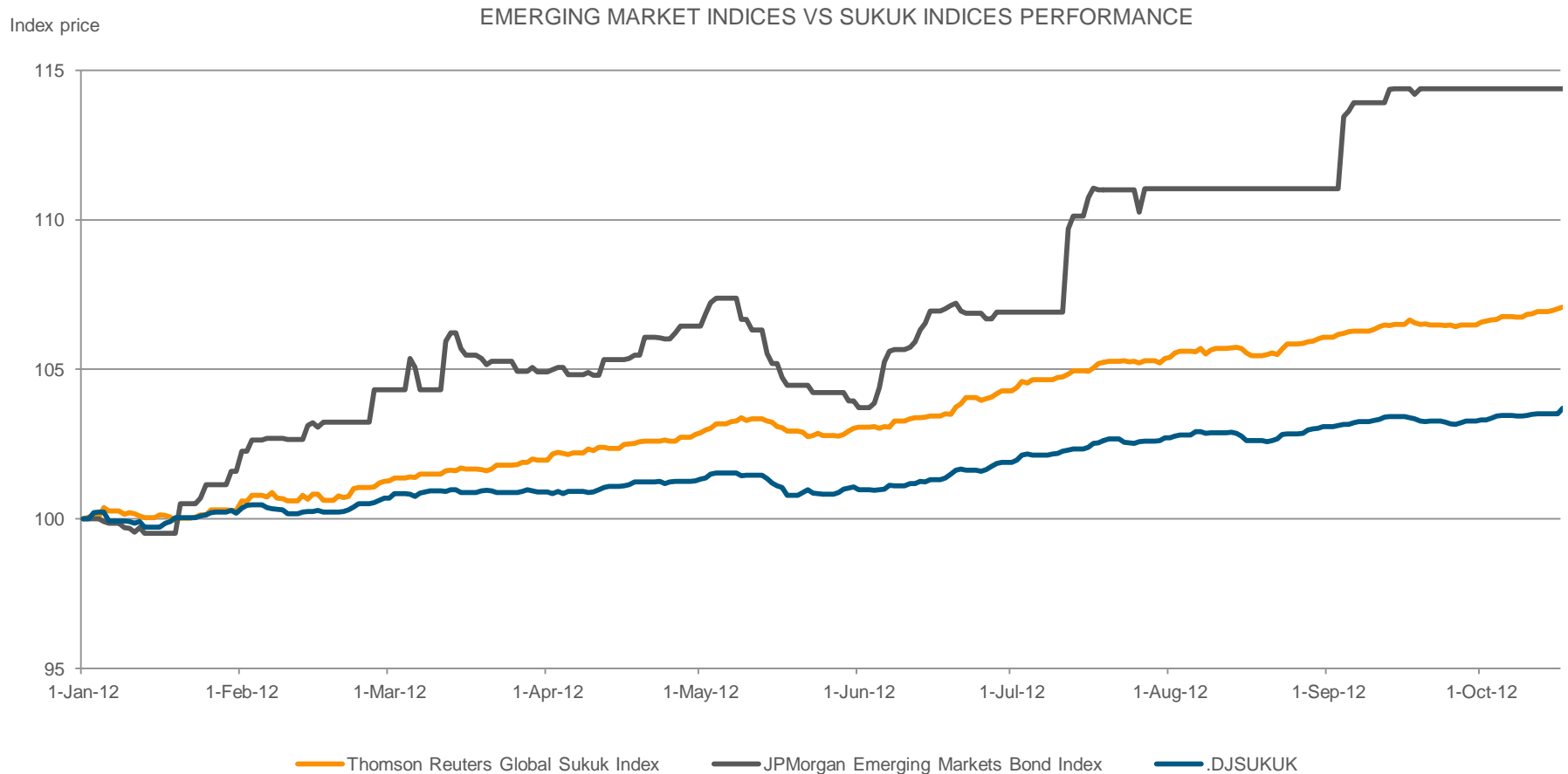


Source: Thomson Reuters EIKON





## ...YET SUKUK UNDERPERFORMED THIS YEAR WHEN COMPARED TO THEIR EMERGING MARKETS PEER...



Source: Thomson Reuters EIKON

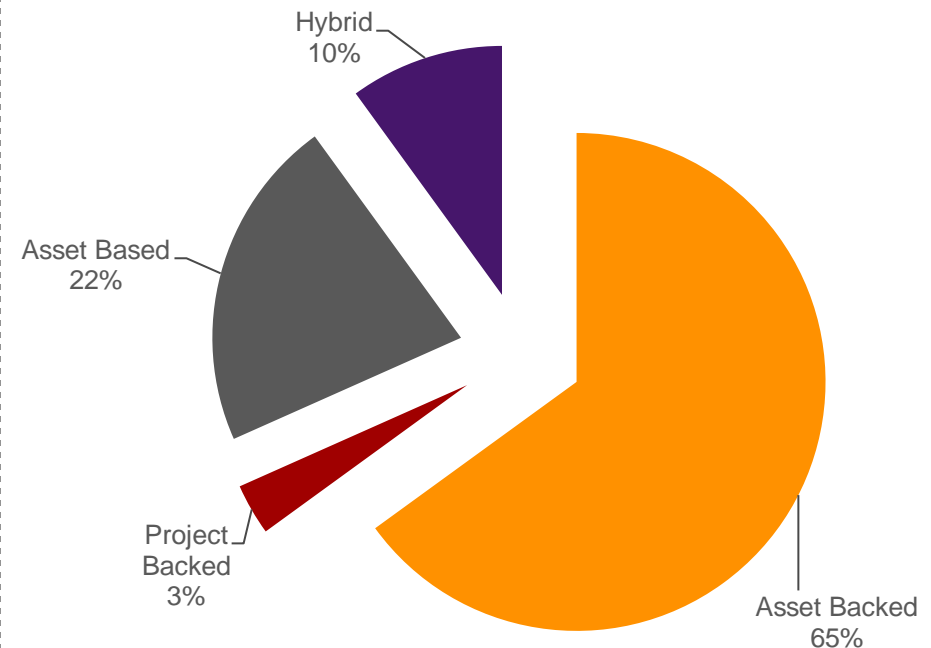


...BUT IN MARKED IMPROVEMENT IN QUALITY, MOST OUTSTANDING SUKUK ARE USUALLY STRUCTURED TO COMPLY WITH AAOIFI STANDARDS / GUIDANCE AND BACKED BY ASSETS...

OUTSTANDING INTERNATIONAL SUKUK BY  
AAOIFI COMPLIANCE AS OF SEPTEMBER 30,  
2012



OUTSTANDING INTERNATIONAL SUKUK  
BREAKDOWN  
BY RISK CLASSIFICATION AS OF SEPTEMBER 30,  
2012



Source: Thomson Reuters EIKON





REUTERS/Beawiharta

# LOOKING TO THE FUTURE....

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## SURVEY FINDINGS



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# I NEED DOLLARS...

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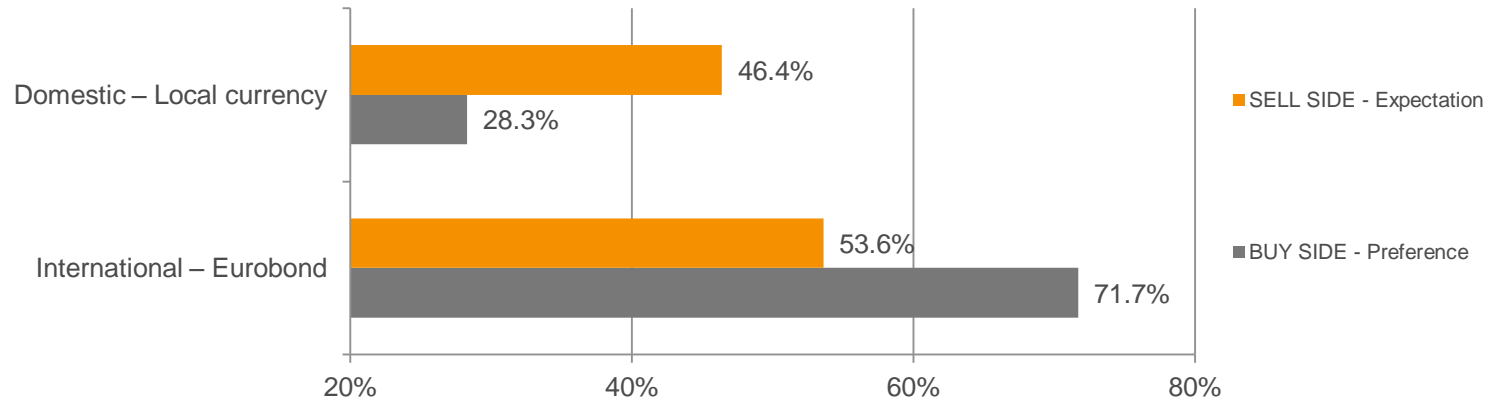
## CURRENCY AND MARKET OF ISSUE PREFERENCES



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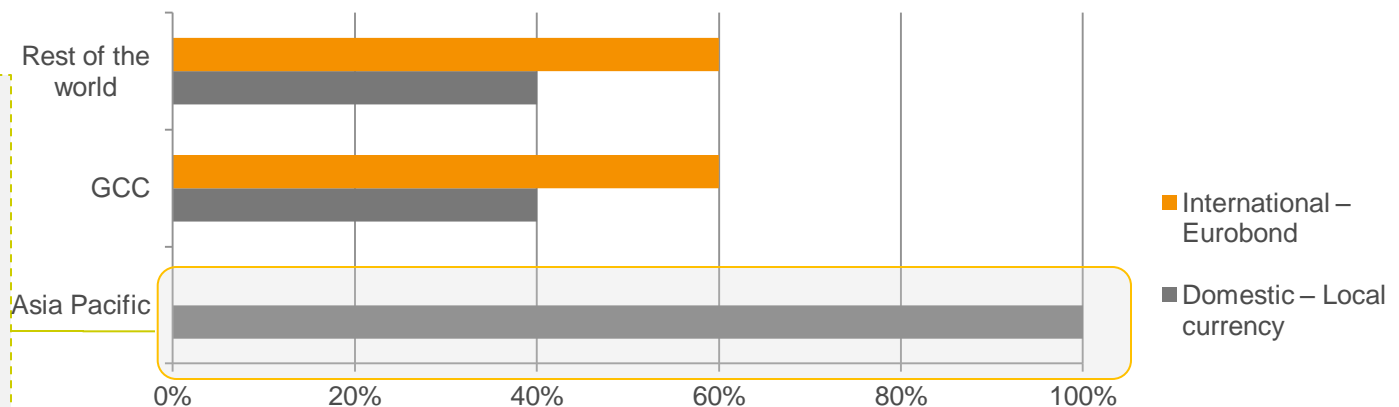


INTERESTINGLY, ARRANGERS EXPECT A GOOD BALANCE BETWEEN LOCAL AND INTL. SUKUK WHILE INVESTORS GLOBALLY HAVE AN OVERWHELMING PREFERENCE FOR INTL SUKUK



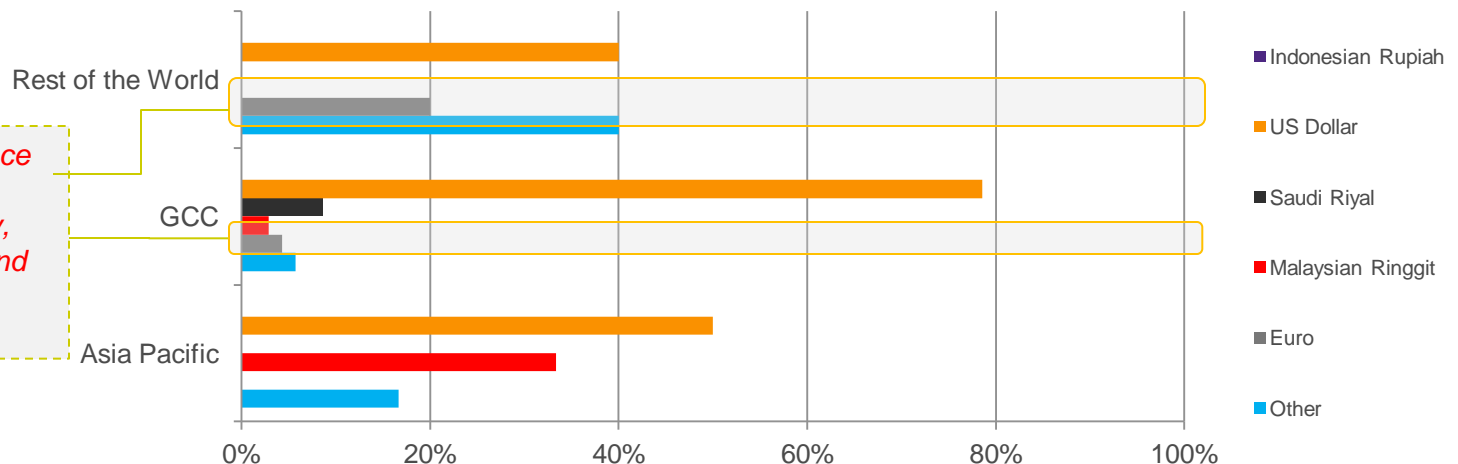
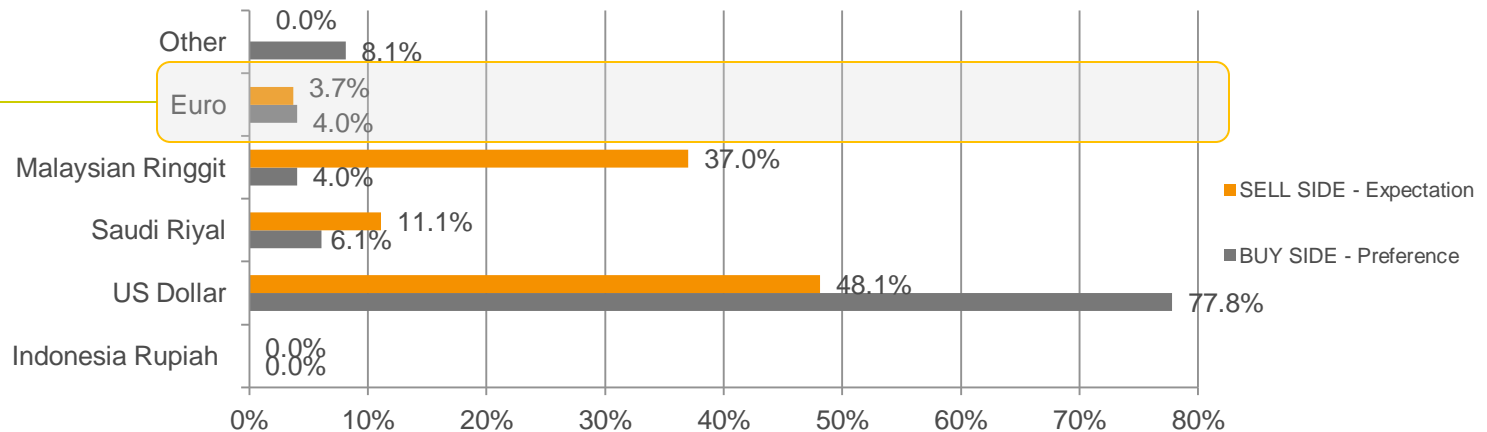
*Buy Side – Preference*

*South East Asian investors more keen to invest in domestic markets most likely due to excess local currency liquidity and better rates*



## AND THIS IS REFLECTED IN THEIR DEMAND FOR US DOLLAR SUKUK

...INVESTORS PREFER US DOLLAR OVERALL, BUT THERE IS GROWING APPETITE FOR OTHER CURRENCIES SUCH AS MALAYSIAN RINGGIT AND SAUDI RIYAL ...



Buy Side – Preference

Perhaps surprisingly,  
there is some demand  
for Euro sukuk







REUTERS/Arnd Wiegmann

# NEW HORIZONS OR COMFORT ZONE?

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## GEOGRAPHIC AND RISK PREFERENCES



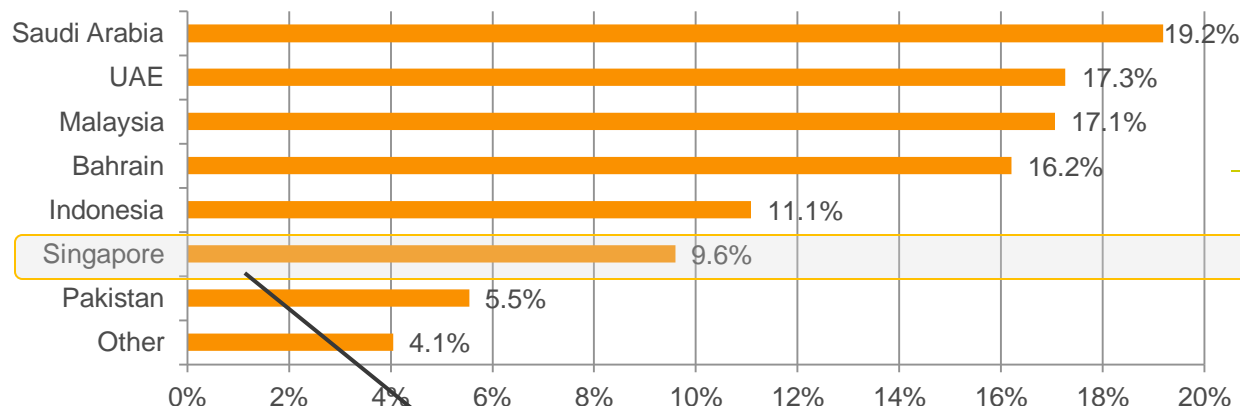
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## GCC AND SOUTH EAST ASIA STILL COMMANDS HIGHEST PREFERENCE FROM INVESTORS

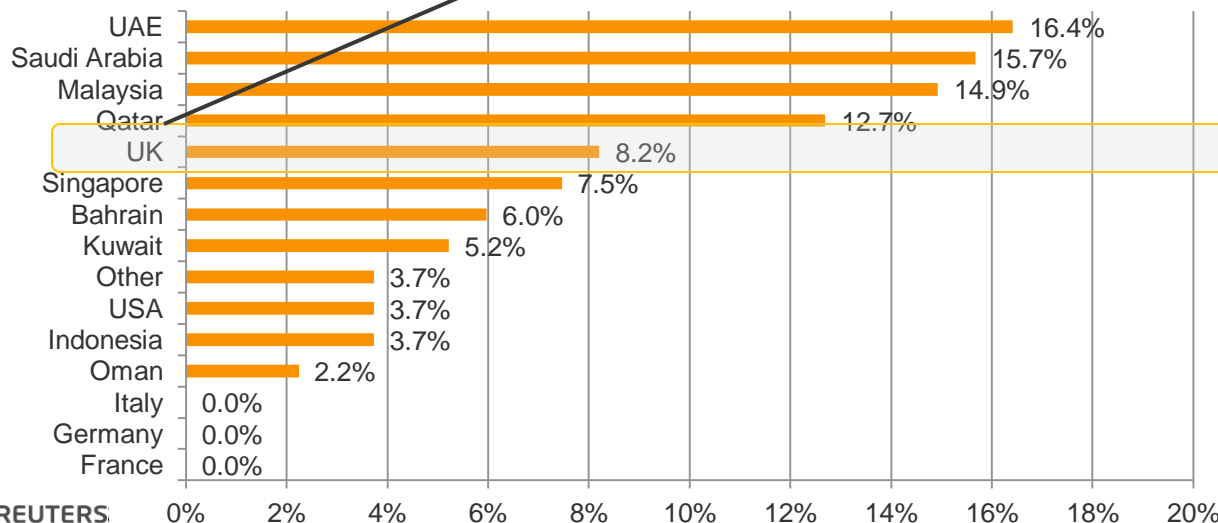
INVESTORS STILL PREFER TO INVEST IN CORE SUKUK TERRITORY - TRADITIONAL GCC AND SOUTH EAST ASIA COUNTRIES WHILE ARRANGERS EXPECT A SIMILAR PATTERN

BUY SIDE  
INVESTORS  
PREFERENCE



OUTLIERS

SELL SIDE  
ARRANGERS  
EXPECTATION



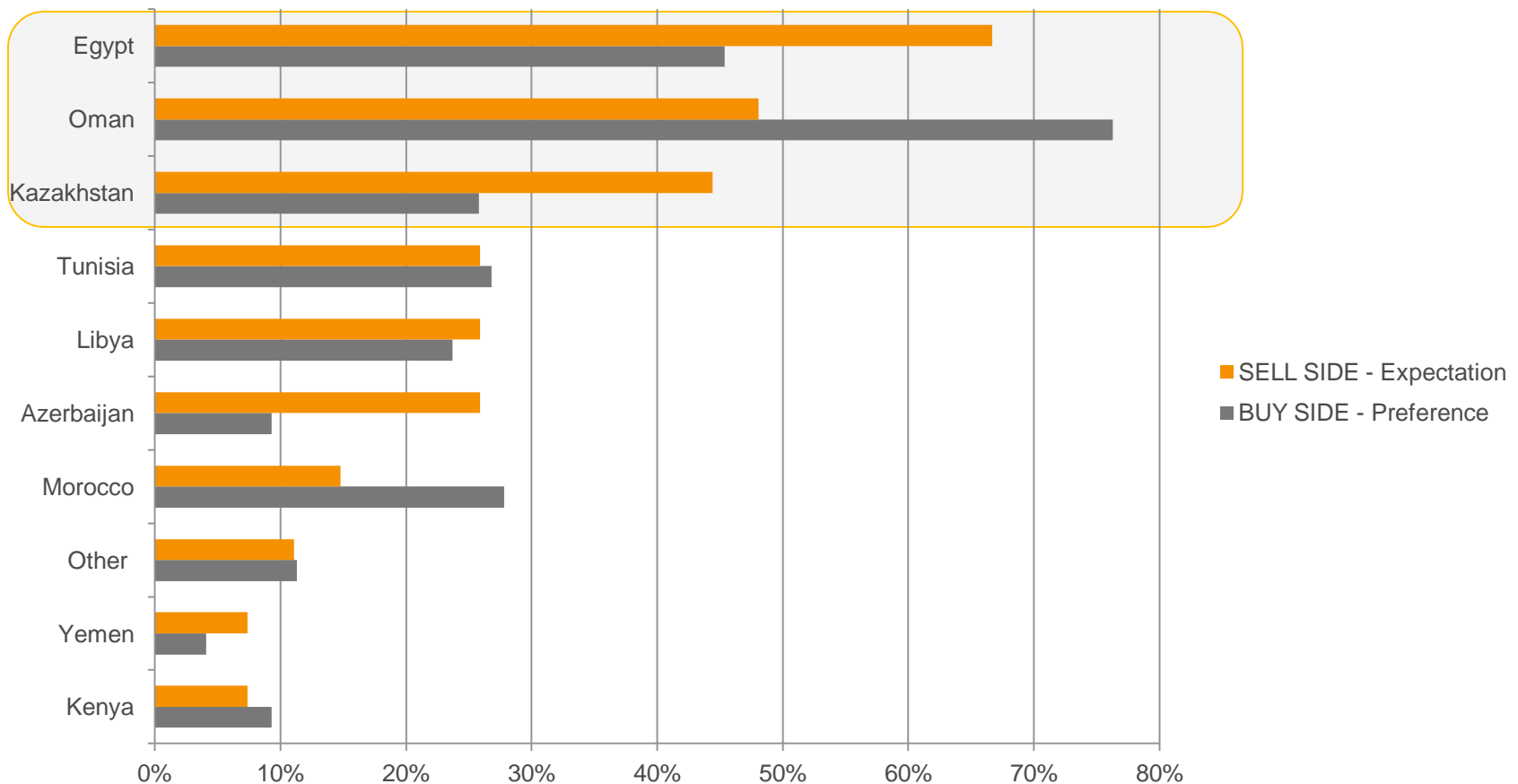
High correlation  
between investors  
preference and  
arrangers  
expectation of  
sukuk issuance  
countries





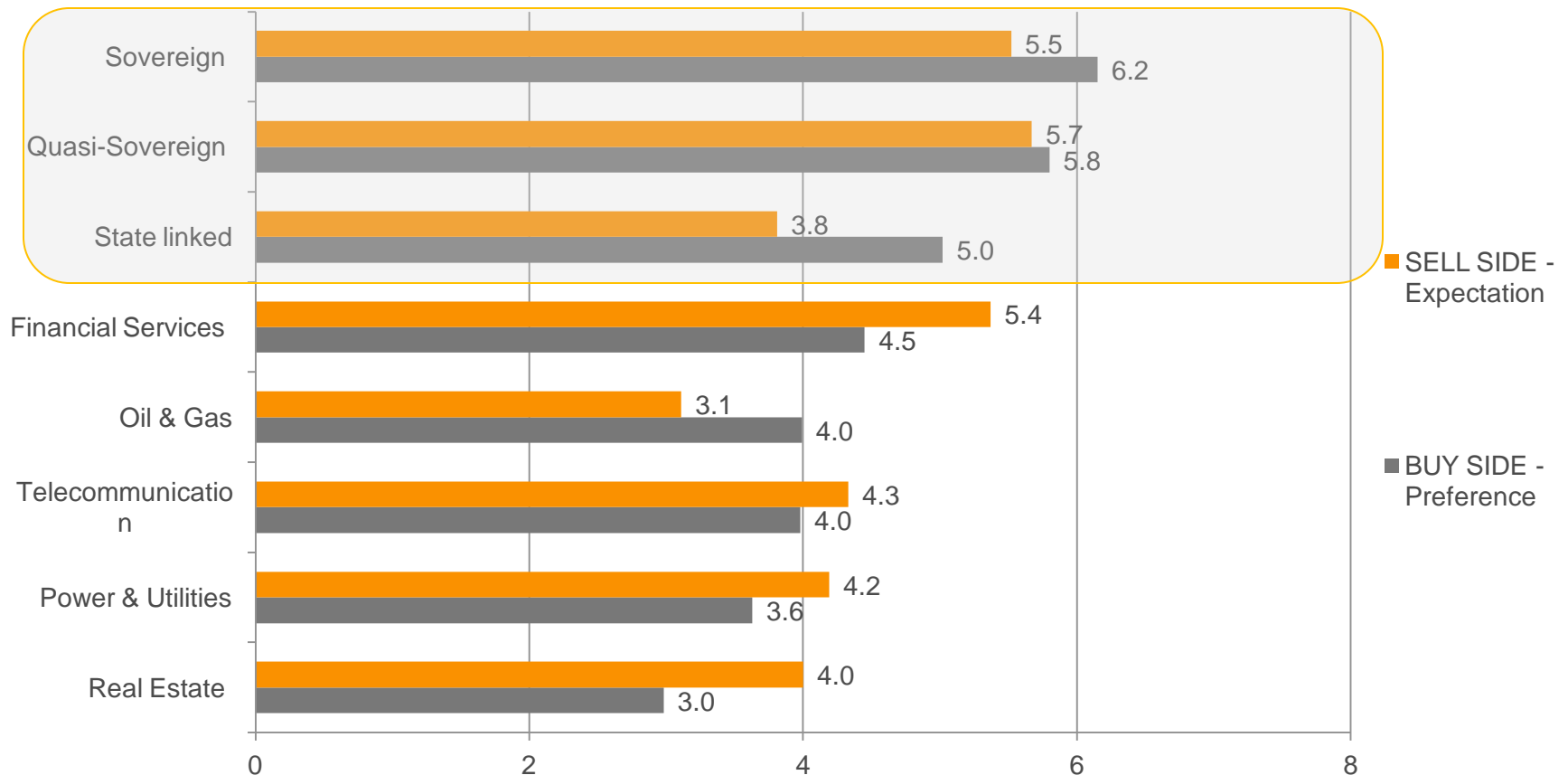
## ..WITH HIGH EXPECTATIONS FROM EMERGING ISLAMIC FINANCE COUNTRIES TO ENTER THE SUKUK MARKET..

ARAB SPRING AND CIS COUNTRIES WOULD BE BEST PLACED TO ISSUE SUKUK GIVEN THE DISPROPORTIONATE SHARE OF INVESTOR PREFERENCE FOR THEIR PAPER



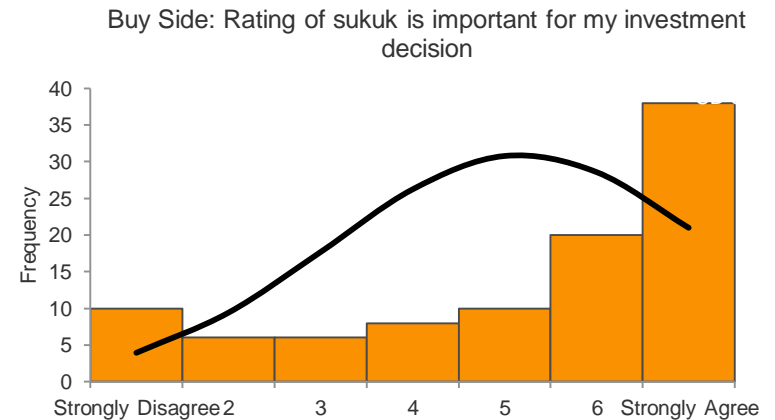
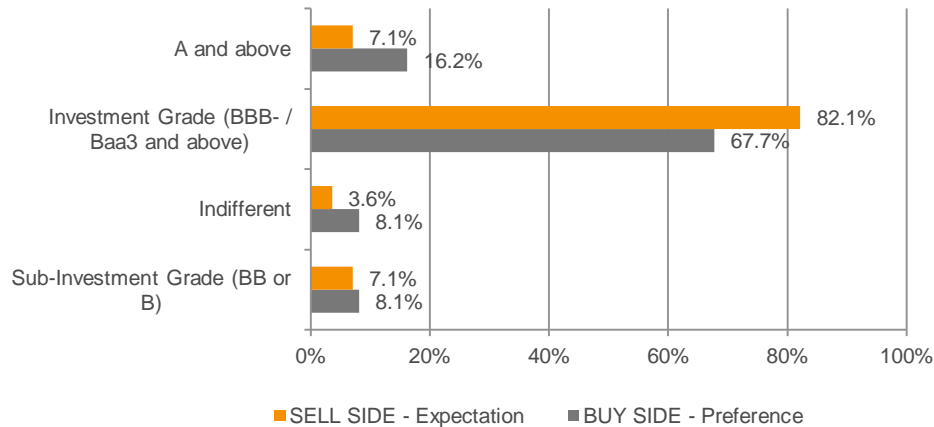
## WHILE INVESTORS STILL SHYING AWAY FROM CORPORATES...

GFC JITTERS STILL PREVAILS WITH SOVEREIGN (LINKED) OR FINANCIALS REMAINING THE FAVOURITES



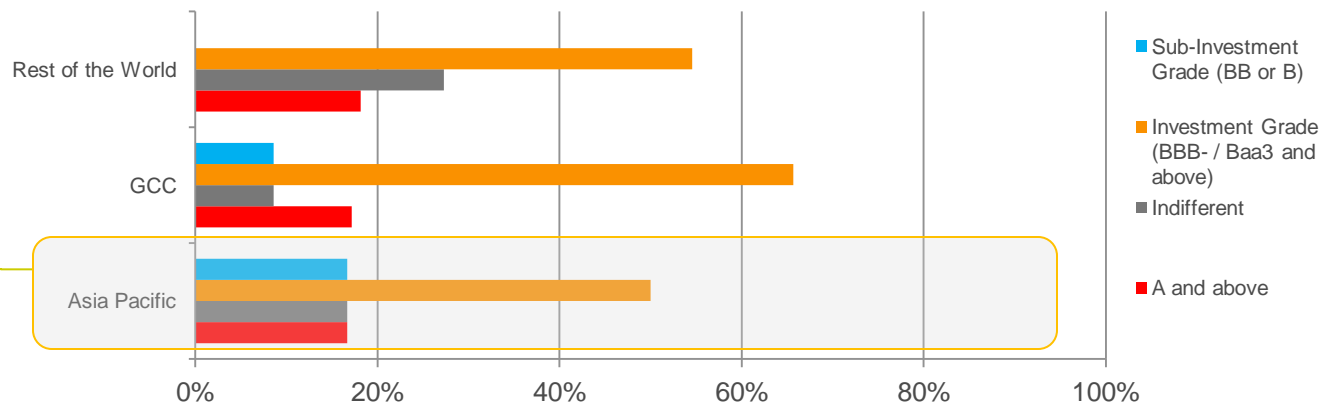
## CHASING RATINGS...

...INVESTORS STILL PREFER TO INVEST IN SUKUK THAT ARE RATED AND INVESTMENT GRADE AND ABOVE. ..



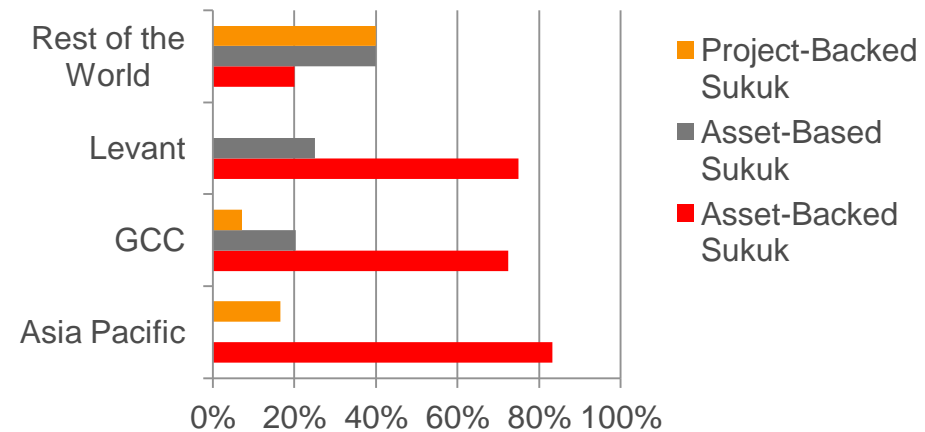
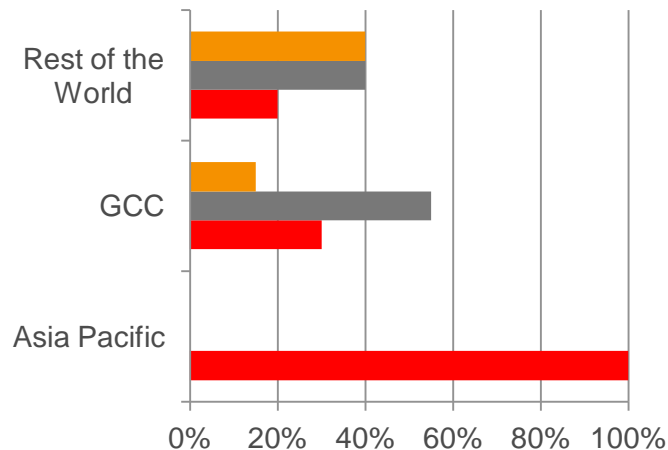
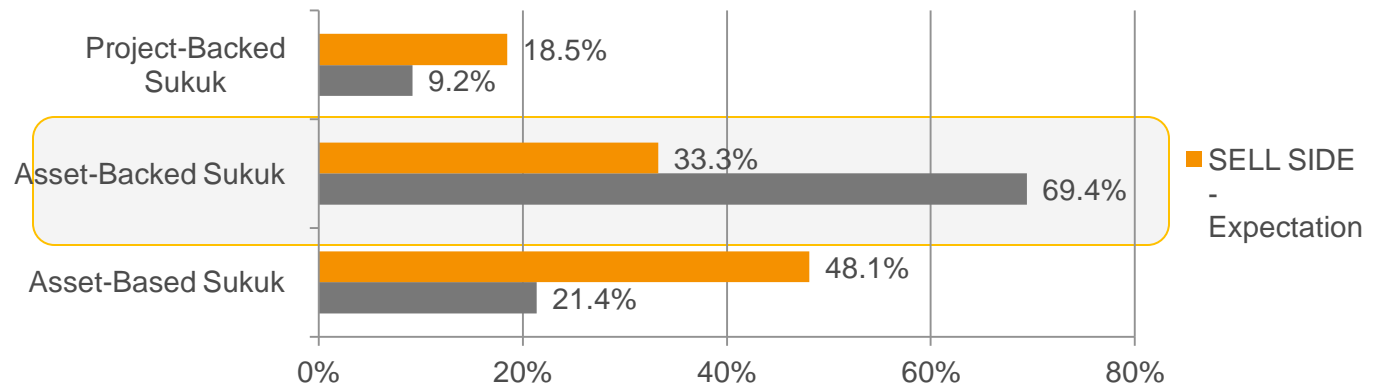
### Buy Side – Preference

Despite Asian investors mostly preferring investment grade issues, they are more open to other options



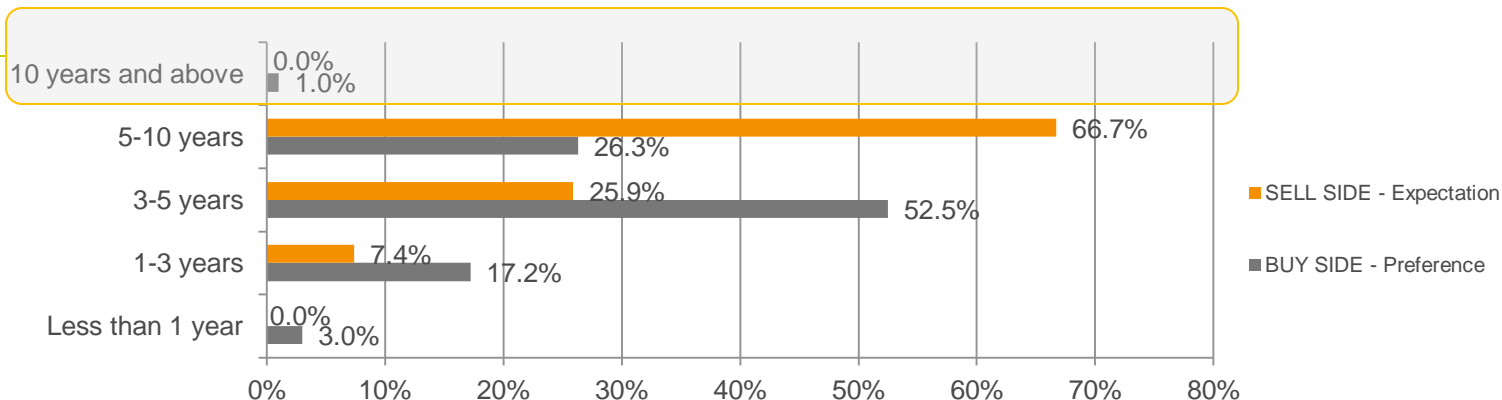
## ..AND LARGELY FAVOR ASSET BACKED SUKUK..

MOST INVESTORS PREFER ASSET BACKED SUKUK AS THEY ARE MORE SECURE AND GRANT RECOURSE TO BOTH THE OBLIGOR AND THE UNDERLYING ASSETS



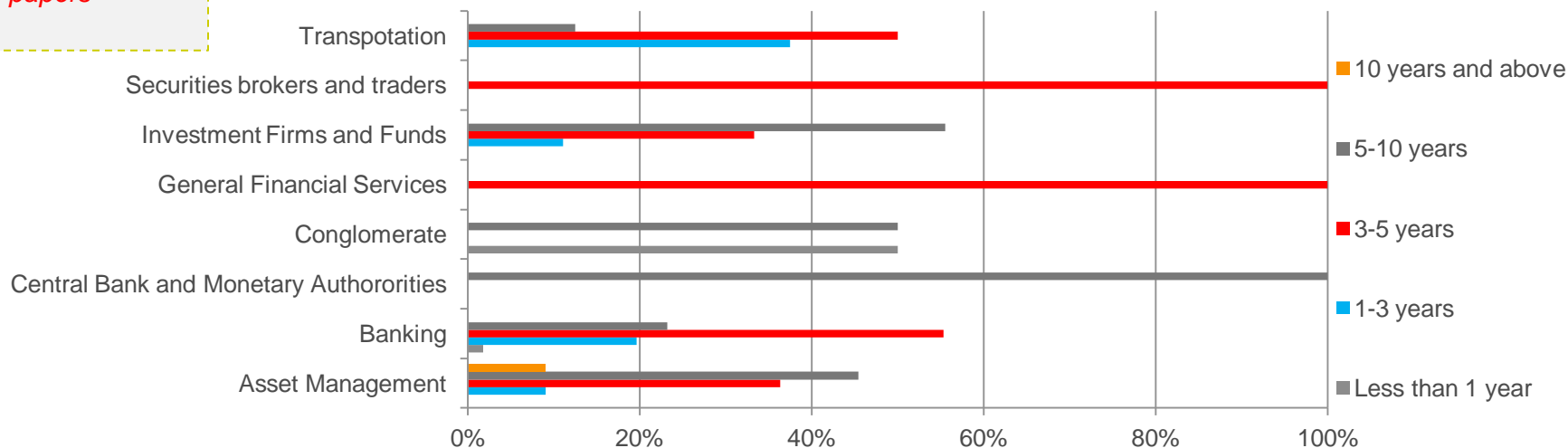
## AND STILL CONSERVATIVE ON TENOR...

UNLIKE CONVENTIONAL BOND INVESTORS, ISLAMIC INVESTORS STILL PREFER SHORTER TERM PAPERS., POSSIBLY REFLECTING THE BANK HEAVY INVESTOR BIAS



*Buy Side – Preference*

*The market is still averse to longer term papers*







REUTERS/Stringer Shanghai

## WILL SUPPLY MEET DEMAND?

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### DEMAND AND SUPPLY EQUILIBRIUM ANALYSIS



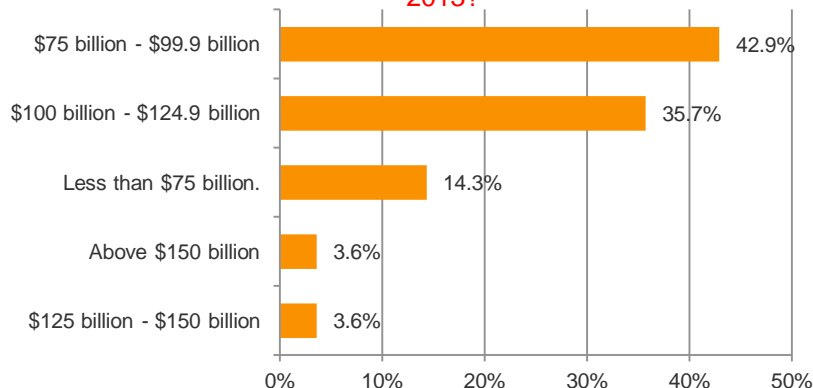
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## SUPPLY

MOST ARRANGERS EXPECT ISSUANCE VOLUME AROUND THE \$75-125 BLN RANGE WITH UP TO 30 EUROBOND ISSUES

What is the expected dollar amount of sukuk issuance in 2013?



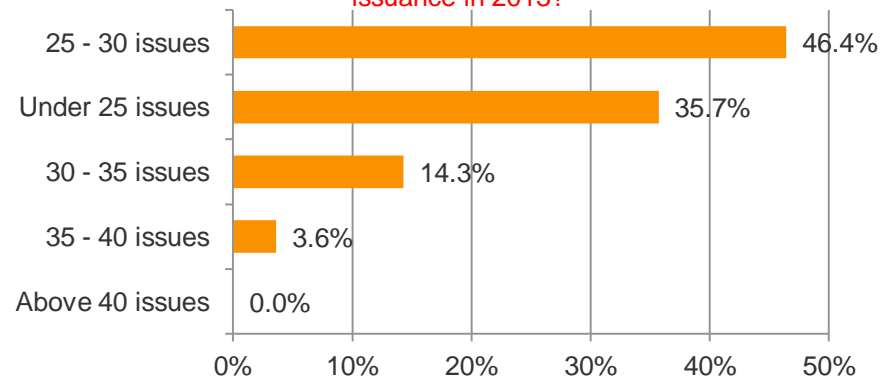
2012 figures are around the \$132 bln range.

Are arrangers being too conservative when projecting 2013 issuance levels?

Number of Eurobond issuances in 2012 were 25.

Are arrangers being too conservative when projecting 2013 issuance levels, when pipeline itself is around the 18-20 mark (Source: IFR)?

What is the expected number of Eurobond (International USD) sukuk issuance in 2013?

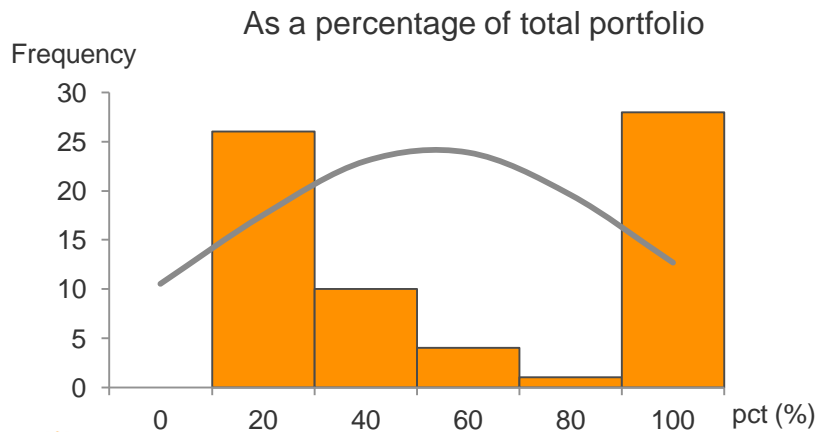
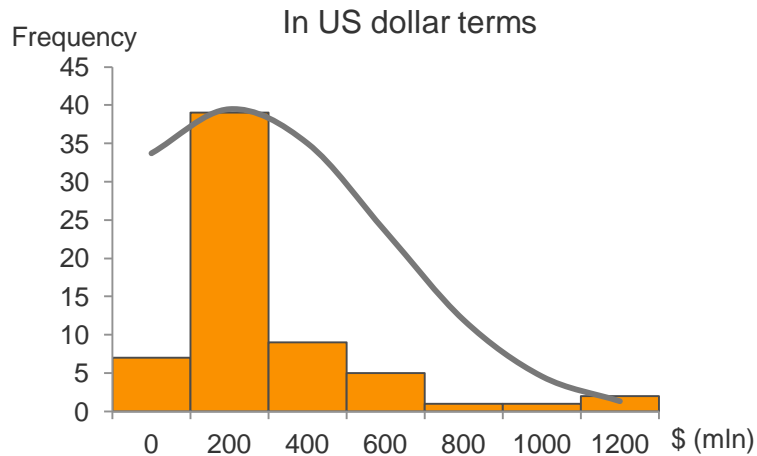




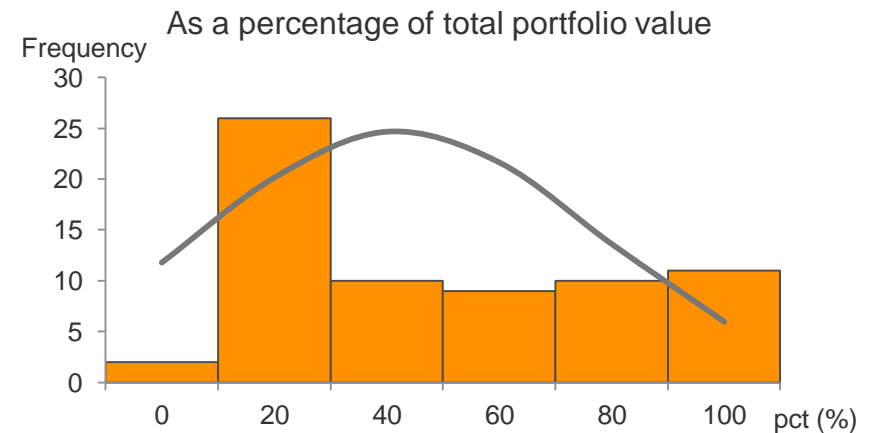
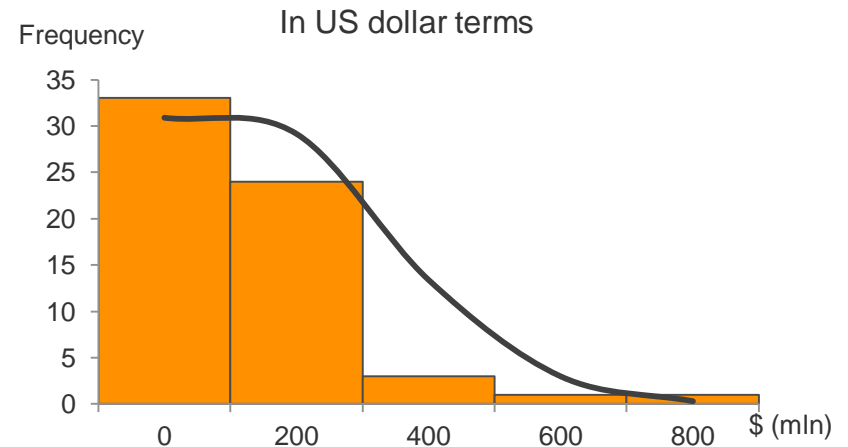
## DEMAND

WHILE MOST ISLAMIC FINANCE INVESTORS WILL INVEST BETWEEN 20-100 PERCENT OF THEIR PORTFOLIO IN SUKUK AND LESS THAN OR AROUND \$200 MLN

### ISLAMIC FINANCE INVESTMENT

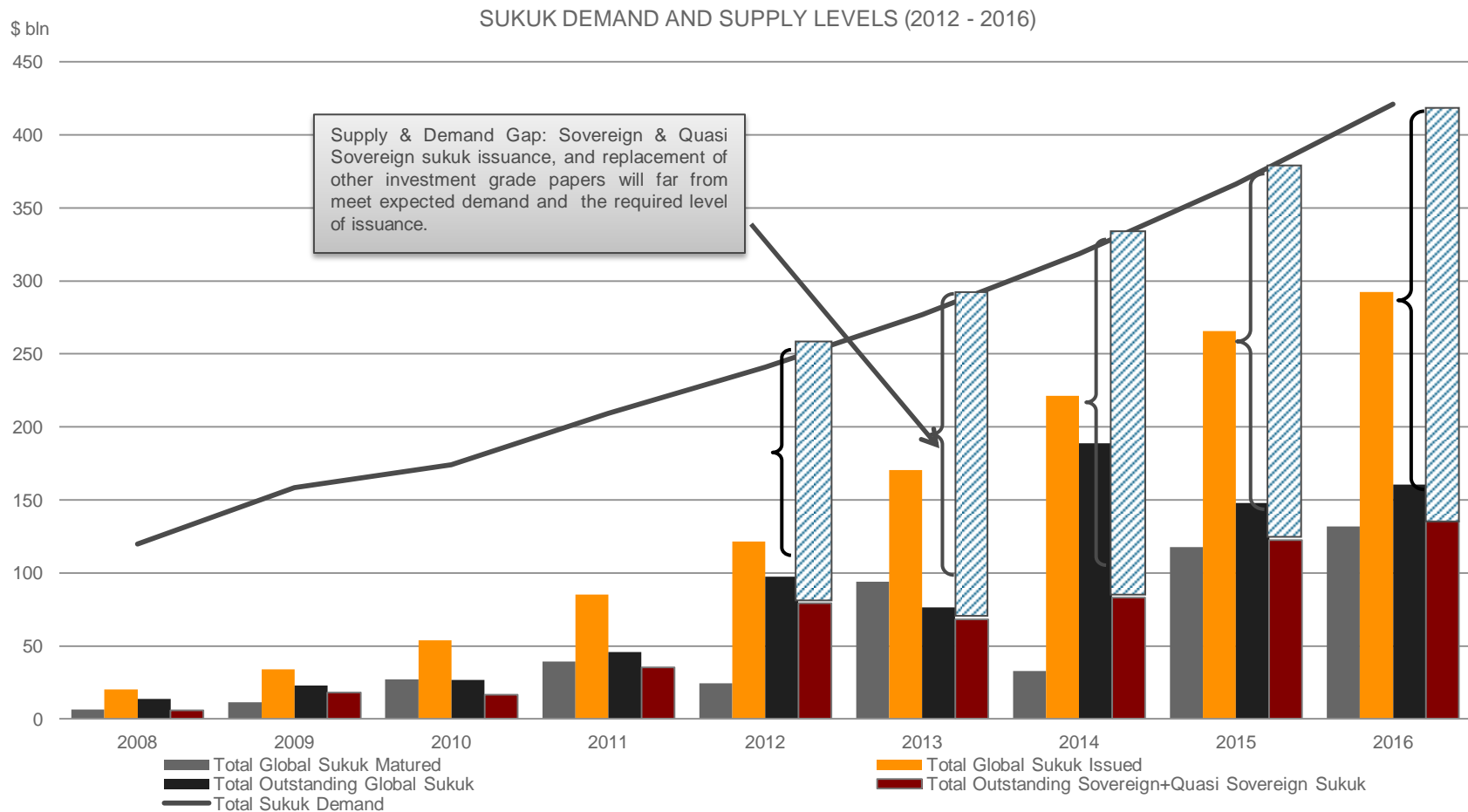


### SUKUK INVESTMENT



## DEMAND AND SUPPLY EQUILIBRIUM

WE PROJECT THAT SUKUK DEMAND WILL SURPASS SUPPLY BY ABOUT USD 250 BLN BY 2016 AT CURRENT SUKUK ISSUANCE GROWTH LEVELS

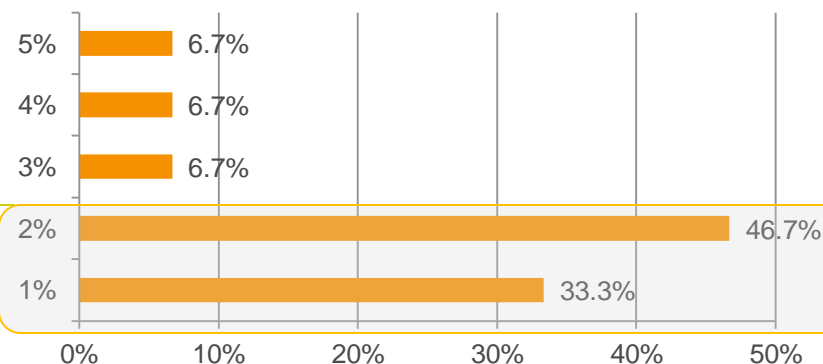
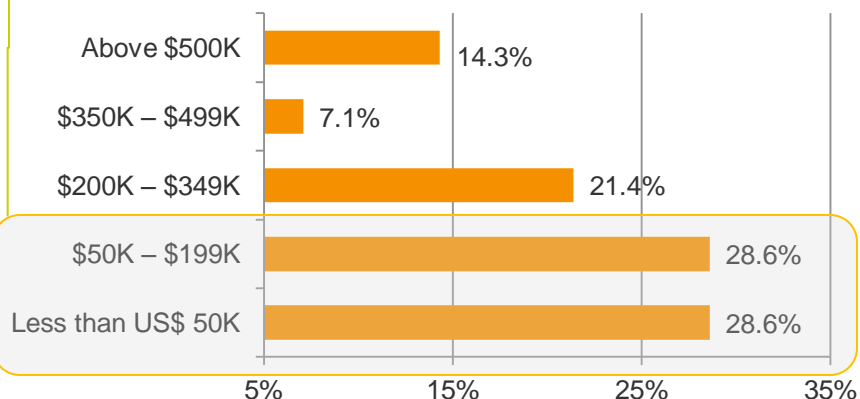
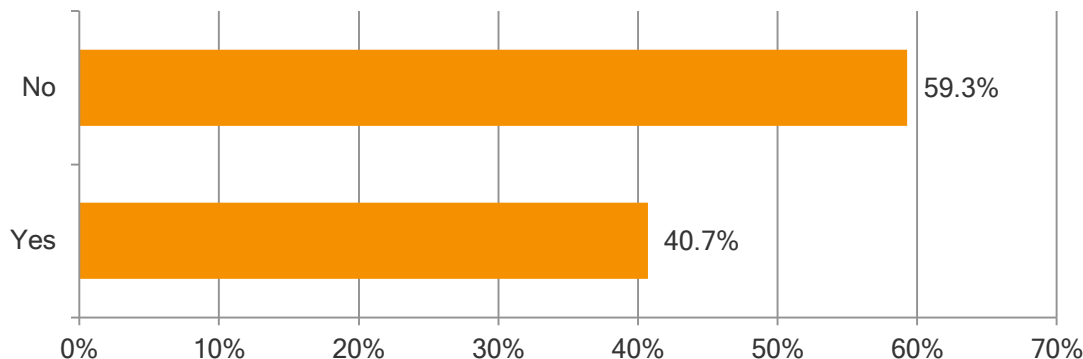


## YET COST OF ISSUANCE STILL A HINDRANCE TO ACHIEVING DEMAND SUPPLY PARITY

MAJORITY OF LEAD ARRANGERS BELIEVE THAT COSTS OF ISSUING SUKUK WILL STILL BE HIGHER THAN COSTS OF ISSUING CONVENTIONAL BONDS

### Sell Side – Expectations

The gap between the cost of issuing sukuk and the cost of issuing bonds is narrowing, due to bigger sukuk investor base (conventional + Islamic)





REUTERS/Jianan Yu

# BUT BUYER BEWARE, SYSTEMIC SUKUK RISKS LOOMING..

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## STRUCTURE RISKS

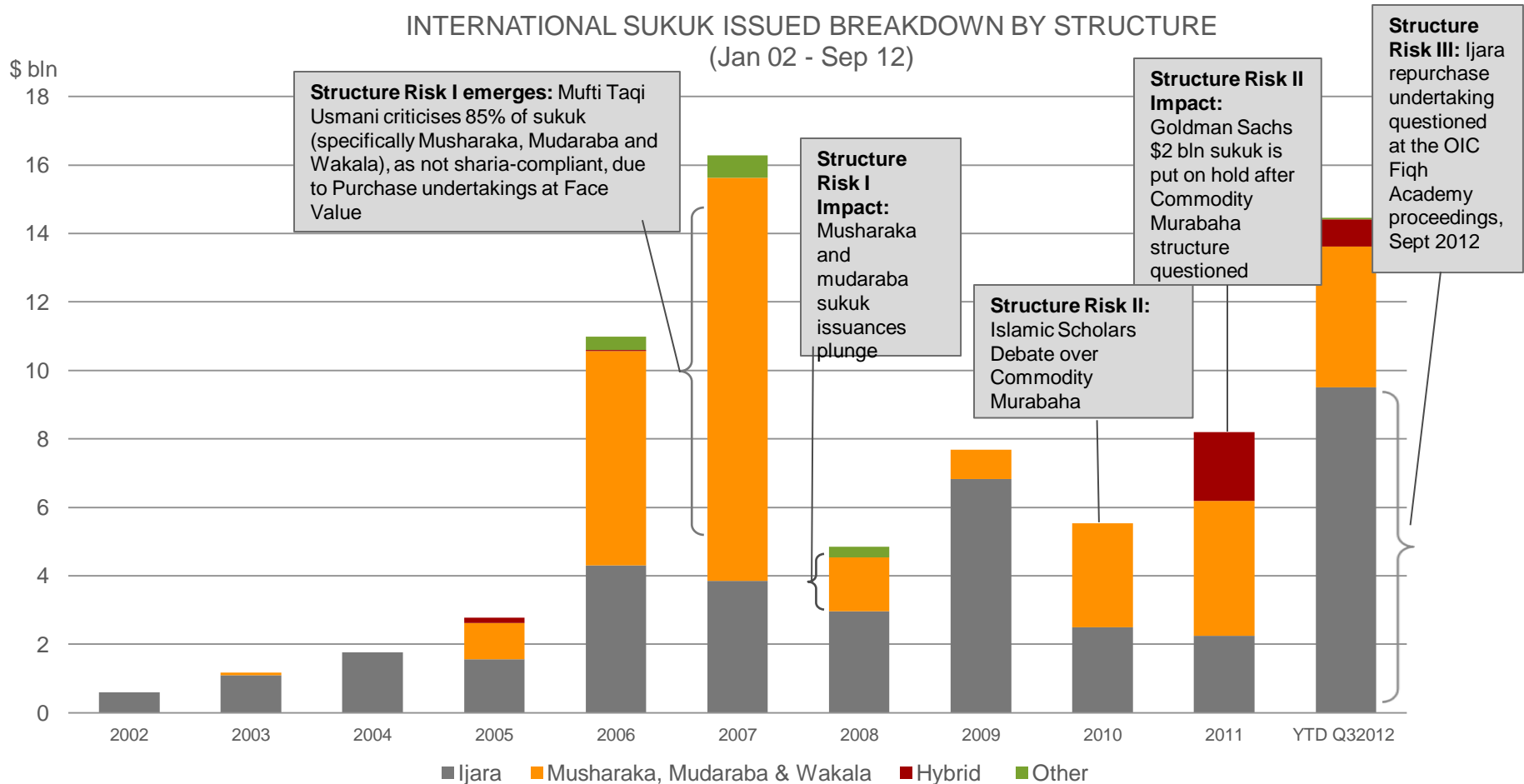


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## STRUCTURE RISK REARS ITS UGLY HEAD AGAIN...

SEVERAL PAST EXPERIENCES ON, POTENTIAL THAT THERE MAY BE ANOTHER STRUCTURE SHOCK TO SUKUK...

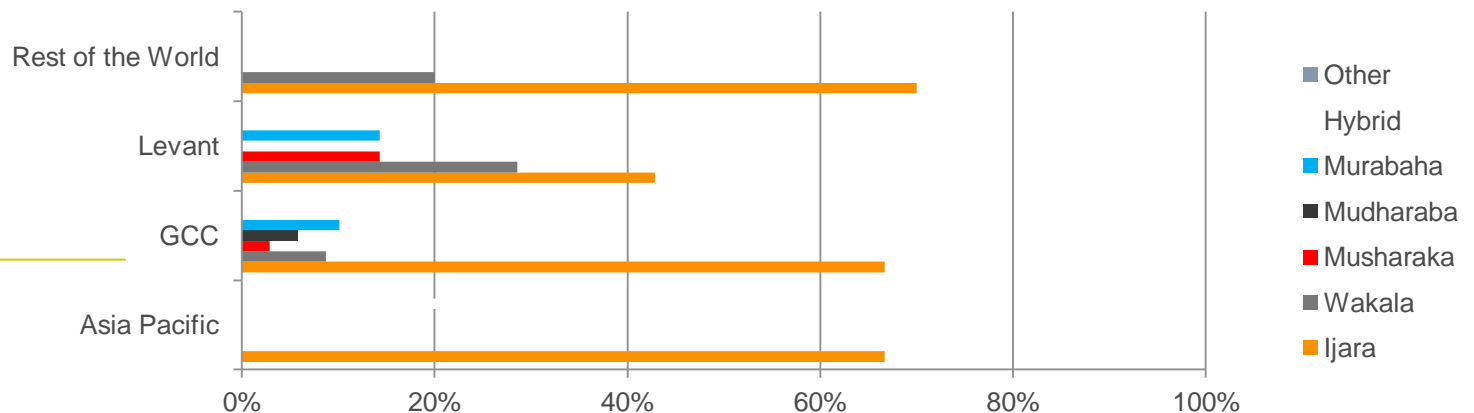
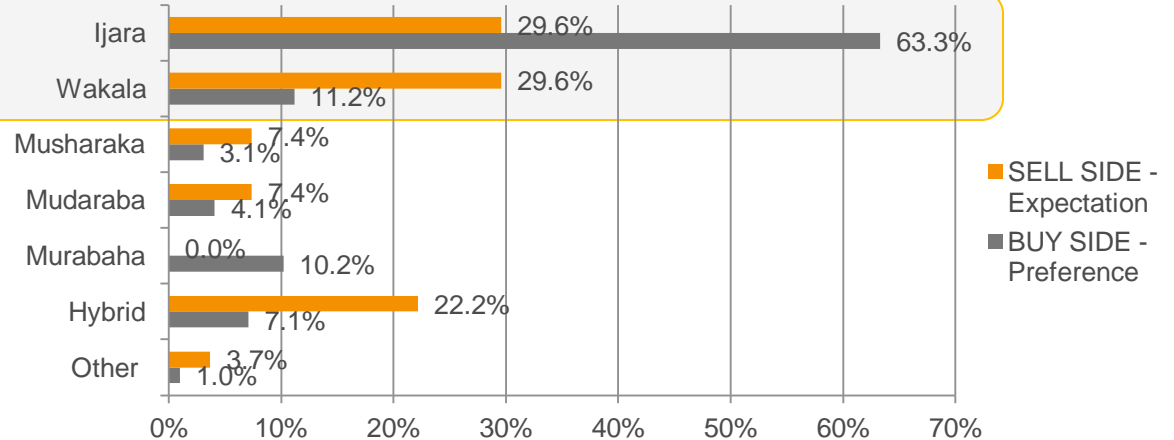


## IJARAH STILL REMAINS FAVOURITE..

DESPITE THE ISSUE WITH THE IJARA REPURCHASE AGREEMENT AT THE ISLAMIC FIQH ACADEMY, INVESTORS STILL PREFER IT OVER WAKALA ...

### Buy Side – Preference

*Ijara and Wakala are most expected by lead arrangers, but Ijara is preferred by a majority of investors*







REUTERS/Fabrizio Bensch

## THE RIGHT INFORMATION IN THE RIGHT HANDS LEADS TO AMAZING THINGS

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