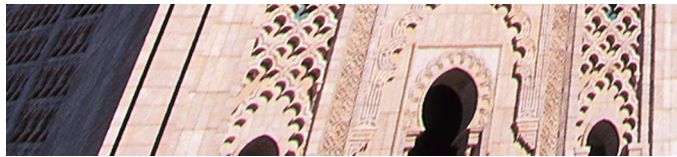


The Securitization Process in Islamic Capital Markets Instruments

Sukuk Summit 2008

Geert Bossuyt – Head of Islamic Structuring



A Passion to Perform.

Deutsche Bank 

Sukuk Summit 2008

The Securitization process in Islamic Capital Markets Instruments

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1. Asset based and Asset backed Securities

Definition of Sukuk

Accounting and Auditing Organisation for Islamic Financial Institutions (“AAOIFI”)

Shari’a Standard 17 applies Sukuk to investment products – Sukuk are certificates of equal value representing, after closing of subscription, receipt of the value of the certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs and services, or equity of a given project or equity of a special investment activity.

Securities Commission Malaysia (“SC”)

Applies the general definition of Sukuk or its singular, Sakk - a document or certificate which represents a value of an asset. SC applies Sukuk to all securities including shares, notes, unit trust and bonds. The Sukuk must have an intrinsic value. The Sukuk may represent *debt obligations* and may be issued for a pool of receivables - loosely defined as Islamic bonds or Islamic securities in Malaysia.

Asset based and Asset backed

- More than 90% of all global Sukuk issues in the market are ON-balance sheet issues (**Asset-BASED**).
- Revenue/income from Sukuk Assets does not necessarily form the source of repayment – usually comes from issuer/obligor’s cash flow. Examples of ON-balance sheet Sukuk structures: Ijarah on buildings, plantation land; Musyarakah on concession assets, shares etc.

Asset-BACKED (ABS):

- usually refers to securities/Sukuk backed by income generating assets sold/transferred by an originator to a buyer/issuer (usually an SPV);
- main source of repayment - revenue from underlying Sukuk assets;
- can either be ON or OFF-balance sheet.
- Examples: Ijarah on plantation land, Musyarakah on Islamic mortgages

1. Asset based and Asset backed Securities (ABS)

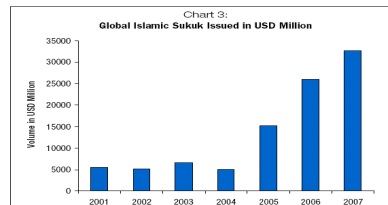
Global Trends in Sukuk Issues – Underlying Asset Requirements...

- Declining requirement for tangible asset-backing throughout the maturity for Sukuk.
- Since 2001, tangible asset-backing has been progressively reduced from 100% to 33%.

	Kumpulan Guthrie Berhad (Malaysia)	Islamic Development Bank 1 st Issue (Middle East)	Emirates Airlines (Middle East)	Islamic Development Bank 2 nd Issue (Middle East)	The National Central District Cooling Co. (Tabreed) (Middle East)
Year	2001	2003	2004	2005	2006
Tangible Assets	100%	51% at issue date and 25% at maturity date	Musharakah – No requirement of physical assets	33%	33%

Global Sukuk Issues

Overall Sukuk issuance volume increased by 71% to USD32.65 billion in 2007 compared to 2006. The number of Sukuk transactions rose to 119 (2006: 109), whilst the average deal size increased to USD269.8 million from USD175million in 2006.



1. The AAOIFI Resolutions

Scholars have modified the use of the Purchase Undertaking

- In February 2008, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), a body comprised of the most prominent and influential Islamic scholars in the industry, had issued a paper outlining several resolutions that the Islamic finance industry should adhere to:
- The most critical resolution concerned the use of the Purchase Undertaking Deed (PUD) in combination with trust-based (as opposed to tangible asset-based) Islamic structures, i.e. Mudaraba, Musharaka, and Wakala agreements vs. Ijara.

The PUD is at the core of all current Sukuk.

It is an essential contract issued by the obligor (akin to borrower in conventional finance) effectively crystallizing the obligation to repay in the event of default and at maturity.

- Based on the argumentation that using a PUD at par value (i.e. having the obligor buy the Issuing SPV's interests in the Mudaraba / Musharaka / Wakala assets at original sale price) as opposed to market value enables the obligor to guarantee the Sukuk holders' returns, the AAOIFI Shari'a Board has declared that the PUD at par is non-Shari'a compliant in such trust-based structures.
- In light of this, if borrowers have physical assets they can exploit, it is possible to do a standard Sukuk-al-Ijara with a PUD at par value
- If borrowers do not have / do not want to use their physical assets, Deutsche Bank recommends the following alternatives:
 - Option I – Issuing Sukuk based on Mudaraba / Musharaka with PUD at market value
 - Option II – Issuing Sukuk-al-Ijara with a Third Party as "asset provider"

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2. Key Issues on Asset Backed Securities

- **Lack of available (tangible) assets/history:**
 - Consumer finance – auto leases, unsecured consumer loans
 - Commercial and residential real estate
 - Infrastructure assets – toll roads, bridges, tunnels
- **Lack of consensus on Shari'a legality (assets, liquidity, tranches)**
- **National legal regulations**
- **Accounting perspective**
- **Tax**
- **Unfamiliarity**
- **Timing**

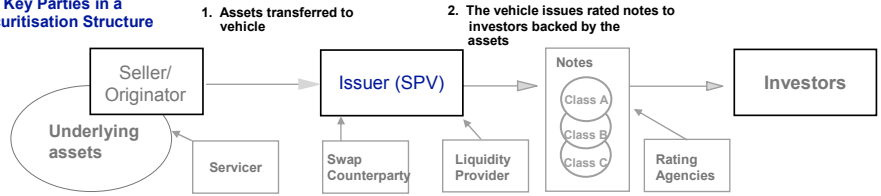
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3. The Mechanism of the Securitization Process

Key Parties in a Securitisation Structure



Asset Originator / Seller

Entity with funding / capital needs and with assets suitable for securitisation.

Issuer (SPV)

Special purpose entity or vehicle (SPE or SPV) that issues ABS/MBS. Vehicle is created specifically for the purposes of securitisation.

Liquidity Provider

Liquidity provider covers any temporary (i.e., timing) mismatches in cash flow usually to cover payments of interest

Swap Counterparty

Swap counterparty hedges basis or currency risk within capital structure.

Servicer

Company that manages asset pool - collecting and remitting cash flows to service debt, managing delinquencies. In Europe, this function often remains with the originator of the securitised assets, who is paid a fee.

Trustee

Holds the security of the assets and represents the noteholders

Rating Agencies

Independent agencies that size credit enhancement levels necessary to achieve desired ratings, taking into account legal and structural aspects.

