



Sukuk

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Sukuk

Definition

Sukuk are called Investment sukuk and defined as “***certificates of equal value*** representing undivided shares in ***ownership*** of tangible assets, ***usufruct*** and services or (in the ownership of) the ***assets of particular projects*** or special investment activity, however, this is true after receipt of the value of the sukuk , the closing of subscription and the employment of funds received for the purpose for which the sukuk were issued”

Shari'a Standards, 1424-5H/2003-4 Accounting and Auditing
Organization for Islamic Financial Institutions, p298

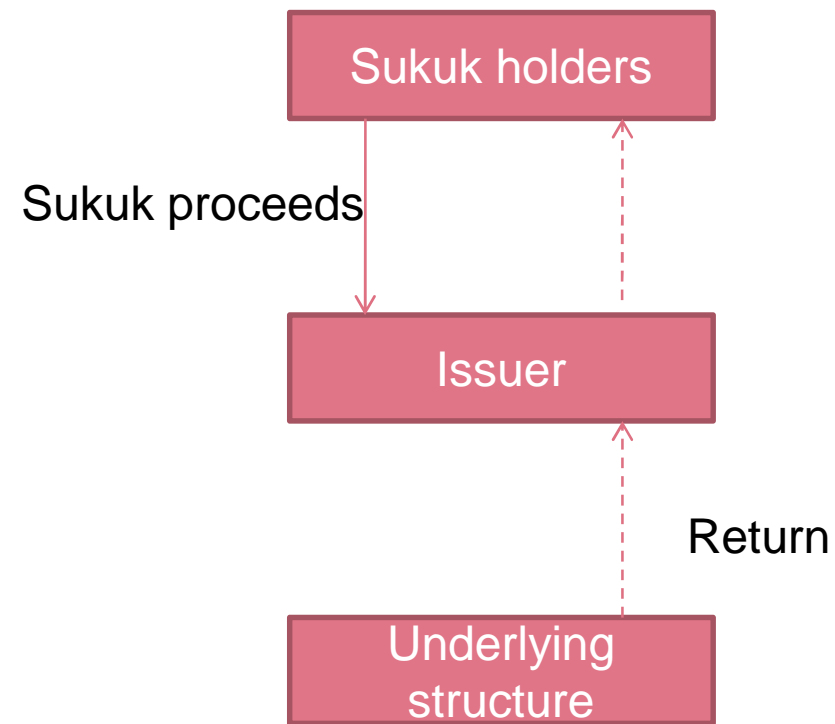
Sukuk - Definition

- Also known as Islamic Bonds
- In essence, the Sukuk is a financial instrument that sits above a Shariah-compliant underlying structure which generates an income for the holder of the instrument.
- Islamic securitisation transactions
- Claim similar to trust certificate
- Certificate represents beneficial ownership interest in underlying asset generating cash flow

Who are the Sukuk investors?

- Investors who would like to invest their funds/money today, in return for an equity stake like common equity, and returns of dividend and /or capital gains,
- Those wanting a periodic and assured rate of return and a maturity value payment , as in the bond markets and
- Venture capitalists who invest in an innovative or promising project with the expectation of reaping the benefits in future, by risking their initial capital investment.

Basic Sukuk Structure



Types of Sukuk

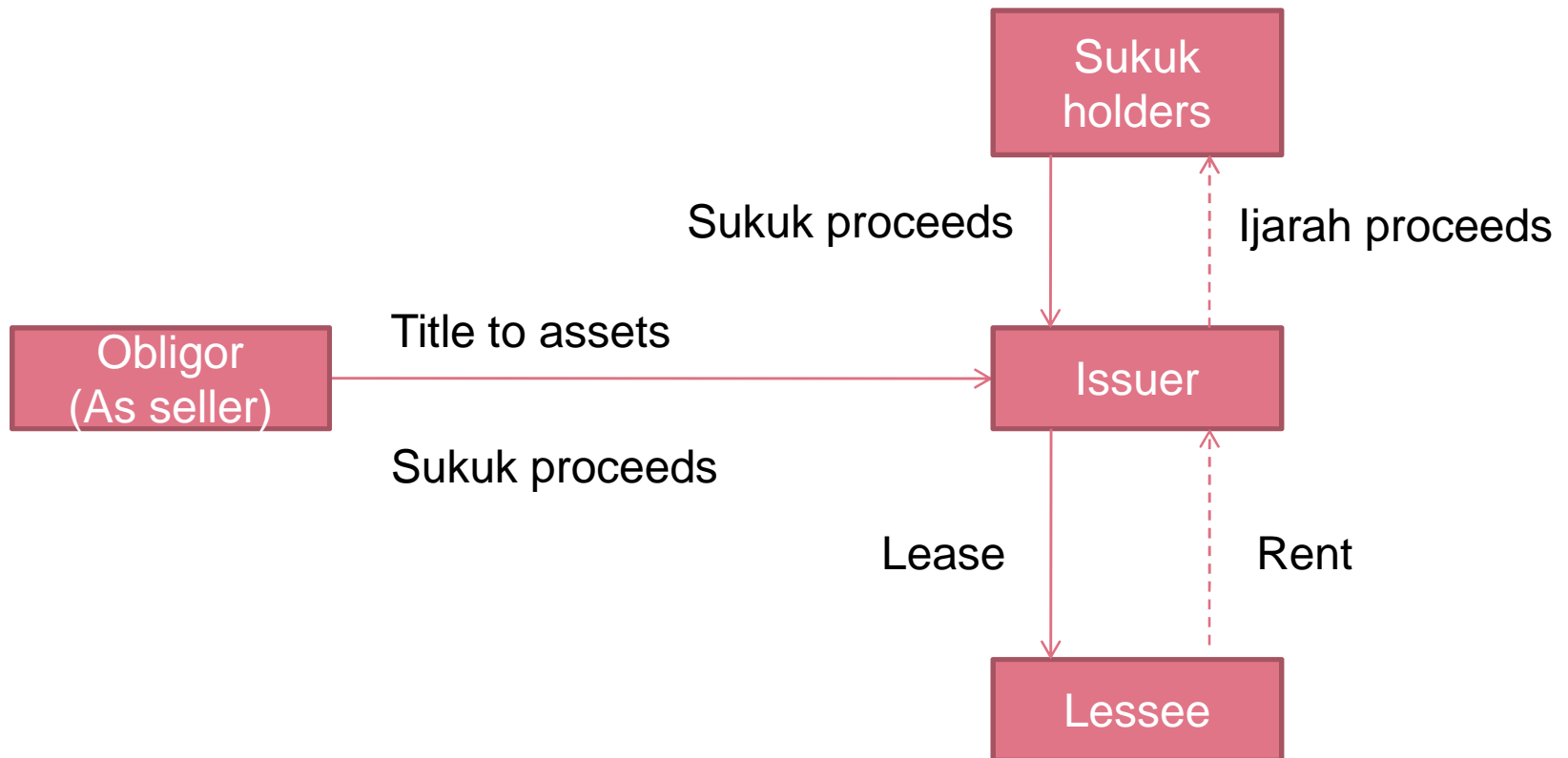
Sukuk Ijarah (leasing)

- investment certificates representing ownership in leased assets or ownership rights in lease rentals or;
- certificates of ownership of usufruct of existing assets
 - Owners of the certificates become owners of the usufruct of the assets for duration of sukuk issue

Sukuk Murabaha

- Acceptable form of credit sale under Shariah Law
- Used as a liquidity management tool underlying asset commodities
- Also used for property purchases - similar in structure to a “rent to own arrangement”

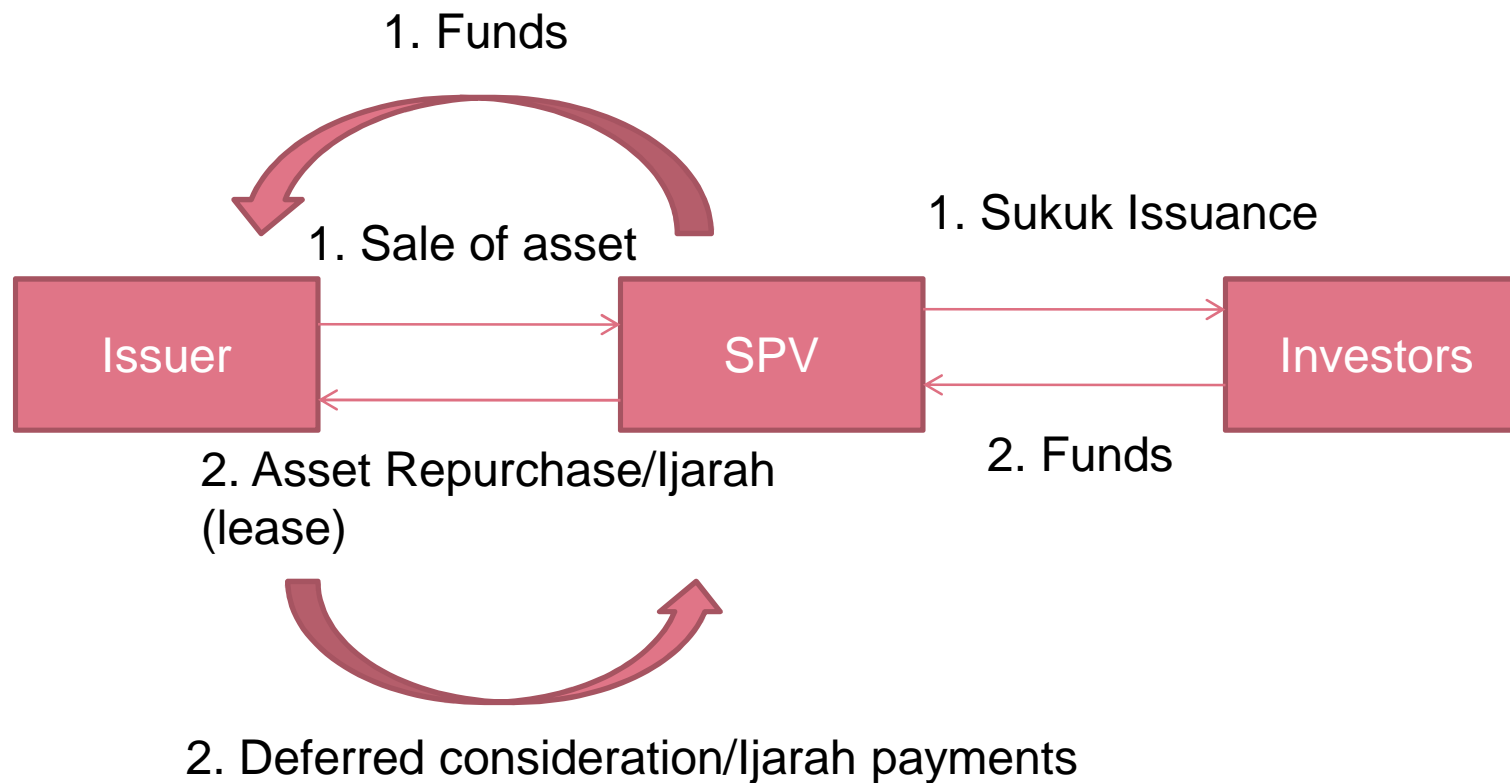
Structure of Sukuk Ijarah



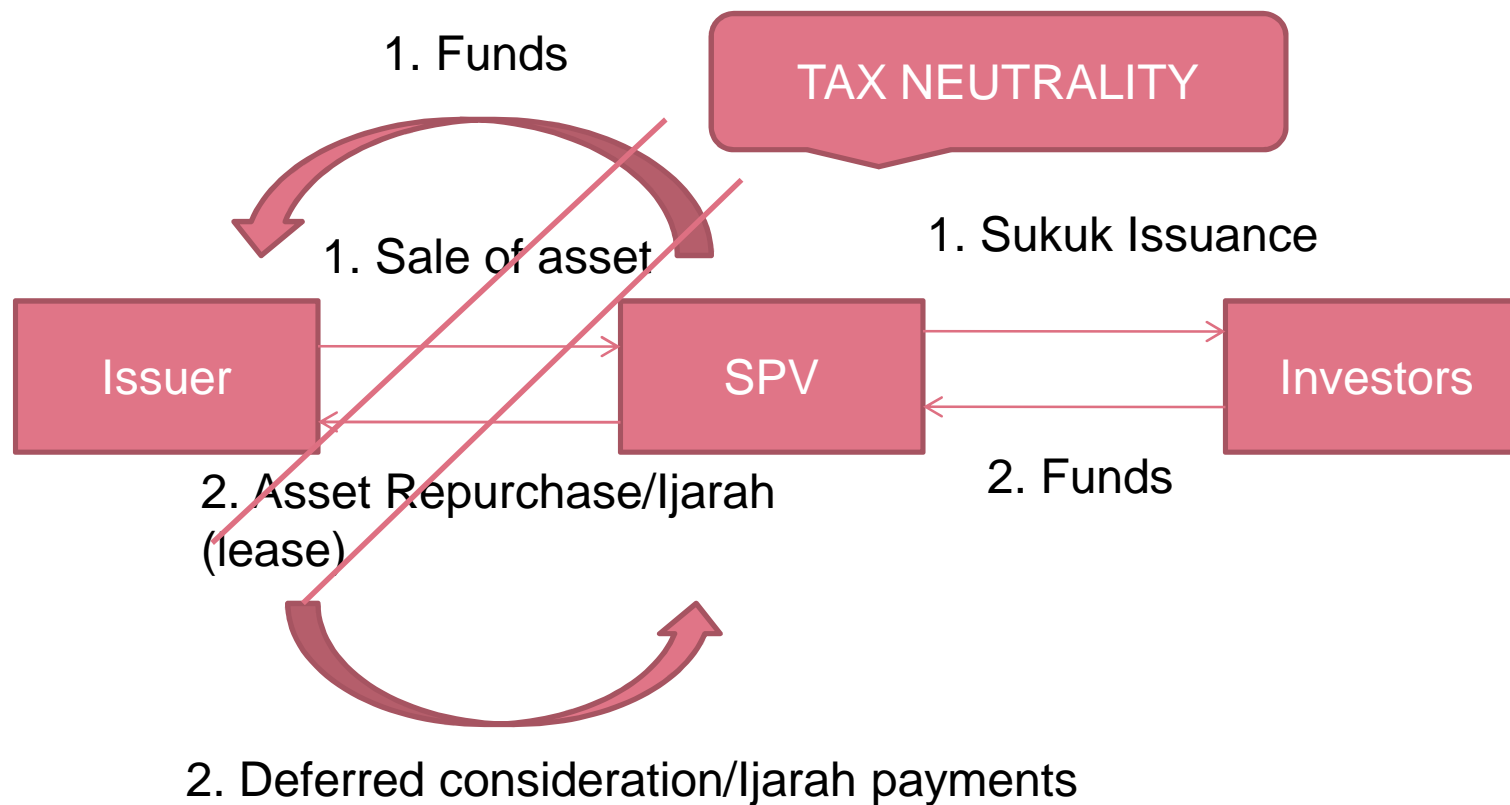
Sukuk Ijarah

- Originator sells assets to Sukuk Issuer
- Issuer pays for assets using sukuk proceeds
- Issuer holds title to assets on behalf of sukuk holders
- Issuer leases back assets to originator for rental income for fixed period
- At maturity originator may have right to buy back assets from issuer
- Asset backed vs Asset based
- Structure commonly used by sovereigns and corporates
- 44% of all sukuk issuances

Tax effect of Sukuk Ijarah



Tax neutrality required for Sukuk Ijarah



Regulatory amendments

- Finance Minister Pravin Gordhan stated:
“The development of Islamic finance in South Africa is critical to the expansion of National Treasury’s strategy to position South Africa as a gateway into Africa. The treasury envisages South Africa being a central hub for Islamic product development and ensuring the rollout of such products into African markets.”
- Budget Speech Feb 2011 – Minister announced:
 - Taxation of Islamic financial products would be aligned with conventional financial instruments
 - This year the rules will address ijarah products, which act like commercial finance leases.
 - Amendments to legislation will facilitate the issue of Islamic-compliant government bonds

Investment Strategy

Asset allocation strategy as part of a Balanced Portfolio:

- Seeks to provide investors with capital appreciation and current income
- Balanced portfolio ideally result in a mix of assets generating cash as well as appreciation over time, with small fluctuations in principle (capital)
- Typically include medium term fixed income obligations, equity stocks paying cash dividends and Real Estate Investment Trusts (REITs')
- Sukuk basically considered a REIT
- Strategy used typically “buy and hold”

Investment Strategy

- Sukuk are selected based on number of factors:
 - ❖ Issuer
 - ❖ Rating
 - ❖ Coupon
 - ❖ Yield
 - ❖ Term to maturity
 - ❖ Call features
 - ❖ Covenants
 - ❖ Target duration

Global Sukuk Market

- Issuances forecast to rise to US\$22 billion in 2011
- Emerged in 2002 – Malaysian Government's US\$600m sukuk issue
- Main issuers – Banks, Governments and Infrastructure, Energy and Real Estate businesses
- UAE and Malaysia most active sukuk markets
- Malaysia sukuk bonds issued > conventional bonds issued
- Western investors interested in sukuk due to strong real value and low risk
- Sovereigns issuing as part of National Agenda
- Gulf Pension funds and Insurance industry looking at investments in sukuk as part of investment strategy

SA Sukuk Market

- **ABSA Equity Murabaha Conduit**
 - Caters for liquidity management
 - Short to medium term requirements
 - Guaranteed returns

- **Investec Product**

PwC Capabilities

- **Global Islamic Finance Team (GIFT)**

Islamic Finance capabilities and services provided:

- Project Co-ordination - provide programme co-ordination services (advise, review, challenge and recommend)
- Change Management - provide change management services (advise, review, challenge and recommend)
- Assessment of Go To Market Strategy, Target operating model and Business Case
- Design of Islamic Banking Unit and Development of Implementation Strategies which includes

PwC Capabilities

- Products and Markets
- Governance
- Processes
- Technology
- Organisation and People
- Build, Test and Training of completed model
- Close working relationship with National Treasury with respect to amendments needed to Regulations and Tax Laws
- Actuarial Capabilities in the Takaffol, Re-Takaffol and Banking Industries

PwC Capabilities

- Assistance with licence application and market entry strategy for Takaffol and Re-Takaffol industry
- Product development and Pricing
- Design and development of Management information systems
- Review and Optimisation of Reserving, underwriting and finance processes and controls
- Capital Requirements and Strategic Growth
- Implementation of Basel II and Capital models
- Implementation of Solvency II

Thank you.

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