

World Islamic Banking Conference

Islamic Capitals Markets & The Global Economic Crisis

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The Rise and Fall of Sukuk

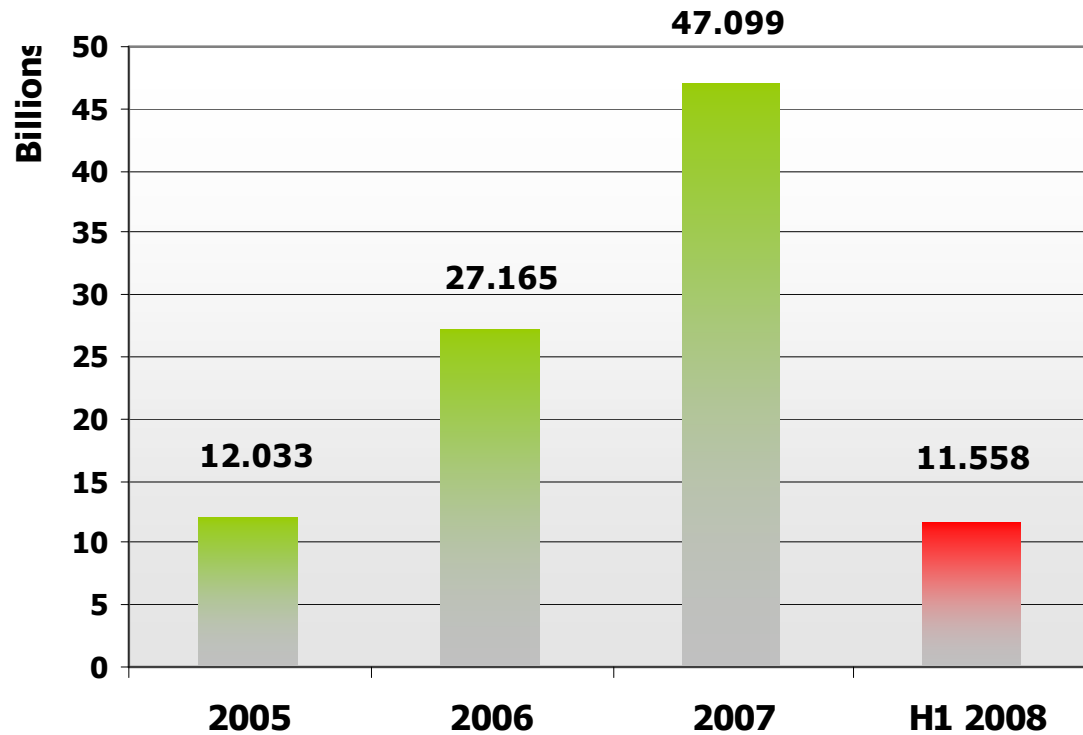
2005 US\$ 12 Billion

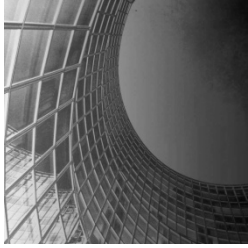
2006 US\$ 27 Billion (growth: **125%**)

2007 US\$ 47 Billion (growth: **73%**)

H1 2008 US\$ 12 Billion (growth: **-51%**)

source: IFIS





Factors Behind The Rise of Sukuk

- **It started with the issuance of sovereign Sukuks by Malaysia, Bahrain and Qatar-benchmark / standard setting**
- **Geopolitical situation impacting the Muslim world (Sep 11, 2001, war in Iraq)**
 - Increase in Oil prices
 - Repatriation of Muslim money from abroad
 - Excess liquidity, demand for alternate asset classes from Investors
 - Infrastructure projects & high growth of corporate sector – development of capital markets
- **Growth of Islamic Financial Institutions**
 - Sukuk Issuance to reduce maturity gap in asset/liability
 - Sukuk Investments – lack of other attractive Islamic investment classes



Factors Behind the Slowdown of Sukuk

- **While IFIs are an important Investor category for Sukuks, the Islamic Capital Markets are still largely dependent on International / Conventional Investors looking for alternate asset classes**
 - The conventional institutional Investor hit by sub-prime credit markets crisis. No longer interested in alternate asset classes
 - Liquidity Squeeze impact not only on the western FIs but on regional FIs and IFIs as well
 - Impact of weakened US\$ slowed down issuances, till market embraced regional currencies for issuance

- **AAOIFI ruling on Shariah compliance of Sukuk Issues (Feb '08)**
 - Asset Backed vs. Asset Based
 - Promise to purchase at face value



The Opportunity for Sukuk in GCC

- **The GCC is expected to bounce back earlier than the west.**

- Expected to be a significant supplier of financial capital
- The Issuer base in GCC values Islamic principles
- Need to develop the local and regional markets

[Sukuk Markets - Lessons from the Far East](#)

- **The principles of Islamic Finance have proven to be viable due to linkage of Islamic transactions to real economic activities**

- Specifically viable for infrastructure projects (petrochemicals, aviation, shipping, telecom – high growth sectors in GCC)

[Islamic Finance – A Distinct Alternative System](#)

- **“Back to Basics” theme poses an Opportunity for Islamic Finance**

[The Way Forward](#)



Sukuk Markets - Lessons from the Far East

- **Leadership in Sukuk issuance through,**
 - Well developed local currency (Ringitt) issuances (regulatory support)
 - Well coordinated effort between Shariah scholars, industry specialists and government
 - Corporate Sukuk issuances on the rise. Government provided the initial momentum
 - Focus on volume not value,
 - Average Malaysian Sukuk size in H1 '08: \$132 M as compared to \$ 280 M in GCC
 - 34 issuances in H1 '08 in Malaysia as compared to 25 in GCC

- **GCC Sukuk Market**
 - Local currency markets not well developed
 - Till the currency crisis hit GCC, most issuance were in US\$
 - Size Matters, focus on value and not volume
 - Non-friendly environment for small issuer, Only local currency issues in Saudi by Sabic and SEC

[The Opportunity for Sukuk in GCC](#)



Islamic Finance – A Distinct Alternative System

- **The industry has been mimicking conventional products, with the belief that the conventional model is safer and more optimum**
- **The sub-prime credit crisis that led to financial markets collapse has raised doubts over the conventional wisdom....**
- **Is Islamic financial system a viable alternative to the conventional system. Compliance to basic shariah principles may address some of the issues faced under the existing system,**
 - the ban on riba,
 - the ban on “gharar” (uncertainty) and “maysir” (speculation),
 - the ban on haram sectors (un-ethical businesses)
 - the obligation to share profits and losses
 - the obligation to back any financial transaction with assets

[The Opportunity for Sukuk in GCC](#)



The Way Forward

- **Need for Shariah scholars and industry specialists to come together and offer asset backed structures that meet the investor and issuer requirements.**
- **Regulatory Reforms to help in development of local and regional capital markets**
 - GCC regulators to provide level playing field for Islamic products
 - Effective legislation required for property, SPV and trust laws
 - [Development of Local Sukuk Markets - Regulatory Challenges](#)
 - Keep the International Investor engaged through multi currency tranches, till the swap markets develop for regional currencies
- **While sovereign issues are important to establish benchmark / standards, real and sustainable growth to come from the corporate sector**
- **Establishing Islamic Finance as distinct alternative system by bringing focus on substance and creating the value proposition [Slide 10](#)**



Development of Local Sukuk Markets Regulatory Challenges

■ **Creation of Special Purpose Vehicles**

- Non existence of SPV laws or Trust laws
- High minimum share capital requirement for creation of limited liability or joint stock companies to serve as a proxy SPV
- Tax / Zakat implications
 - Calculation of Zakat on Total Assets or Assets net of liabilities ?
 - Lack of precedence

■ **Off-shore SPV is the only alternative**

- Withholding tax implications
- Inability to list on local exchange, hence hinders development of local Sukuk markets

[The Way Forward](#)



Thank You