Corporate Sukuk Issuance and Prospects
(Utility and State Owned Enterprises)

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SUKUK

Definition
- Sukuk Certificates represent proportionate beneficial ownership and may be described as an Islamic Bond for a defined period the risk and return on which is associated with cash flows generated by a particular asset belonging to the investors i.e. Sukuk holders.

Structure
- Sukuk must be asset linked.
- Backing by real assets make it tradable.
- linking to pure receivables encounter it with prohibition for secondary market trading. However this can be overcome by mixing it with mode having its backing by real assets.
- The periodic payments and scheduled amortization of the principle due to investors are structured matching with the income and capital returns arising out of the underlying assets.
- The profit payment can be fixed or benchmarked to the inter-bank offered rate plus a margin
Global Sukuk Issuance

Number of Issues

Year

Corporate
Govt

2001 2002 2003 2004 2005 2006

Global Sukuk Volume

Volume in Millions

Year

Corporate
Govt

2001 2002 2003 2004 2005 2006
Global Sukuk - Countries Share

Sukuks are required for:

- Investors to place their funds in accordance with Shariah compliant principles.
- Govts/Corporates to raise funds for their working capital/Project financing under Shariah Compliant framework.
- Financial institutions undertaking shariah compliant business for their liquidity management.
Driving Force

Three main driving forces behind the development of the Sukuk market are :-

- Growing demand by the investors for shariah compliant instruments (competitive yields provide better results).
- Desire of the Corporates to raise shariah compliant funds cost effectively.
- Features of Sukus as such that they can be used as liquidity management instrument by the Financial institutions undertaking Shariah Compliant business and for their use as monetary policy tool.
- Innovations are required to match these all extremes

International Experience-Malaysia

Share of Malaysia in Global Sukuk Market is 36%.

Steps taken on Supply side include:-
2. Consistent supply of Sovereign as well Corporate Sukus.
3. Innovations like offering new sukuks i.e. Khazana Exchangeable, Mukah Mudarabaha and plus Musharakha sukuks etc.
4. Sukus in any currency and by offering both to residents and non-residents.

Steps taken on Demand side include:-
1. Developing Islamic Interbank Market with ample number of Islamic Financial institutions.
2. Facilitating entry of foreign fund managers/Tax exemptions to non-residents.
3. Developing Islamic Funds/REITs/Infrastructure financing sector.
**International Experience-UAE**

Share in Global Sukuk Market is 32%.

Steps taken on Supply include:-
- Government and Regulatory support with consistent supply of Sukus.
- Innovations like introduction of convertibles and issuance of large size Sukus.

Steps taken on demand side include:-
- Developing Islamic Interbank market and listing of Sukus at Stock Exchanges.
- Focusing Onshore/offshore investors.
- All sectoral Financing viz: Infrastructure financing, Construction, Trade, Oil, Industrial investment are now being raised through Islamic mode.

**International Experience-Bahrain**

Share in Global Sukuk Market is 15%.

Steps taken on Supply side:-

1. Short-term as well long term, tradable, asset-backed sukuks have been provided by the Government in collaboration with BMA consistently since 2001.

Steps taken on Demand side

1. The Sukus were listed on the Bahrain Stock Exchange to enable their trading in the secondary market for its investors.
2. LMC was established to facilitate the creation of an interbank money market.
3. Government projects/Infrastructure financing projects carried out by Private/Public entities being financed by Islamic mode.
KEY CONSIDERATIONS FOR SUCCESS

- Proper Shriah, legal and Regulatory framework.
- Islamic Interbank market with ample number of participants.
- Innovation in Sukuk products by focusing on its pricing and risk characteristics (The success in this respect is evident from the fact that in Sukus 40-50% investment have come from conventional investors).
- Presence of short term as well long term Sovereign sukuk with consistent supply.
- Interbank market infrastructure.
- Tradability factor of Sukuk for its use by market participants as well Central Bank for its monetary policy operations.
- Developing investor base i.e. Islamic Funds/REIT/Infrastructure financing and providing incentives like tax exemptions.
- Developing Domestic Capital market.

PAKISTAN
## Growth of Islamic Banking in Pakistan

<table>
<thead>
<tr>
<th>Islamic Banking Players</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Islamic Banks</strong></td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>a) Number of branches of Islamic Banks</td>
<td>8</td>
<td>10</td>
<td>32</td>
<td>48</td>
</tr>
<tr>
<td><strong>Number of Conventional banks operating Islamic Banking Branches</strong></td>
<td>0</td>
<td>5</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>b) Total Number of Standalone Islamic Banking Branches of Conventional Banks</td>
<td>0</td>
<td>10</td>
<td>30</td>
<td>39</td>
</tr>
<tr>
<td><strong>Total Islamic Banking Branches (a+b)</strong></td>
<td>8</td>
<td>20</td>
<td>62</td>
<td>87</td>
</tr>
</tbody>
</table>

## Growth Trends

<table>
<thead>
<tr>
<th>Description</th>
<th>June 2003</th>
<th>June 2004</th>
<th>% Growth</th>
<th>June 2005</th>
<th>% Growth</th>
<th>June 2006</th>
<th>% Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits</td>
<td>6,517</td>
<td>13,158</td>
<td>102%</td>
<td>37,835</td>
<td>188%</td>
<td>59,657</td>
<td>58%</td>
</tr>
<tr>
<td>Financing &amp; Investments</td>
<td>5,421</td>
<td>13,102</td>
<td>142%</td>
<td>37,171</td>
<td>184%</td>
<td>57,936</td>
<td>56%</td>
</tr>
<tr>
<td>Total Assets</td>
<td>8,821</td>
<td>18,830</td>
<td>113%</td>
<td>54,017</td>
<td>187%</td>
<td>87,603</td>
<td>62%</td>
</tr>
</tbody>
</table>
Status of Sukuk Issuance in Pakistan

- No GOP Sukuk issued.
- The Sukuk issued in Corporate market are:

<table>
<thead>
<tr>
<th>Sukuk</th>
<th>Tenor</th>
<th>Amount</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sitara Chemicals</td>
<td>5 Years</td>
<td>360 million</td>
<td>Variable</td>
</tr>
<tr>
<td>Al Zamin Lease-II</td>
<td>5 Years</td>
<td>275 million</td>
<td>P&amp;L sharing</td>
</tr>
<tr>
<td>Wapda Sukuk</td>
<td>7 Years</td>
<td>8 Billion</td>
<td>6-month KIBOR+35bps</td>
</tr>
</tbody>
</table>

Prospects

- Potential of Capital market growth is enormous in Pakistan due to its geographical location/natural requirements
- PSEs / Utility services / Sub national authorities require huge financing for carrying out developments in their respective areas.
- To mitigate moral hazard/agency problem Securitization / Islamic Financing are the most appropriate techniques.
- Apart from Federal Government support, Infrastructure financing requirements estimated in the respective areas in next 10-15 years are as under:
  - Ports = Rs 104 billion
  - Aviation= Rs 133.9 billion
  - Energy = Rs 1,102 billion from Private/Federal Government
  - KESC = Rs 58 billion
  - Water Resources = Rs 219 billion
  - Fuel Sector = Public Sector Rs 219 billion + private sector Rs 174 billion
Issues

- Sovereign Sukuk market not existing.
- Islamic Interbank market is at infancy.
- Sub National/Infrastructure/mortgage instruments markets yet to emerge.
- Islamic financial/Takaful Industry is at early stage of development.
- Primary Sovereign/Corporate Sukuk market has yet to take shape. So obviously Secondary Market that follows Primary market is altogether non existing.
- Islamic Financing activities not yet part of Monetary Policy Operations.

Recent Domestic Sukuk Issuances

2006 has proved good for Sukuk market in Pakistan and following Sukus have been issued in the 2nd H/Y 2006 or are in the pipeline. They all represent Public Utilities/PSEs/Private Sector.

- Sitara Chemical Industries Limited : Standard Chartered Bank
  1,100,000,000 June-06
- Sitara Chemical Industries Limited : Meezan Bank Limited
  625,000,000 December-06
- Wateen Telecom : Standard Chartered Bank
  1,200,000,000 December-06
- Sui Southern Gas Company Ltd : Standard Chartered Bank/Dubai Islamic
  1,000,000,000 in Process
- Karachi Shipyards & Eng Work : Dubai Islamic Bank /Jahangir Siddiqui
  3,500,000,000 in Process
- Pakistan International Airline : Citi Bank
  2,000,000,000 in Process
Way forward

- Creation of Primary Sovereign Sukuk Market first.
- Creation of critical mass in Sovereign market to the level of Rs 30 billion. This would enable Islamic banks to meet their reserve requirements leaving some mass for secondary market trading.
- Creation of Repo market by innovating some model in accordance with our Shariah requirements and devising documentation/master Repo agreement.
- Making Islamic financing activities part of Monetary policy Operations. This can be done through introduction of short term Islamic MM instrument mimicking features of T.Bills/legislative changes/providing infrastructure.
- Install Price dissemination mechanism.
- Sequencing these developments

Conclusion

- SBP is coordinating with IFSB/IIFM in developing Islamic MM and Sukuk Market.
- In house SBP has also formed a Task Force to develop Islamic MM and suggest GOP regarding structure/Issuance of Sovereign domestic Sukuk.
- SBP is also coordinating with SECP to develop Corporate Bond Market by making them cost effective and by providing requisite market infrastructure. This would facilitate Corporate Sukuk issuance as well.
Thanks