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Contents

MARKET OPINION

Foreword

DR SAYD FAROOK
Global Head of Islamic Capital Markets
Thomson Reuters

Thomson Reuters welcomes you to the third consecutive Sukuk Perceptions & Forecast for 2015. This study continues to provide a much-needed overview and forward-looking analysis of the global sukuk market, taking stock of the key challenges and issues affecting the industry. The study is complemented by the findings of our comprehensive Sukuk Forecast & Perceptions Survey, that delivers insights and preferences from a wide range of investors and issuers, and that provides insights on the preferences of investors and expectations of key players. In addition, this study presents market insight through leadership analysis and opinion pieces on different aspects of the sukuk industry.

The global sukuk market, today worth over $312.3 billion (outstanding sukuk), continues to drive the growth and development of the Islamic finance industry. 2014 witnessed a significant milestone in terms of sovereign issuances putting sukuk in the mainstream. Non-OIC countries such as Hong Kong, Luxembourg, South Africa and the United Kingdom tapped the market for the first time, increasing the confidence in the industry and paving the way for other countries to follow. There were also other firsts including Goldman Sachs and Bank of Tokyo-Mitsubishi issuing a first-ever U.S. bank and Japanese bank sukuk.

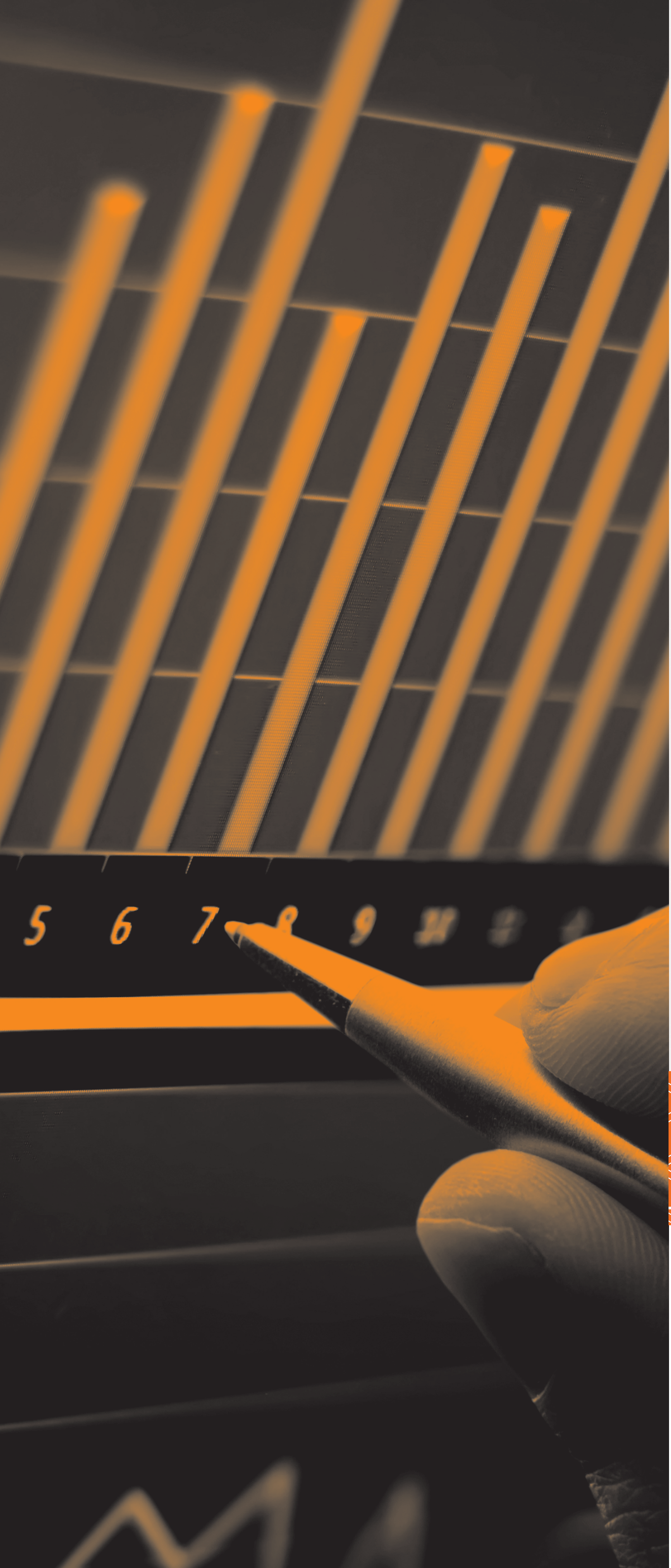
New sukuk markets are also opening up, with a number of countries working to finalise regulations to allow the issuance of sukuk. Countries such as Egypt, Jordan, Morocco, Oman, and Tunisia have shown great interest in issuing sukuk in 2015, particularly to support and fund infrastructure projects.

Nevertheless, a number of challenges that limit the growth of the sector need to be solved. Deficiencies still persist in areas such as transparency, standardisation, and liquidity in the secondary market, mainly due to limited trading mechanisms and the different treatment of certain structures in different jurisdictions.

We believe that studies such as these are essential for a global forward-looking perspective of the industry, addressing the challenges and issues affecting the industry and developing strategies to solve them. We expect this report to be of interest to a wide range of public and private sector stakeholders. In particular, the findings of our survey will assist issuers to assess market appetite for potential issuances and assist lead arrangers, originators and advisors to better understand the scope of available opportunities.

We would like to thank all participants of the Sukuk Survey, and the authors and experts who have contributed to this report. We would like to extend our thanks and appreciation to the sponsors who have supported the development of this study, specifically Barwa Bank, NASDAQ Dubai and Türkiye Finans.

In addition, we are grateful to Thomson Reuters management, particularly Nadim Najjar, Managing Director, Middle East and North Africa, for his foresight to invest heavily in the development of the Islamic financial services industry, and their continuing support of our work.



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Executive Summary

Sukuk Perceptions & Forecast 2015 provides forward-looking analysis of the global sukuk market, insights and preferences from a wide range of investors and issuers through the Sukuk Survey, and market opinion through leadership articles and a Sukuk Debate.

KEY HEADLINES

Market bounces back from 2013 low

2013's global sukuk market plunged 15% from 2012's high of $137 billion worth of sukuk. There's good news for 2014 - total issuance for the first 9 months of the year reached **$99.26 billion**, which is 85% of 2013's full-year value, and the market is optimistic it will break free of last year's depression.

More jurisdictions than ever before: new sovereigns and corporates

The recovery from last year's low has been driven by more jurisdictions issuing sukuk. For the period under review, the first 9 months of 2014, 19 countries were represented in the global market. This is the highest number the industry has ever seen, surpassing the previous high of 18 in 2012. There were notable debutantes including a group of sovereigns – UK, Hong Kong, Luxembourg, South Africa, and Senegal – and corporates – a real estate company in the Maldives, Goldman Sachs, and Bank of Tokyo-Mitsubishi.

The strong momentum for sovereign and quasi-sovereign sukuk issuance is met by fundamentally solid market demand and appetite for quality papers. For the period under review versus full-year 2013 total sovereign sukuk reached $63.05 billion versus $76.26 billion, quasi-sovereign total issuance was $13.61 billion versus $8.46 billion, and $22.6 billion versus $32.21 billion for corporates.

Financial institutions continue to dominate all corporate issuances, followed by issuers from power and utilities, construction, real estate, and transport. Our Sukuk Survey reveals market appetite for sukuk from oil and gas, power and utilities, real estate, and construction, which bodes well for both governments and corporates overlooking large infrastructure multi-asset projects in countries actively planning sukuk such as Oman, Tunisia, Morocco, Jordan, and Egypt.

Demand and supply drivers

The order book for the UK's GBP200 million sukuk was reportedly GBP2.3 billion, making the sale 12 times oversubscribed. Hong Kong's sukuk was 4.7 times oversubscribed, South Africa's 4.4 times, Goldman Sachs' 3 times, and Luxembourg's 2 times. Investors regularly over-bid in the hope of better allocation but these inflated orders point to solid demand and oversubscription is driven by excess demand chasing limited supply.

Based on growth trajectories we forecast the sukuk demand and supply gap to narrow the next 5 years, from $227.1 billion in 2015 to $208.7 billion in 2018 to $195.8 billion in 2020.

The debutante sovereigns and corporates of 2014 may not continue to tap the sukuk market but supply growth will not fall off in their absence. Sovereigns, quasi-sovereigns and corporates from the GCC and Southeast Asia (i.e. Malaysia and Indonesia) will continue to be long-term repeat issuers who use sukuk as a major financing instrument. Malaysia and the UAE issued new guidelines this year to encourage more corporate issuances and the pipeline is strong for new sovereign entrants from the GCC and the wider Middle East region who are more likely to be mainstays of the global sukuk market and whose issuances will pave the way for their quasi-sovereigns and corporates to go to market; these include Oman, Tunisia, Morocco, Jordan, and Egypt. Oman has already indicated it will issue a sovereign sukuk early 2015 to support the liquidity needs of its domestic Islamic banking sector, and there may also be consideration to raise sukuk to boost public finances as oil price drops lower state revenues.

Additionally, infrastructure projects in the other GCC countries will continue to drive sukuk growth from sovereigns, quasi-sovereigns and corporates, with UAE and Saudi Arabia expected to continue to lead.

Another growth driver is the implementation of Basel III rules with their demands on banks to hold high quality liquid assets. Sovereign, quasi-sovereign and high-quality corporates will find appetite from Islamic banks to invest in their sukuk (as already evidenced by high demand for IILM sukuk). Islamic banks will also be looking to boost their Tier 1 and Tier 2 capital and we will see more Basel III-compliant sukuk in the market.

OUTLOOK FOR 2015

As sukuk issuance approached the $100 billion mark at the end of Q3, 2014, issuers, investors and other market players from our Sukuk Survey expect issuance for the whole of 2014 to be in the range of **$125 billion** to **$149.9 billion** as all look to a strong pipeline for Q4, 2014. Most of the market players from our Sukuk Survey expect 2015's total issuance to be within the range of $150 million to $174.9 billion, reflecting strong market confidence in the future of sukuk. Supply growth will be driven by financing needs for infrastructure projects especially in the GCC and the wider Middle East region.

However, our Sukuk Survey reveals that about 50% of investors expect to allocate between **5%** and **24.9%** of their portfolios to sukuk, which is markedly lower than last year when investors indicated in the 2013 survey that they would allocate an average of 25%-35% to sukuk. We attribute the drop to market expectations of higher interest rates due to economic recovery in Western markets.

Market Opinion

Paving the way for future sukuk bids

By Arsalaan (Oz) Ahmed, Head of Capital Financing – Barwa Bank

The year 2014 has been a standout year for sukuk. After the significant successes of the last few years, it felt almost impossible to mark this year with similar achievements or top them. Surprisingly, this year was special as it saw the culmination of a number of highly anticipated issuances that were years in the making, mainly the sovereign issuances from the United Kingdom, Hong Kong, Luxembourg and South Africa.

Seeing these deals finally come to fruition is a massive signal that the sukuk market is 'open for business' worldwide. Such openness entails not only past issuers but also the cautious ones, or those who had any doubts of the importance, relevance and accessibility of sukuk as a liquidity pool. For the senior unsecured global sukuk product, the vista of acceptance has been reached and many can and will follow.

Now that the blockbusters have been played, what is next? There will be some sequels anticipated which may rival the originals. A UK corporate issuing will no doubt have a "wow" factor, but following on from the UK sovereign issuance it will not be a surprise despite its ability to cause investor frenzy like the sovereign deal. The eight hundred pound gorillas, yes plural, sitting in the room are the local currency sukuk, short-term sukuk and asset-backed sukuk.

The asset-backed global market has not really returned to the pre-2010 heyday and it is unlikely that the sukuk market will carve itself out something different in this space. An issuance or two with 'truly' asset-backed sukuk might find its way to market through other non-traditional market influences. This would be a positive step for sure; however the factor with the greatest impact would be the growth of local currency market as well as the short-term sukuk market outside of Asia.

LOCAL CURRENCY MARKET

The local currency bank market, particularly in the GCC, is certainly witnessing resurgence, which reflects the comfort and preference for many local clients with their native currency. Still, a need to better construct capital structures given the regional downturn a few years ago is emerging and clients are increasingly seeking other options. One of the main reasons for the preference of local currency bank finance is the lack of rating of potential sukuk issuers. For example, when a USD sukuk is presented, most clients know that without a rating the pricing will not make sense for such funding diversification and they will not be ready to go through an international rating process. Yet at the same time it is clear that the credit of these clients is considered "blue chip" locally. Moreover, banks and other institutions can and would get comfortable with such clients but policy restriction on rating will be a barrier. Clearly, there is a gap.

ARSALAAN (OZ) AHMED

Arsalaan is a Sukuk specialist with over 10 years of experience in Financial Services & Islamic Banking. Oz joined Barwa Bank in October 2013 from HSBC where he played a lead role in developing the Islamic Debt Capital Markets & Wholesale Banking platform.

Oz has originated and executed multiple Sukuk transactions across the Middle East and Asia notably including the first public Sukuk related to Makkah development. Over the past 5 years he has also advised government bodies in Europe, Asia and Africa in setting up Islamic finance and developing a roadmap to issuing Sukuk.

He is a graduate from University College London and has a Master's Degree from the University of Bristol.

LOCAL RATINGS AND REGULATORY SUPPORT

The gap can be filled by looking at the Malaysian example where there is a very healthy sukuk market, one which is often economically preferable to the parallel bond market, as a result of investor depth and breadth. This has been facilitated by the growth and diversity of liquidity seeking Shariah-compliant assets as well as the local rating setup and regulatory support.

In the GCC, the liquidity pools are certainly there and the diversity is picking up. What is needed is a drive to build up the institutions to support development instead of leasing a local rating setup and regulatory capital relief against such ratings. This is implied already with local sovereigns not being investment grade but attracting regulatory relief – it is not a stretch to relax capital constraints for companies with local ratings, of course, once such rating setup has local regulatory blessing.

Introducing new institutions and getting capital relaxation takes time, understandably. Something that might be able to come in sooner would be the allowance of commercial paper instruments based on internal credit analysis. Although this may send shivers down the spines of veterans who live to tell the tales of the recent financial meltdown, they would probably say that the idea is sound if implemented properly. Clearly, lessons can be learnt from the past on how to do this correctly. It is also a nice way to lure companies into the capital markets, a taster if you like.

These are just a few examples of where sukuk needs to go, more local currency, more short-term, some asset-backed whilst the senior unsecured reaches new highs. The question to be answered is how to get there, and the response is clearly a lot of joined-up hands from practitioners, institutions, investors and most importantly daring clients.

Chapter One

Global Sukuk Market Overview

What happened?

in the global sukuk market in 2013

ISLAMIC FINANCE DEVELOPMENT INDICATOR – GLOBAL SUKUK DEVELOPMENT

The sukuk sub-indicator of the Islamic Finance Development Indicator (IFDI) assesses sukuk growth and performance. The seven metrics considered are: Number of sukuk issuance, Number of outstanding sukuk, Sukuk issuance volume, Sukuk outstanding volume, Number of listed sukuk, Number of rated sukuk, and Bid/ask spread.

SUKUK HEADLINES

- 26% (24 countries) of the IFDI universe of 92 countries contributed to the Sukuk sub-indicator
- Global Average Indicator Value for Sukuk is 3
- 11 of the 24 countries (46%) scored higher than the global average
- Out of the 11 that scored higher than the global average 36% (4) are from GCC, 36% (4) Southeast Asia, 9% (1) from Africa, 9% (1) from Europe, and 9% (1) from North America
- Top 10 geographical representation – 40% GCC, 30% Southeast Asia, 10% Africa, 10% North America, 10% Europe

ICD THOMSON REUTERS ISLAMIC FINANCE DEVELOPMENT INDICATOR BACKGROUND

The ICD Thomson Reuters Islamic Finance Development Indicator is a composite weighted index that measures the overall development of the Islamic Finance industry by providing an aggregate assessment of the performance of all its parts, in line with the objectives of Islamic principles.

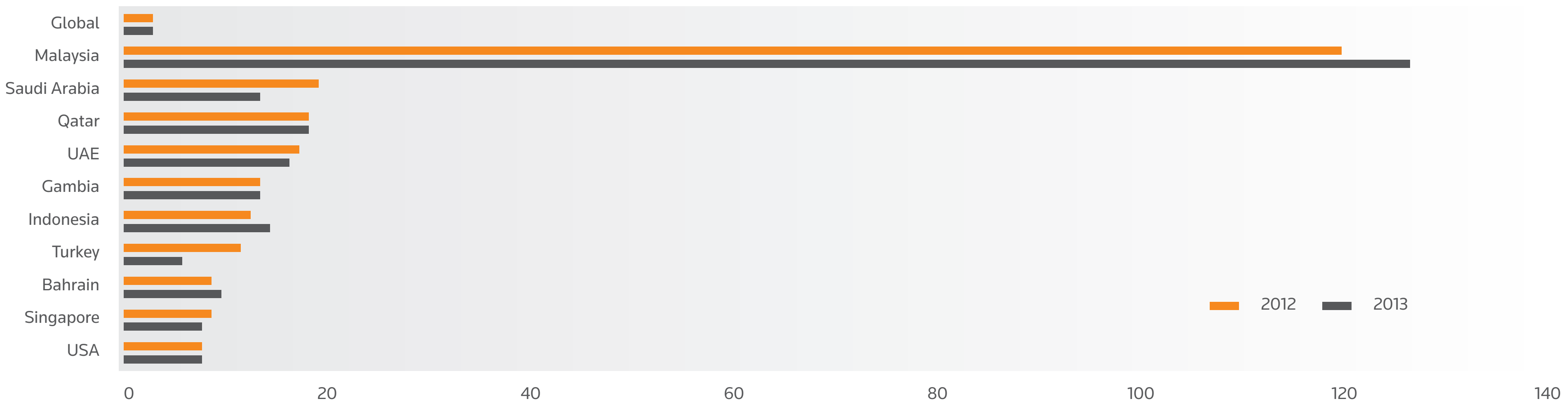
It is a global level composite indicator with country and unit specific level indicators. The composite indicator is released annually, featuring a full report detailing each country and unit specific level indicator and their raw numbers.

Each indicator within the composite indicator's constituents will be equally weighted and aggregated, i.e. all variables are given the same weight. In addition, normalisation is required prior to any data aggregation as the variable indicators in a data set have different measurement units.

For the Country Composite Indicator level, country indicators are normalized to allow for meaningful comparisons over time for a given country and between countries. Various economic indicators (e.g. population size) will be considered while measuring the health of the Islamic finance industry in each country.

For all other insights, visit IFDI Online Model and download the ICD-Thomson Reuters Islamic Finance Development Indicator Report 2014
https://zawya.com/islamic-finance-development-indicator/

INDICATOR VALUE FOR TOP 10 COUNTRIES 2013 VS 2012 SUKUK SUB-INDICATOR, IFDI



MALAYSIA STILL #1

Malaysia was the runaway sukuk leader. Its outstanding sukuk value stood at $166 billion at the end of December 31, 2013

SUKUK GAINING GROUND IN SAUDI ARABIA AND QATAR

Saudi Arabia and Qatar ranked a distant second and third behind Malaysia for Sukuk development but both were strong performers. These two markets are expected to continue to issue more sukuk, especially Qatar given the number of infrastructure projects in the pipeline for World Cup 2022.

TURKEY'S SUKUK POT FILLED UP FAST

Turkey was the newest sukuk market to reach the top 10 in 2013. Its debut sovereign sukuk was issued in September 2012 and at end-2013 the Republic had 10 outstanding sukuk with an outstanding value of $6.43 billion.

SUKUK REACH WIDENS

Muslim-minority countries Singapore and the U.S. made it to the top 10 sukuk markets, indicating an increasing preference for sukuk as an alternative source of funding and debt management. The latter had 3 outstanding sukuk as at end-2013 to the value of $766 million.

DESPITE A SLOWDOWN IN 2013, THE SUKUK MARKET REGISTERED A NUMBER OF KEY MILESTONES

Sukuk volume dropped by approximately 15% in 2013. The slowdown was attributed to a number of reasons chief of which was the U.S. Federal Reserve announcement to taper its bond-buying programme which sparked uncertainty about interest rate movement. 2012 was always going to be a tough act to follow; there were big-ticket deals which weren't likely to be repeated the following year, including the Malaysian government $10 billion mega issue, Saudi Arabia's GACA's SR15 billion ($4 billion) issue, and Qatar's $4 billion sukuk.

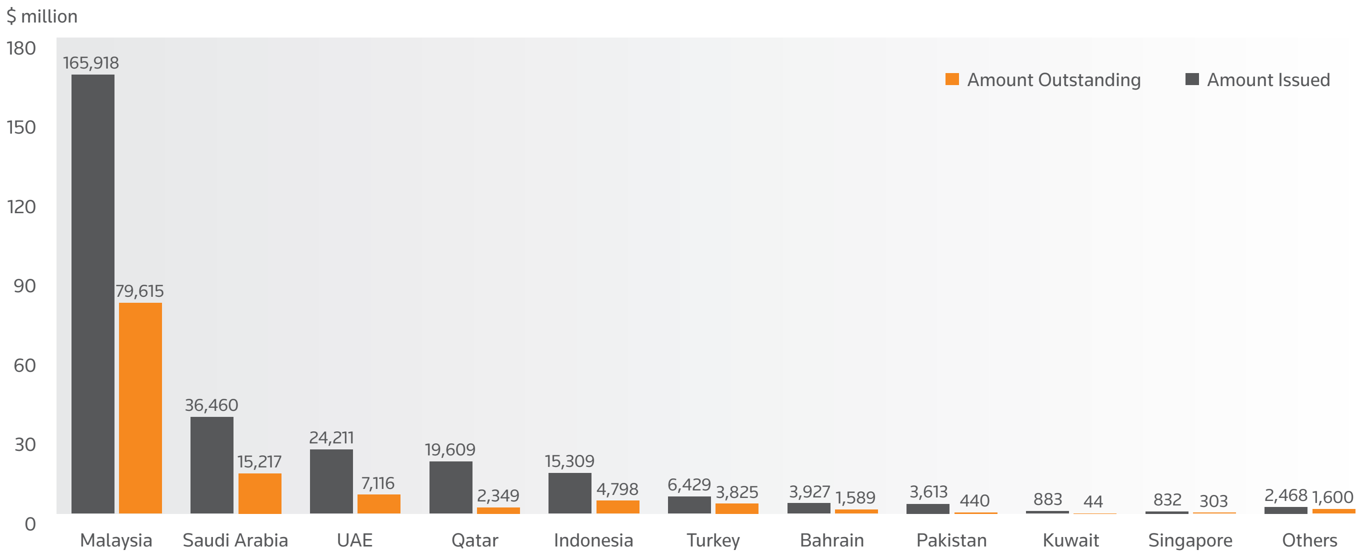
However, in 2013 sukuk market trends and movements more or less remained the same. Malaysia dominated the market with $79.6 billion issued, representing 68% of the total sukuk market. Malaysia will continue to dominate the market; liquidity and tradability factors put the country at the top of the list for both local issuances as well as cross-border sukuk.

Saudi Arabia also performed well and was the GCC's top issuer with $15.2 billion.

Of the $116.9 billion sukuk issued globally in 2013, 85%, or $99.3 billion, were issued domestically compared to $17.6 billion issued internationally. In terms of sectors, approximately two-thirds of issuances were from sovereigns.

However, corporates are coming out of their shells a lot more; 27.3%, equivalent to $31.9 billion was raised by corporates for different reasons, including debt refinancing and business expansion.

GLOBAL SUKUK AS AT DECEMBER 31, 2013
OUTSTANDING VS ISSUED AMOUNT



Total Global Sukuk issued volume in 2013

$116.9 billion

Total Global Sukuk issues in 2013

812

Total Global Outstanding Sukuk volume in 2013

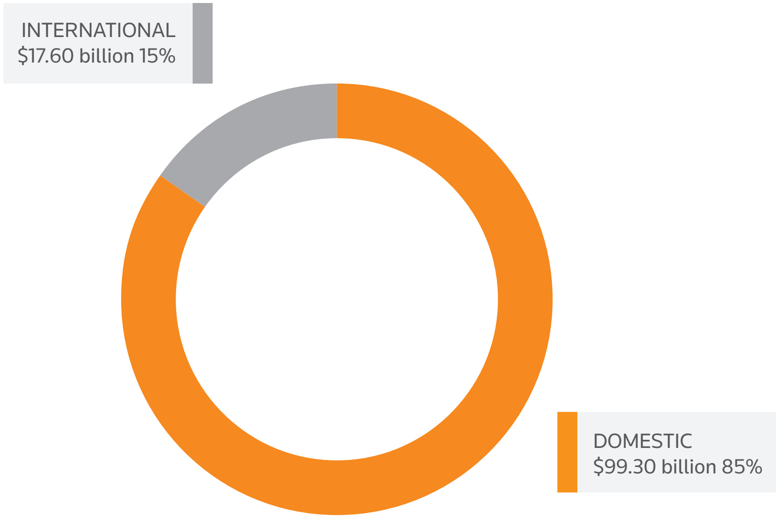
$279.6 billion

Total Global Outstanding Sukuk issues in 2013

1,812

GLOBAL SUKUK ISSUED IN 2013 BREAKDOWN BY SECTOR (USD BILLION)

GLOBAL SUKUK ISSUED IN 2013 BREAKDOWN BY MARKET TYPE (USD BILLION)



Q1 2013

2013 started off with a Sime Darby sukuk registering the lowest corporate coupon ever in the USD sukuk market. Sime Darby set a new benchmark yield for Malaysian credits that will surely entice more Malaysian corporates to the international markets. The $400 million 5-year Reg S paper was issued at 130bps over US Treasuries and the 10-year tranche at 145bps. What drove the company to achieve such a low yield was the scarcity of investment grade paper as well as scarcity of Malaysian bonds. Additionally, Sime Darby is an infrequent visitor to the international market and was hence given a very warm welcome.

In March, Dubai's Emirates Airline went to market with a $1 billion amortising sukuk, which priced at the tighter end of guidance. Sukuk, without a doubt, are optimal for the airline and aviation sector given the excellent match of the long-term nature of the assets with a regular income stream from passenger traffic.

Q2 2013

In April, Saudi corporate Al Bayan tapped the Malaysian sukuk market, making it the first Saudi corporate to raise funds in the ringgit market with an issue at par of $65.7 million. The company wanted to test investors' appetite for Middle Eastern credits that are not sovereign or quasi-sovereign. The success of the deal could suggest that another may not be too far away.

Q3 2013

In August, Singapore-based offshore marine services company Swiber sold a SGD$150 million ($118 million) debut sukuk. The price clinched by Swiber was more competitive than conventional debt, and Brunei investors bought more than half of the sukuk. While this is not the first time Brunei buyers have participated in Singapore's fledgling sukuk market, their dominance of Swiber's order book is a good sign for other Singaporean companies that are looking to sell Islamic debt in the local market, such as Mustafa Group and Sabana REIT.

On the money market side, IILM launched its long-awaited sukuk debut, a $490 million sale. As expected, the paper was fully subscribed. Because of the sukuk's multinational structure, multiple boards of Islamic scholars needed to rule on its religious permissibility.

Perhaps one of the most interesting sukuk of 2013 was the exchangeable sukuk from Khazanah Nasional offering a negative yield for the $484 million issue. The exchangeable sukuk is the first equity-linked offering with a negative yield from Asia ex-Japan since March 2012, when Khazanah issued a $357.8 million sukuk exchangeable into shares of Parkson Retail. The paper was priced with a yield of negative 0.25%, skewed at the tighter end with initial price guidance 0% to negative 0.25%, and with an exchange premium of 17%, from guidance of 10% - 17%.

Meezan Bank announced in August plans to arrange a $68.5 million airtime sukuk that was approved by its Shariah board, making it the first airtime sukuk out of Pakistan. However, the sukuk is yet to be issued. The planned sukuk uses intangible assets, in this case mobile telephone minutes.

In September, Nigeria finally made it to the sukuk market with a small corporate issuance of $62.6 million after Nigeria's Securities and Exchange Commission approved new rules facilitating sukuk in March 2013. The sukuk pays 14.25%, which is not surprising given Nigeria's credit quality.

Q4 2013

In October, the last GCC country to allow Islamic finance finally made its sukuk debut. Omani real estate developer Tilal Development Co sold the country's first sukuk, a 50 million rial ($130 million) sukuk that could pave the way for similar issues by other companies in the Sultanate.

On the exit side, in December, Dana Gas agreed with its creditors to restructure its $1 billion convertible sukuk. The restructuring came into play after the company had missed its sukuk repayment, after investors threatened the largest private sector energy group to call a default and enforce on the group's assets.

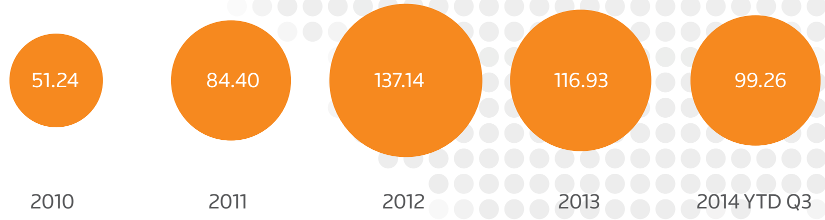
THE VIEW FROM 2013

Despite the slowdown in sukuk issuance, 2013 registered many key milestones. The outlook for the years ahead are promising with investors becoming more confident tapping the sukuk market to raise funds or diversify their investments. Investor sentiment is positive especially for cross-border sukuk; we have seen GCC issuers, as well as Kazakhstan, tap the Malaysian market. Most recently in July 2014 Turkiye Finans issued a ringgit sukuk in Malaysia. The market has also welcomed new entrants such as Hong Kong, Japan (corporate) Luxembourg, Maldives (corporate), Senegal, South Africa and the UK and it looks forward to debut sukuk from Tunisia, Morocco and possibly Egypt once the political environment settles. In terms of structure, a few have attracted the attention of market players, such as airtime sukuk that allows companies to raise funds using intangible assets.

What has been happening?

in the global sukuk market up to Q3, 2014

Global Sukuk Historical Trend – $ billion



Total Sukuk issued up to Q3, 2014

$99.26 billion

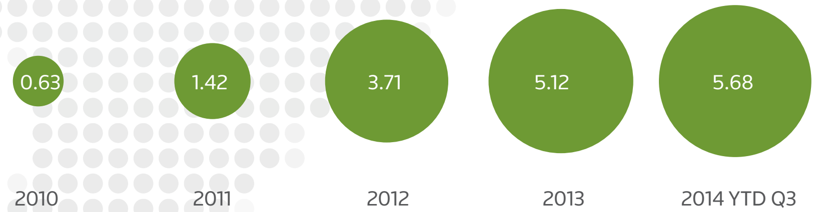
Number of Sukuk issued up to Q3, 2014

739

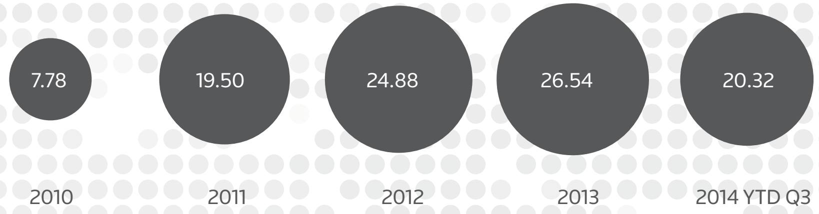
SUKUK MARKET KEY HIGHLIGHTS

- **$632 billion** total aggregated sukuk issued (1996-Q3,2014)
- **Qatar Government Sukuk**, biggest issuance in 2014 amounting QAR7 billion
- **19 jurisdictions** tapped the sukuk market in 2014
- Sukuk were issued in **16 currencies** in 2014
- **Hong Kong**, **Luxembourg**, **Senegal**, **South Africa and the UK** were new sovereigns to the sukuk market
- **Malaysia** issued $66.23 billion accounting for 67% of market share
- **GCC** issued $20.32 billion (20%), Asia ex. Malaysia $7.04 billion (7%) & **other regions** $5.68 billion (6%)
- **Malaysian Ringgit** dominates all issues - $62.24 billion followed by USD with $20.87 billion
- Total **sovereign** sukuk issuance reached $63.05 billion compared to $13.61 billion **quasi-sovereign** and $22.60 billion corporates
- 56% of outstanding listed sukuk are **on the LSE**, **Nasdaq Dubai and Bursa Malaysia**
- **14 structures** used: murabahah most used at 37.3% then salam at 21.1%
- 94% of sukuk issuance **domestic**, 6% **international**

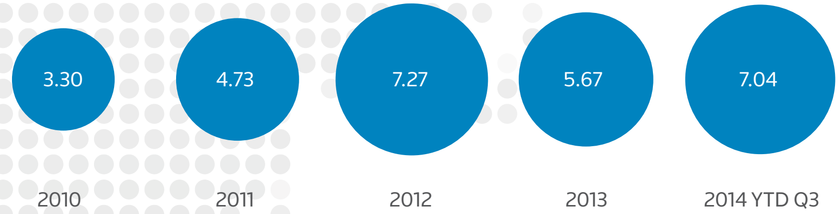
Other Regions – $ billion



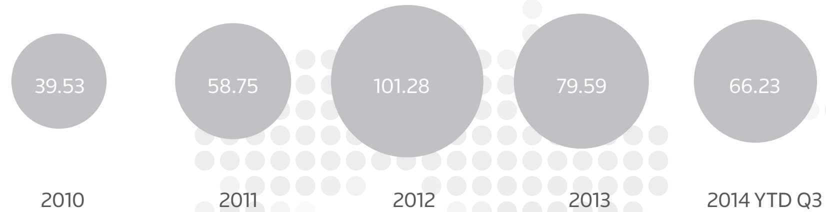
GCC – $ billion



Asia ex Malaysia – $ billion



Malaysia – $ billion



Total Outstanding Sukuk volume at Q3, 2014

$312.3 billion

Number of Outstanding Sukuk issues at Q3, 2014

587

Sukuk Key Milestones 2014

JAN

Issuance

First sukuk out of Maldives issued – 10-year corporate sale worth $3.29 million

Regulation

- **UAE** UAE exposure curbs to boost bond and sukuk issuance
- **Egypt**'s sukuk law to be replaced with chapter in existing securities law

Sukuk Pipeline

- **Oman** plans OMR200 million sovereign sukuk

FEB

Issuance

- Malaysia's **EXIM Bank** sells first USD sukuk from an Ex-Im bank, issuing a $300 million, 5-year sukuk
- Malaysia's **AmIslamic** issues RM200 million Basel III-compliant Tier 2 Subordinated Sukuk Murabahah

MAR

Regulation

- **Hong Kong** passes sukuk bill

APR

Regulation

- **UAE** cuts minimum corporate sukuk size, announces other standards for issuing, listing and trading

MAY

Issuance

- **Türkiye Finans** raises $252 million from first sukuk issuance in Malaysia

Regulation

- **Jordan** introduces sukuk rules
- **Luxembourg** approves bill paving way for sukuk

JUN

Issuance

- **Britain** becomes first sovereign outside the Islamic world to issue sukuk, a GBP-denominated 200 million 5-year paper

Regulation

- **Malaysia** announces scrapping of mandatory credit rating for corporate bonds and sukuk from 2017
- **Bangladesh** seeks sukuk rule amendments, sovereign issuance

JUL

Issuance

- **Senegal** raises Sub-Saharan Africa's first sovereign sukuk – 100 billion CFA francs 4-year paper

AUG

Regulation

- **Malaysia** provides guidelines for socially responsible sukuk

SEP

Issuance

- **World Bank** says working on up to $500 million 5-year 'immunisation sukuk'
- **Goldman Sachs** raises $500 million, becoming first conventional U.S. bank to issue sukuk
- **Hong Kong** raises $1 billion in debut 5-year sukuk priced at a 2.005% profit rate
- **South Africa** launches $500 million 5.75-year sukuk at 3.90% yield
- **Japan**'s Bank of Tokyo-Mitsubishi UFJ issues debut (dual tranche) $25 million, 2.5 billion yen sukuk in Malaysia, becoming first Japanese corporate to issue sukuk
- **Luxembourg** issues debut sovereign sukuk – 200 million euro 5-year paper

OCT

Issuance

- **Al Baraka Bank Pakistan** raised 2 billion rupees ($19.5 million) via the country's first issuance of subordinated sukuk

Regulation

- **Malaysian Budget 2015** extends tax deductions favouring ijarah and wakalah sukuk up to 2018
- **State Bank of Pakistan** announces it will trade government sukuk in the open market

2014: The year the sovereigns reigned

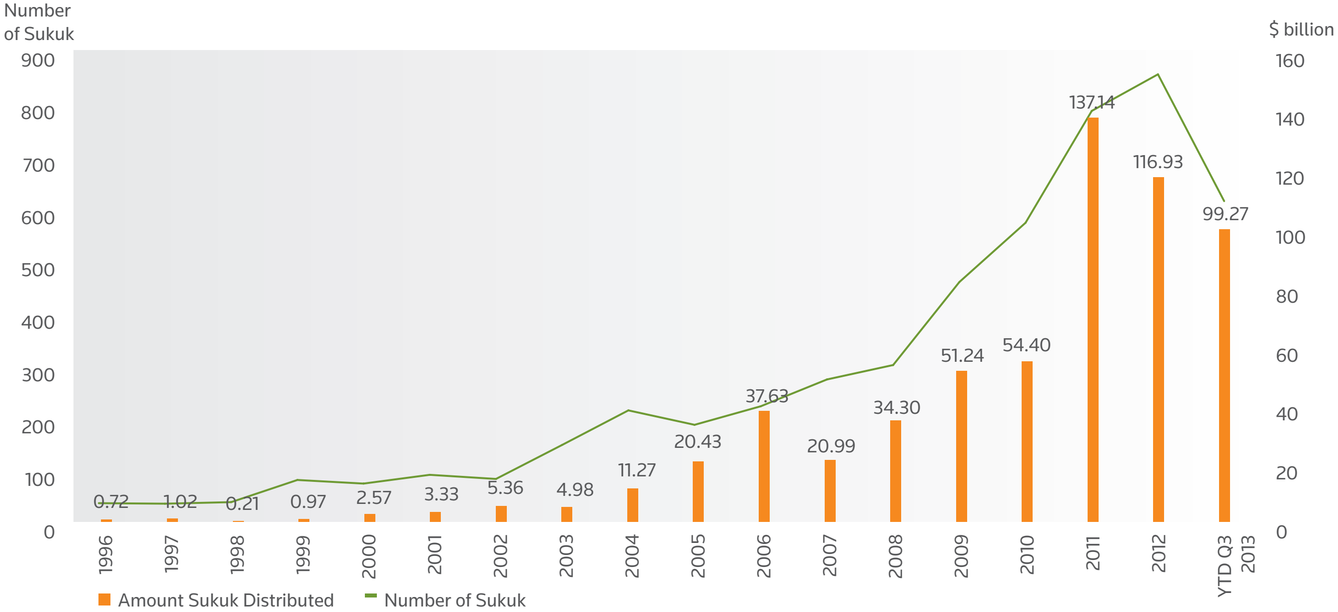
Sukuk Market Overview

Total sukuk issued in the first 9 months of 2014 climbed significantly by **24.5%** to **$99.26 billion** compared to **$79.9 billion** for the same period in 2013. 2014's sukuk market will most likely break the $100 billion mark and surpass 2013's **$117 billion**.

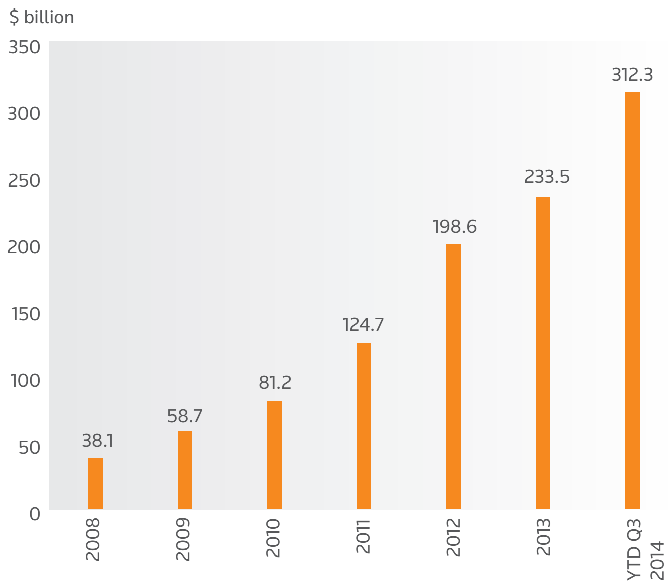
In 2014, many financial institutions looked to sukuk to increase their capital to meet Basel III requirements and a handful of non-OIC governments made their debut. In June the UK issued a GBP200 million sukuk to become the first non-OIC sovereign to tap the sukuk market, followed in September by Hong Kong's $1 billion sukuk, South Africa's $500 million issue, and then Luxembourg's EUR200 million sukuk. OIC member Senegal issued its debut sukuk in July, a 100 billion CFA francs sale. Corporates from new jurisdictions also featured in 2014 – a real estate company issued Maldives' first sukuk in January and in September the Bank of Tokyo-Mitsubishi UFJ became the first Japanese corporate to issue a sukuk (in Malaysia), a dual tranche $25 million and 2.5 billion yen sale and Goldman Sachs sold a $500 million paper, making it the first conventional U.S. bank to issue sukuk. Despite high profile entrants, the sukuk market is still considered niche and only makes up a small percentage of the fixed income sector. Growth rates have been volatile in the past 5 years, surging in 2012 and then plunging in 2013. The market has found its feet again in 2014.

Global Sukuk Growth for the first nine months (2011-2014)		
Period	Sukuk Amount	Growth Rate
YTD Q3, 2014	$99.27 Billion	24.5%
YTD Q3, 2013	$79.7 Billion	-26.8%
YTD Q3, 2012	$109 Billion	68.4%
YTD Q3, 2011	$64.7 Billion	48.4%
YTD Q3, 2010	$33.39	Base Year

GLOBAL AGGREGATE SUKUK HISTORICAL TREND (1996-Q3 2014)



TOTAL GLOBAL OUTSTANDING SUKUK HISTORICAL TREND (2008 – YTD Q3, 2014)



Domestic markets are still more popular as local funding needs take precedence

By Market of Issuance: Domestic vs. International

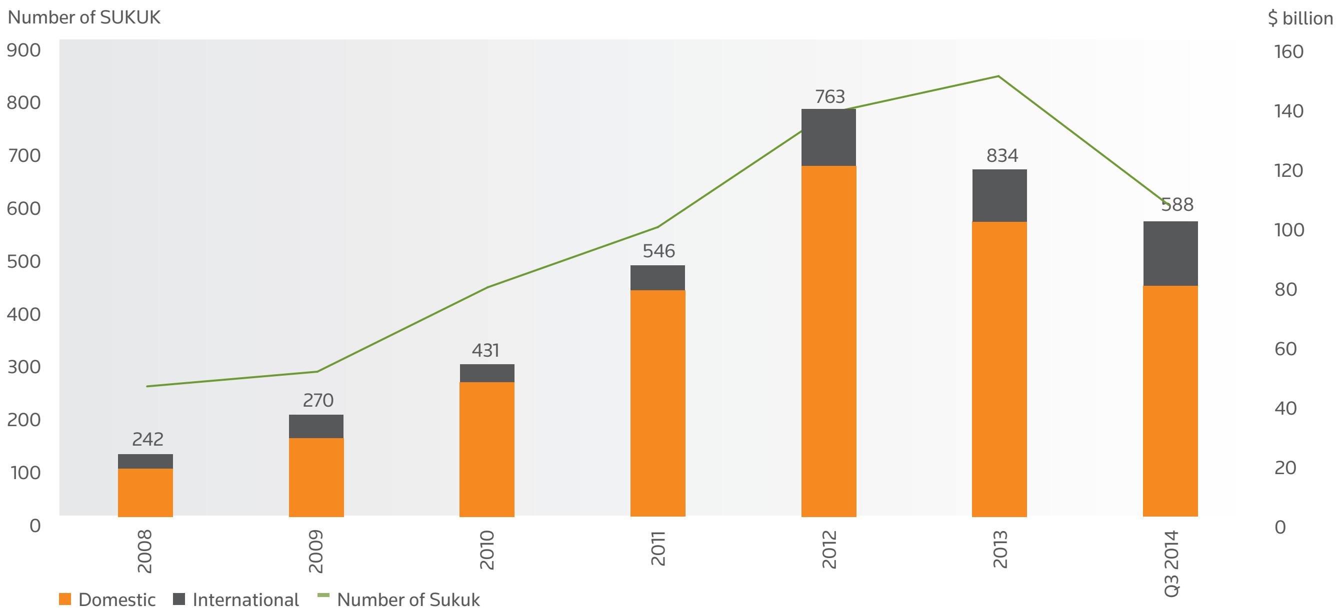
Total international sukuk issued in the first 9 months of 2014 reached **$21.6 billion**, which is **21.8%** of all sukuk issued up to Q3, 2014. Domestic issues still dominate, reaching **$77.61 billion**. Total International sukuk issued up to Q3, 2014 surpassed full-year 2013's $17.59 billion. Total domestic sukuk issued for the whole of 2013 was $99.34 billion. Most domestic sukuk are issued in Malaysia where there is a very active local Islamic capital market. Saudi Arabia, Bahrain, Brunei, UAE and Indonesia are some of the other key local markets.

Despite international sukuk gaining momentum and attracting global demand, our Sukuk Survey finds that market players still prefer domestic markets, although investors show only a slight preference for domestic over international issues (52% v 48%). Most issuers look to fulfil their funding needs through local currency that is less expensive to hedge and which are cheaper and faster to issue, and other market players such as regulators prefer to activate their local market instead of going to global markets.

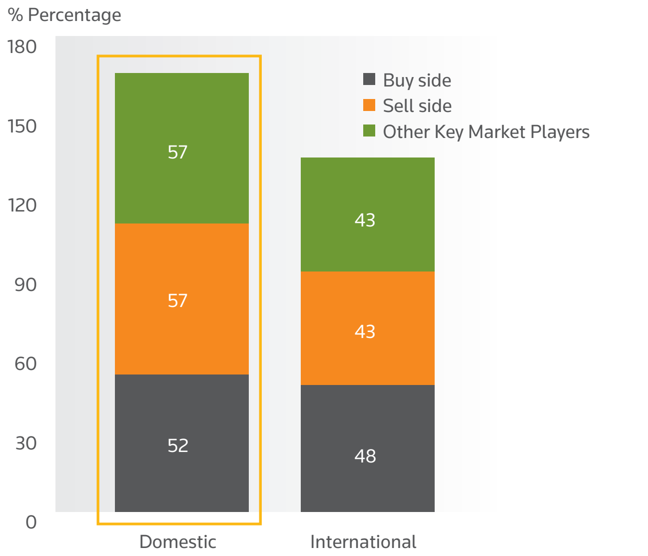
Our Sukuk Survey finds that investors prefer domestic sukuk over eurobonds although the gap is a narrow 4%. An equal number of issuers and other key market players prefer domestic issues.

Survey	Respondents	Skipped
Buy Side	106	0
Sell Side	41	1
Others	48	6

GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY MARKET OF ISSUANCE (2008 - Q3, 2014)



SURVEY FINDINGS
2014: TYPE OF ISSUE: INTERNATIONAL VS. DOMESTIC



19 jurisdictions tapped the sukuk market in 2014 with more countries in the pipeline

By Region & Country

As the market becomes more familiar with sukuk and investors' acceptance of Islamic instruments rise, more countries are entering the sukuk industry than ever before. 19 jurisdictions issued sukuk in the first **9 months of 2014** compared to **16** in **2013** and **18** in **2012**.

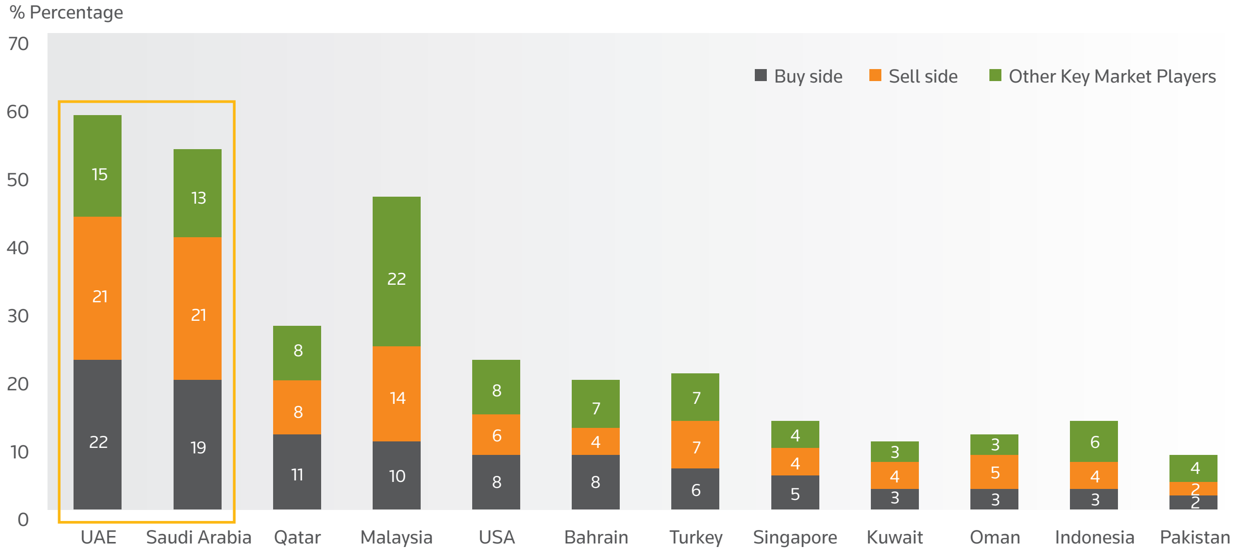
Hong Kong, **Luxembourg**, **Senegal**, **South Africa**, and the **United Kingdom** were the new sovereign entrants in the first 9 months of 2014. We also saw a corporate sukuk in the Maldives, and also welcomed the first Japanese and conventional U.S. bank's to the sukuk market. Issuers from Kuwait, Nigeria, and Oman were absent in 2014 after issuing in 2013. UK, Luxembourg and Hong Kong sovereigns were key market issuers, and their lead may encourage their local corporates to follow and also show the way for other jurisdictions, especially non-OIC countries, to consider sukuk.

Malaysia continues to lead. $66.23 billion (67%) of all sukuk issued for the first 9 months of 2014 came from Malaysia, compared to $20.32 billion (20%) from the GCC, $7.04 billion (7%) from Asia ex. Malaysia, and $5.68 billion (6%) from all other regions. Saudi Arabia and the UAE lead in the GCC while Indonesia and Turkey continue to build their mid-sized markets.

Our Sukuk Survey reveals investors prefer UAE and Saudi Arabia to invest and issue sukuk. Lead arrangers and issuers show equal interest in Saudi Arabia and UAE for sukuk issuance. Other than the usual suspects in Southeast Asia and the GCC more market players are looking to the U.S. than Turkey or Bahrain.

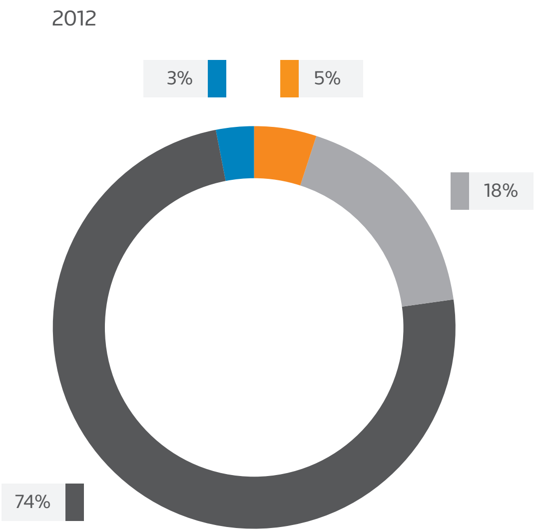
Survey	Respondents	Skipped
Buy Side	102	4
Sell Side	42	2
Others	50	4

SURVEY FINDINGS – COUNTRY PREFERENCE

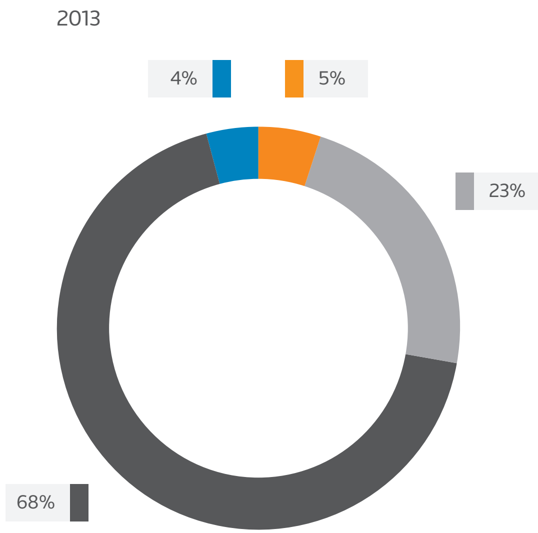


"Hong Kong, Luxembourg, Senegal, South Africa, and the United Kingdom were the new sovereign entrants in the first 9 months of 2014."

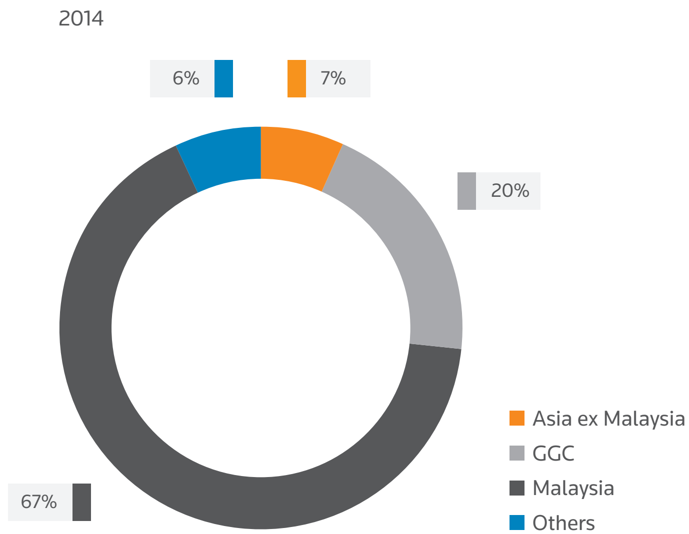
GLOBAL SUKUK BREAKDOWN BY REGIONS 2012



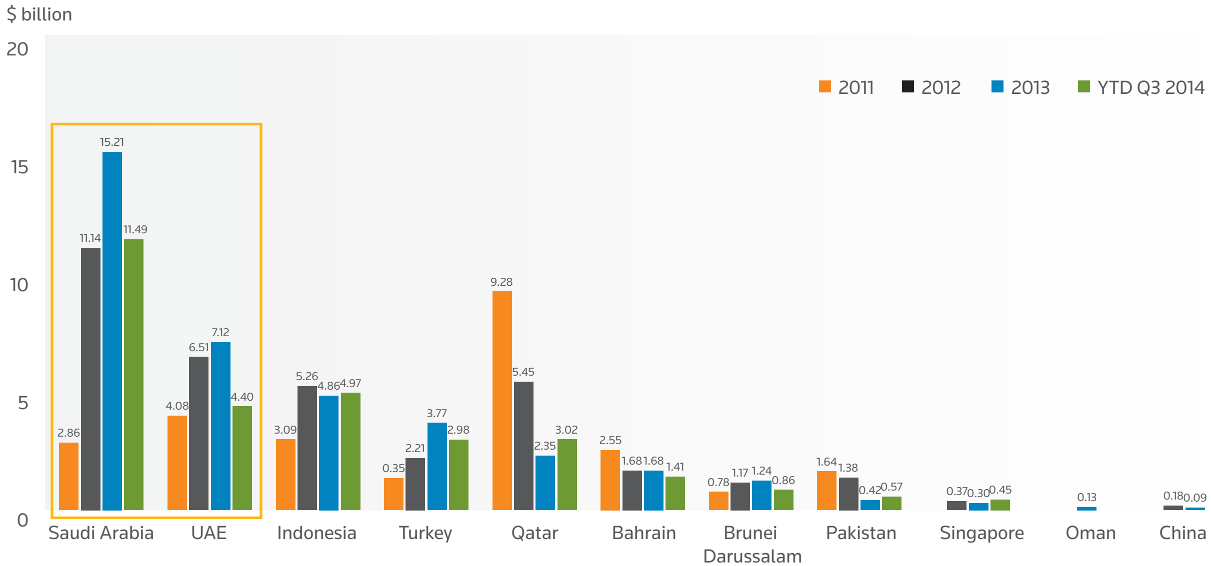
GLOBAL SUKUK BREAKDOWN BY REGIONS 2013



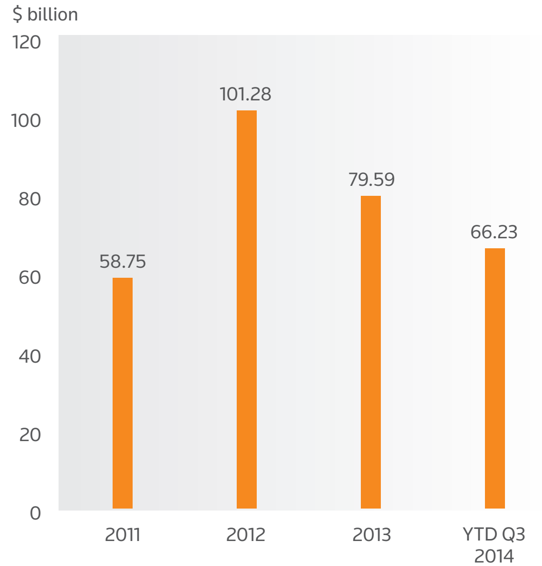
GLOBAL SUKUK BREAKDOWN BY REGIONS IN 2014 UP TO Q3



GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY TOP COUNTRIES (2011-Q3, 2014)



MALAYSIA SUKUK HISTORICAL TREND BREAKDOWN (2011-Q3, 2014)



Game of Thrones: Governments compete for high sukuk demand

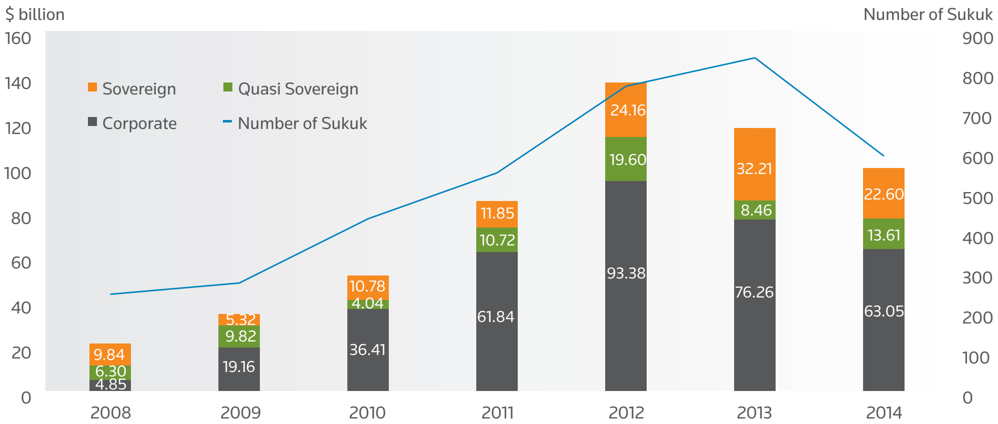
By Sector

The sukuk industry is at the growth stage of its life cycle and still depends heavily on government issuance to activate markets. Corporates have been recently drawn to tap the sukuk market to benefit from the high demand from Shariah-compliant investors and opportunistic buyers looking for good credits with attractive yields.

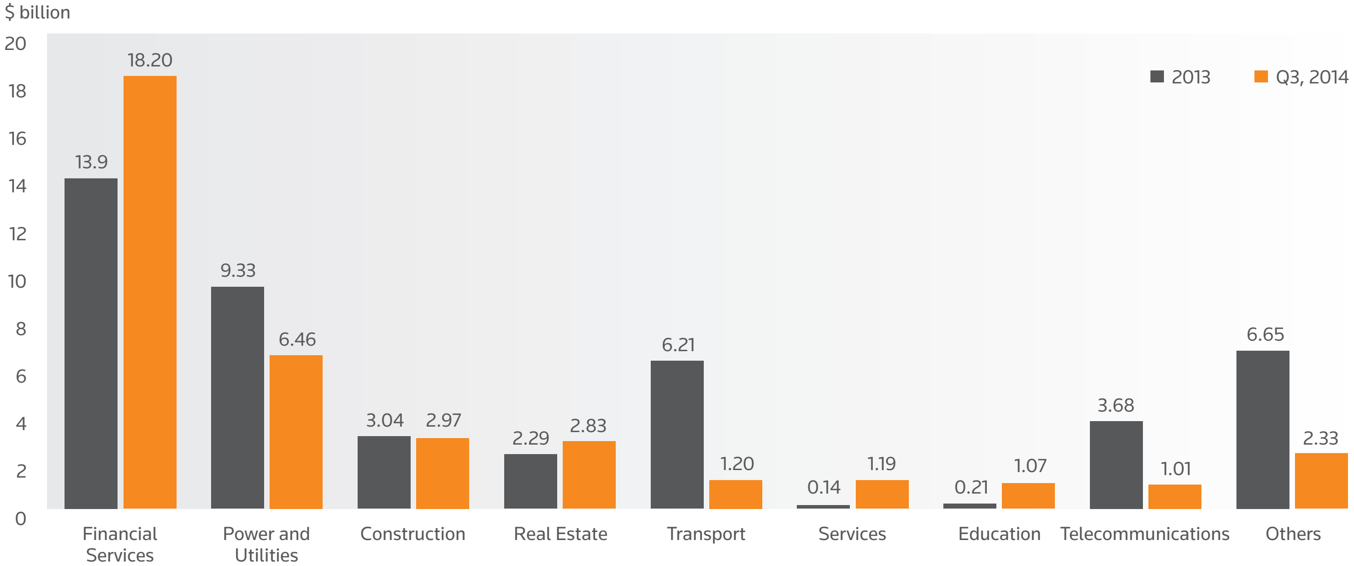
In the first 9 months of 2014, **total sovereign sukuk issuance** was **$63.05 billion** compared to **$13.61 billion quasi-sovereign** and **$22.60 billion corporate issues**. In the whole of 2013, total sovereign sukuk amounted to $76.26 billion, and quasi-sovereign and corporates totalled $8.46 billion and $32.21 billion, respectively. In percentages, total government-related issuance (sovereign+ quasi-sovereign) made up 77.23% of the sukuk market up to Q3, 2014 compared to 72.46% for the whole of 2013. More sovereigns are looking to tap the market in Q4, 2014 and 2015 such as Oman, Egypt, Tunisia, Yemen, Libya, Jordan, Philippines and Morocco.

One of the key sukuk in 2014 was the UK's GBP200 million sovereign sukuk. Its order book reached GBP2.3 billion, making it 12 times oversubscribed. Hong Kong, Luxembourg, and South Africa issued $1 billion, EUR200 million and $500 million, respectively.

GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY ISSUER (2008 – YTD Q3, 2014)



GLOBAL CORPORATE SUKUK GROWTH COMPARISON (2013, Q3, 2014)



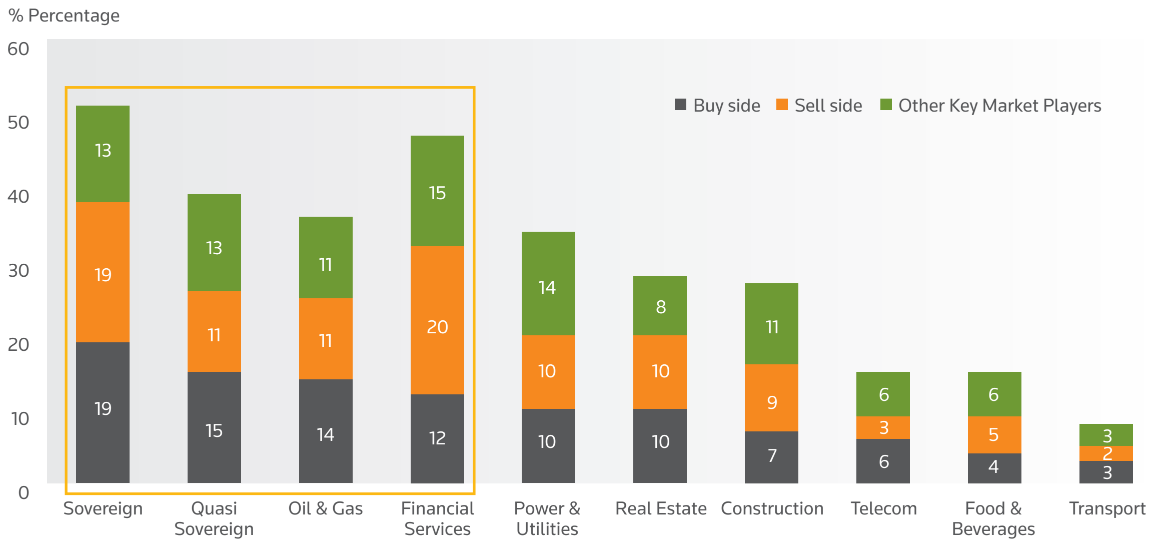
> *"One of the key sukuk in 2014 was the UK's GBP200 million sovereign sukuk."*

In the market for the first 9 months of 2014, financial institutions continued to lead all corporate issuances, followed by power and utilities, construction, real estate and transport. More and more sectors are coming to the market each year. However, Industrial manufacturing and IT were absent from the sukuk market in the first 9 months of 2014.

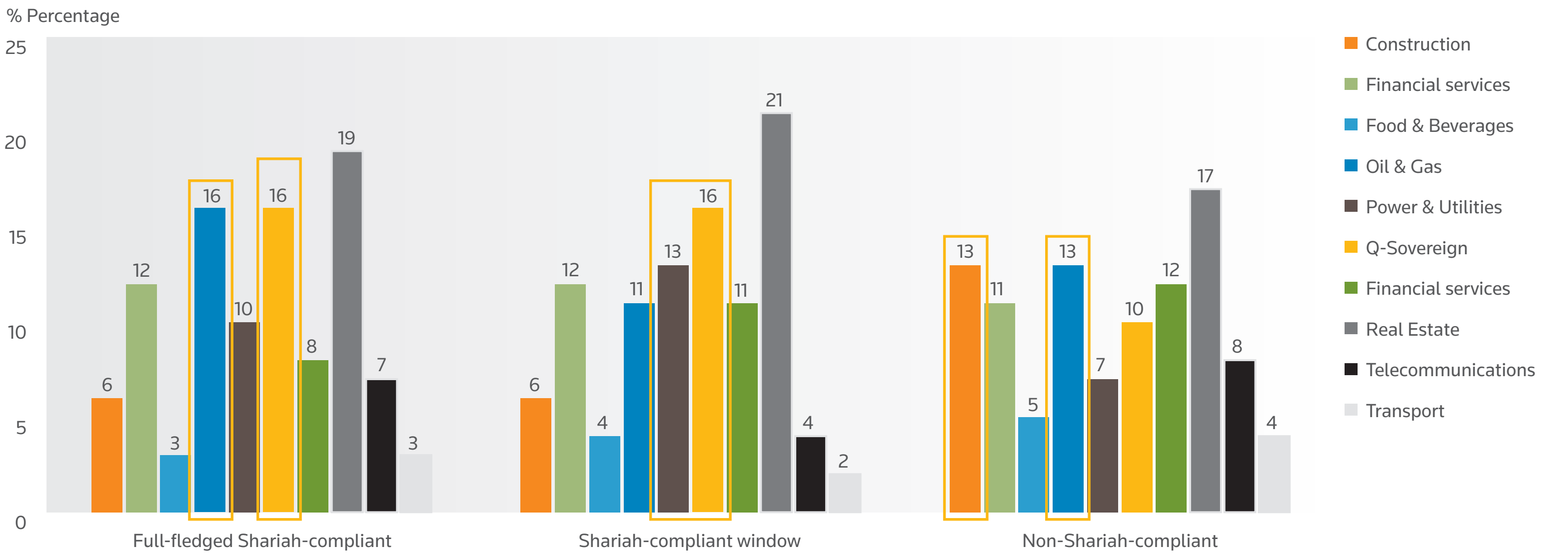
Our Sukuk Survey reveals that the majority of lead arrangers and issuers prefer issuances from sovereigns and financial services. Sovereigns are investors' most preferred sector, with quasi-sovereign in second place. There is also investor appetite for oil & gas, power & utilities and construction. We see room for more sukuk across these sectors. From the survey responses, it is clear that investors consider the quality of the paper over returns.

Survey	Respondents	Skipped
Buy Side	99	7
Sell Side	43	1
Others	48	6

SURVEY FINDINGS – SECTOR PREFERENCE



SURVEY FINDINGS – SECTOR PREFERENCE – BUY SIDE



Sukuk issued in 16 currencies in 2014

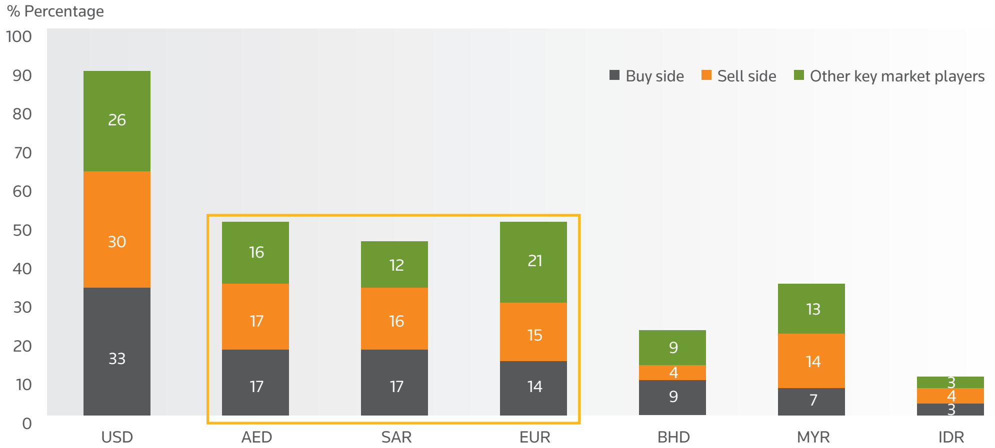
By Currency

The **Malaysian Ringgit** continues to dominate the sukuk market with RM203.62 billion (**$62.24 billion**) of sukuk in the first 9 months of 2014. USD sukuk trails RM papers, totalling **$20.87 billion**, mostly issued in international markets towards the end of Q3, 2014. GCC currencies were led by the Saudi riyal, Qatari riyal and Bahraini dinar. There were more Indonesian rupiah and Turkish lira sukuk due to higher number of domestic issuance from corporates and financial institutions. 2014 was a good year for European currencies with the euro and sterling entering the sukuk market.

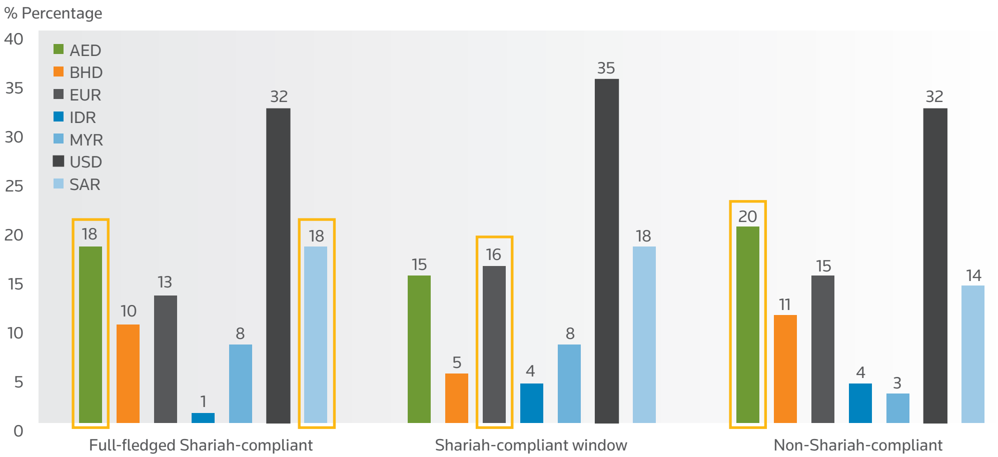
Our Sukuk Survey reveals that the USD is the most preferred currency for all market players whether to invest or issue sukuk. A lot of currencies are pegged to the USD (including 5 of 6 GCC currencies), making it an obvious preference especially to reduce currency risk. Investors equally prefer the SAR and AED (17% each). Lead arrangers' preference for the AED and SAR are also almost alike, at 17% and 16%, respectively.

Survey	Respondents	Skipped
Buy Side	103	3
Sell Side	43	1
Others	50	4

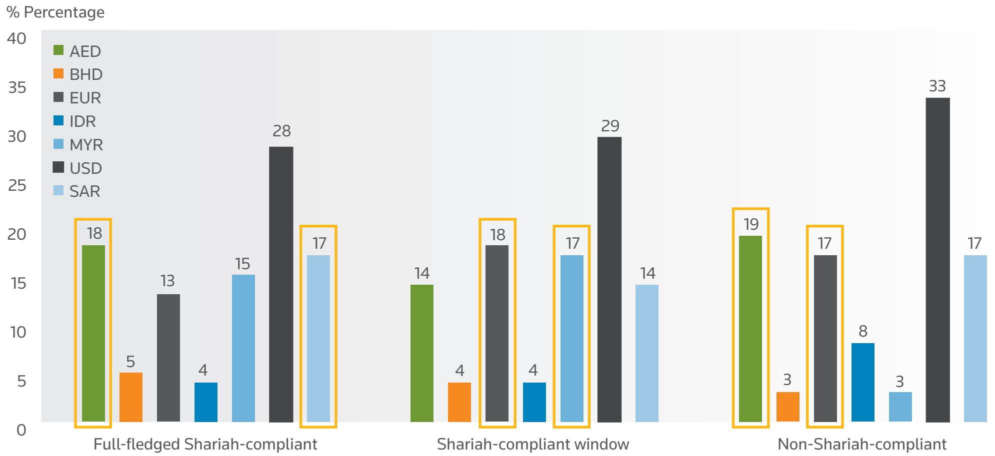
SURVEY FINDINGS – CURRENCY PREFERENCE



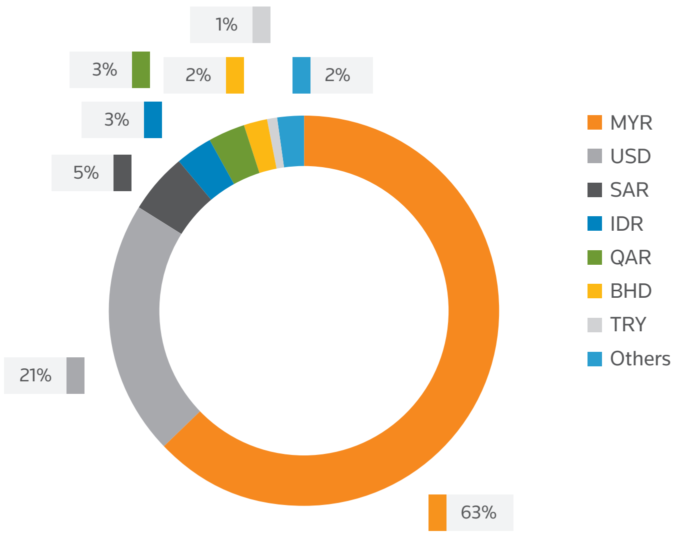
SURVEY FINDINGS – CURRENCY PREFERENCE – BUY SIDE



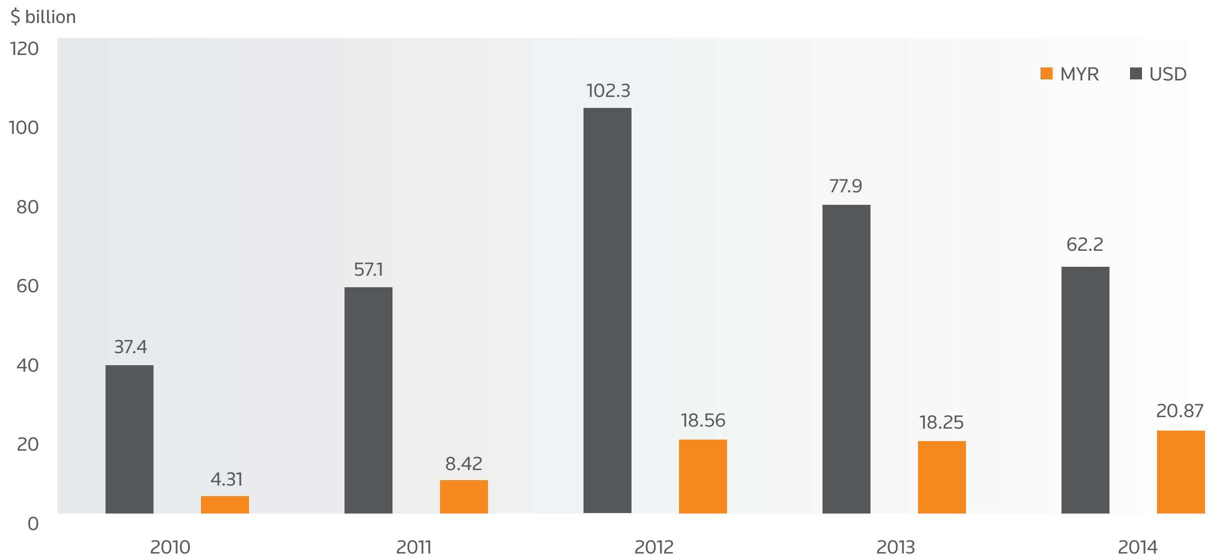
SURVEY FINDINGS – CURRENCY PREFERENCE – SELL SIDE



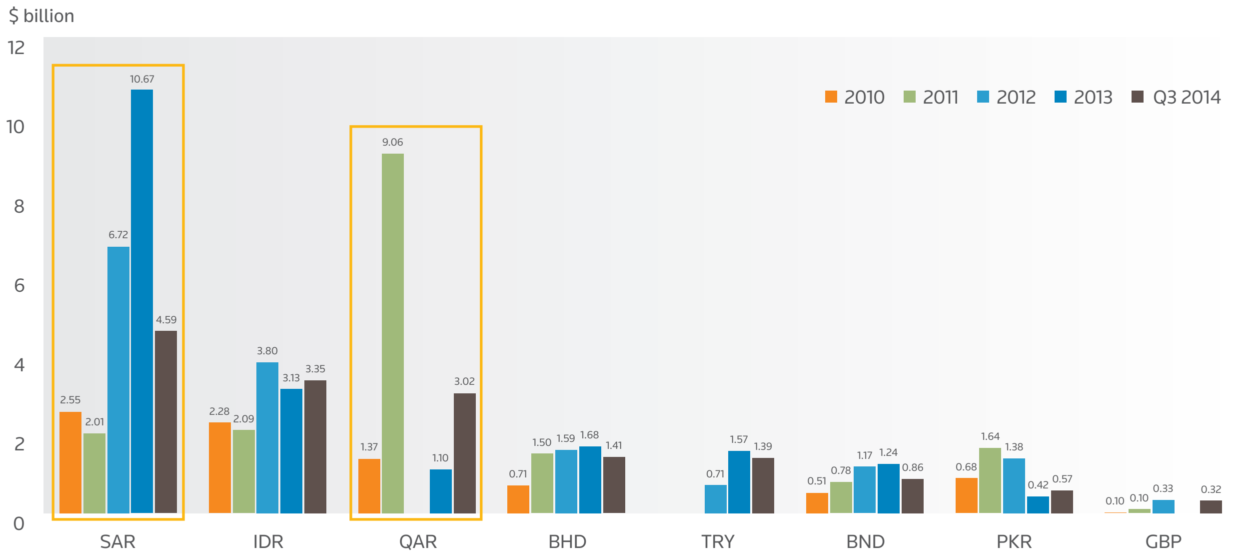
GLOBAL SUKUK ISSUED BREAKDOWN BY CURRENCIES IN 2014



GLOBAL SUKUK HARD CURRENCIES COMPARISON (2010-Q3, 2014)



GLOBAL SUKUK HISTROICAL TREND BREAKDOWN BY TOP CURRIENCIES – EX. MYR & USD (2010 - Q3, 2014)



“2014 was a good year for European currencies with the euro and sterling entering the sukuk market.”

What will happen?

in the global sukuk market in 2015 and beyond

Survey	Respondents	Skipped
Buy Side	105	1

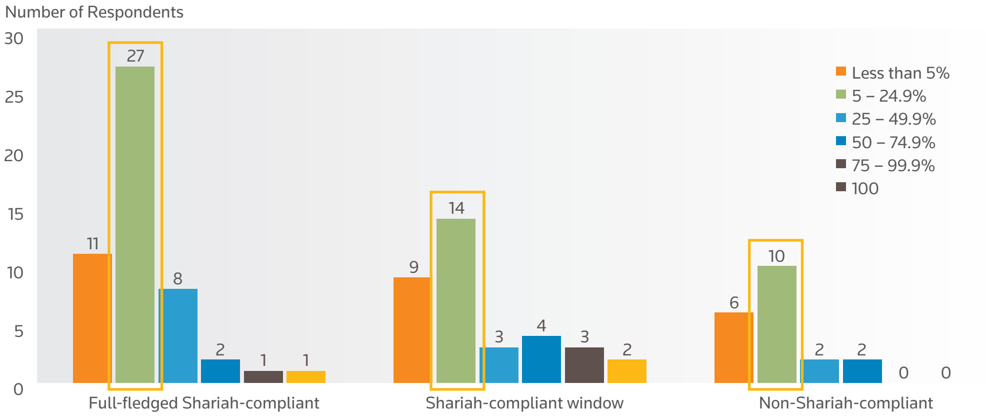
Conventional investors allocate more of their Islamic assets to sukuk

By Sukuk Demand

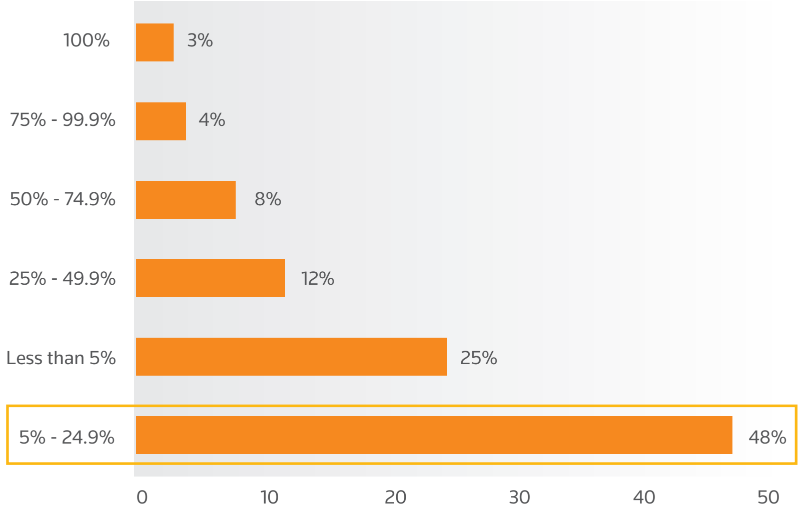
Our sukuk survey reveals that about 50% of investors expect to allocate between 5% and 24.9% of their portfolios to sukuk. This is markedly lower than last year when investors indicated in the 2013 survey that they would allocate an average of 25%-35% to sukuk. We attribute the drop to market expectations of higher interest rates due to economic recovery in Western markets.

Full-fledged Shariah-compliant institutions are more likely to allocate their assets to sukuk due to limited Islamic instruments. Shariah-compliant windows and conventional investors would allocate higher weight to sukuk from their Islamic assets as sukuk is the most secure and easiest Shariah investment option currently available.

SURVEY FINDINGS – FOR THE REST OF 2014 AND 2015, WHAT PROPORTION OF YOUR ISLAMIC ASSETS WILL BE ALLOCATED TO SUKUK? – BUY SIDE



SURVEY FINDINGS
FOR THE REST OF 2014 AND 2015, WHAT PROPORTION OF YOUR ISLAMIC ASSETS WILL BE ALLOCATED TO SUKUK? (IN %)



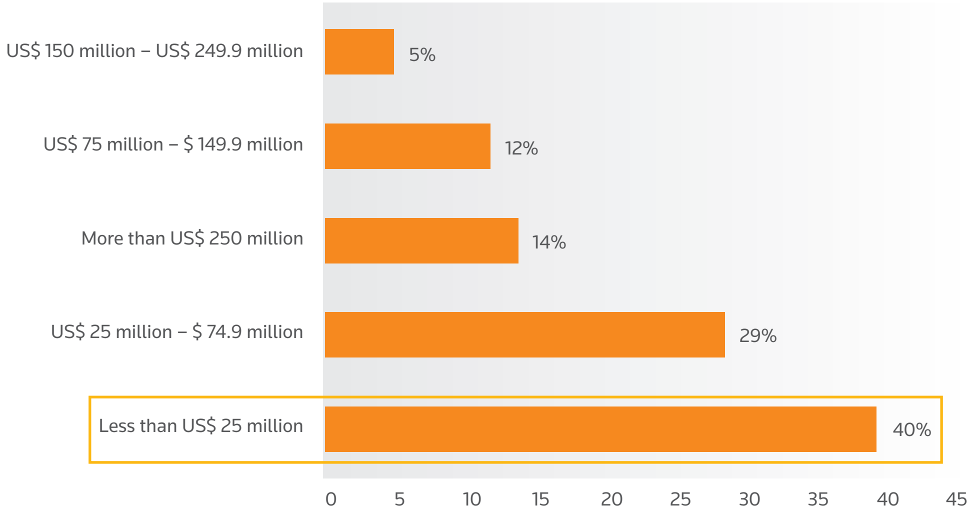
> *"Conventional investors allocate more of their Islamic assets to sukuk."*

Sukuk investors usually come from Islamic financial institutions which are obliged to invest in them due to limited Islamic offerings. However, most of these investors have small investment books, in proportion to their overall size. On the other hand, conventional investors would usually allocate some of their portfolio to Islamic assets where sukuk will be the most available and suitable investment (especially if they operate as Islamic windows).

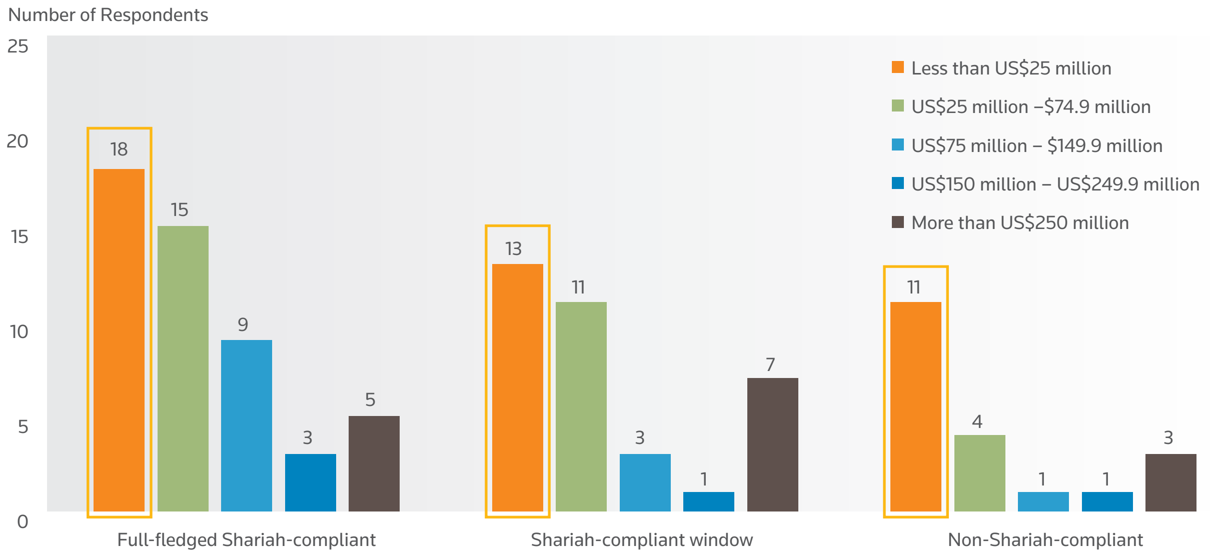
Further, given improved economic and market conditions, the majority of investors (whether full-fledged Islamic or not) expect to allocate less than $25 million of their investments to sukuk, followed by 29% of investors expecting to allocate $25 million to $74.9 million. Interestingly, a higher number of windows than full-fledged Islamic or conventional institutions would allocate more than $250 million. We expect this number to include big conventional institutions that have much bigger investment books.

Survey	Respondents	Skipped
Buy Side	105	1

SURVEY FINDINGS
FOR THE REST OF 2014 AND 2015, WHAT PROPORTION OF YOUR ISLAMIC ASSETS WILL BE ALLOCATED TO SUKUK? (IN DOLLAR)



SURVEY FINDINGS
FOR THE REST OF 2014 AND 2015, WHAT PROPORTION OF YOUR ISLAMIC ASSETS WILL BE ALLOCATED TO SUKUK? – BUY SIDE



> *"...most of these investors have small investment books, in proportion to their overall size."*

2014 will exceed 2013 levels and come close to 2012 peak

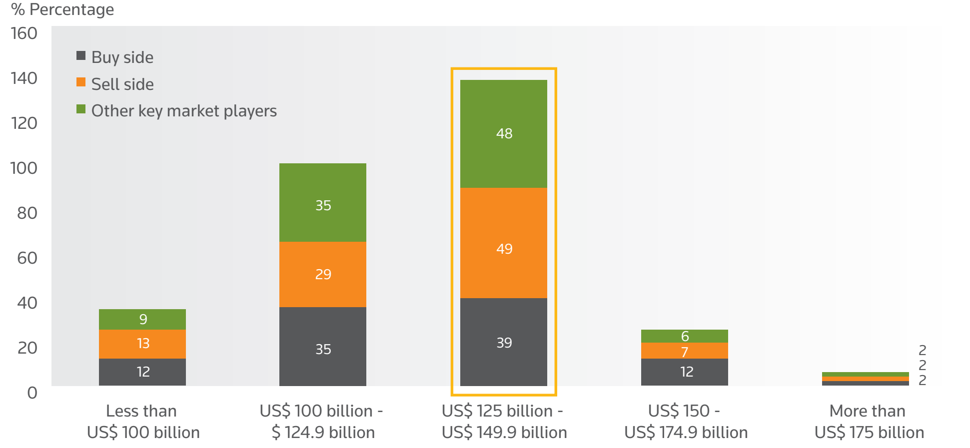
Sukuk Supply

As sukuk issuance almost crossed the $100 billion mark as at the end of Q3, 2014, all market players from our Sukuk Survey expect sukuk issuance for the whole of 2014 to be in the range of **$125 billion** to **$149.9 billion**. This was the same expected range for our 2013 survey. This expectation for 2014 can be attributed to the strong pipeline for Q3/Q4 2014 and early 2015 from both sovereigns and blue chip corporates.

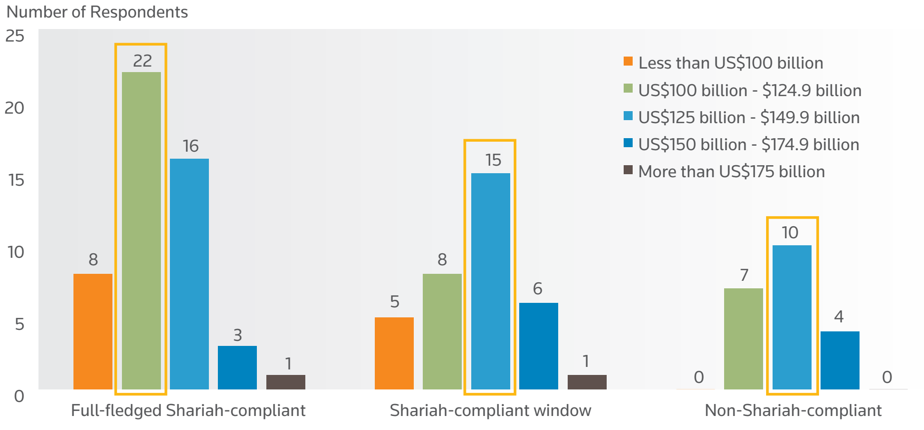
Surprisingly, the full-fledged Shariah-compliant investors aren't as optimistic as the rest of the market and expect a lower level of issuance.

Survey	Respondents	Skipped
Buy Side	106	0
Sell Side	41	1
Others	48	6

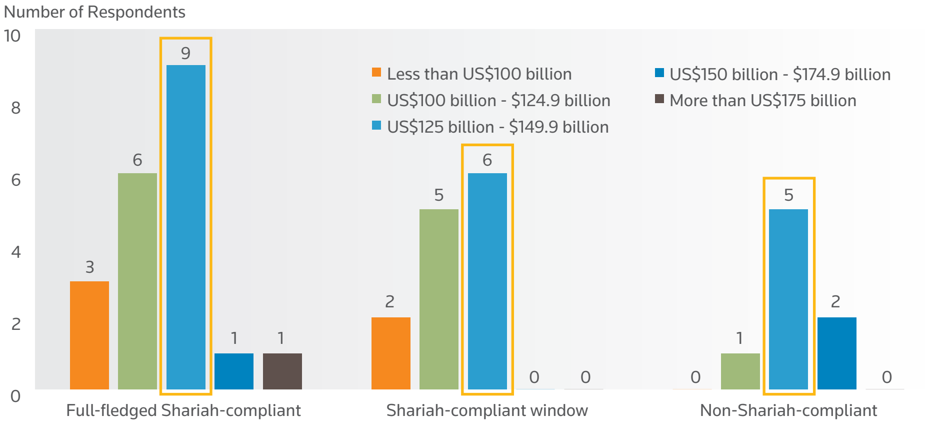
SURVEY FINDINGS – WHAT VOLUME OF GLOBAL SUKUK ISSUANCE DO YOU EXPECT IN 2014? THE TOTAL GLOBAL SUKUK ISSUANCE IN 2012 WAS US$ 135 BILLION AND 2013 WAS US$ 118 BILLION



SURVEY FINDINGS – WHAT VOLUME OF GLOBAL SUKUK ISSUANCE DO YOU EXPECT IN 2014? THE TOTAL GLOBAL SUKUK ISSUANCE IN 2012 WAS US$ 135 BILLION AND 2013 WAS US$ 118 BILLION. – BUY SIDE



SURVEY FINDINGS – WHAT VOLUME OF GLOBAL SUKUK ISSUANCE DO YOU EXPECT IN 2014? THE TOTAL GLOBAL SUKUK ISSUANCE IN 2012 WAS US$ 135 BILLION AND 2013 WAS US$ 118 BILLION. – SELL SIDE

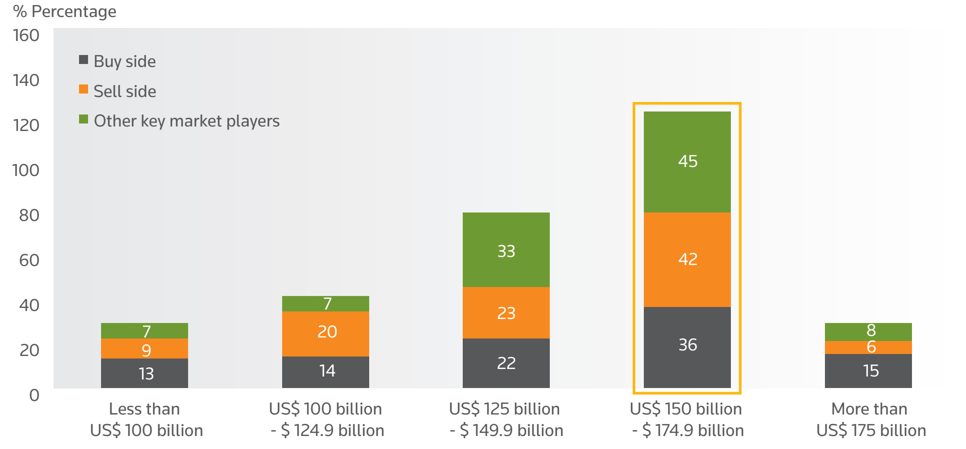


All market players foresee a boost in sukuk issuance in 2015, expecting total issuance to be between **$150 billion** and **$174.9 billion**. This reflects market confidence in the future of sukuk. Based on the sukuk pipeline data from Zawya Islamic Sukuk Monitor, many governments and blue chip companies plan to tap the sukuk market to benefit from the high demand, especially before interest rates go up and opportunities narrow.

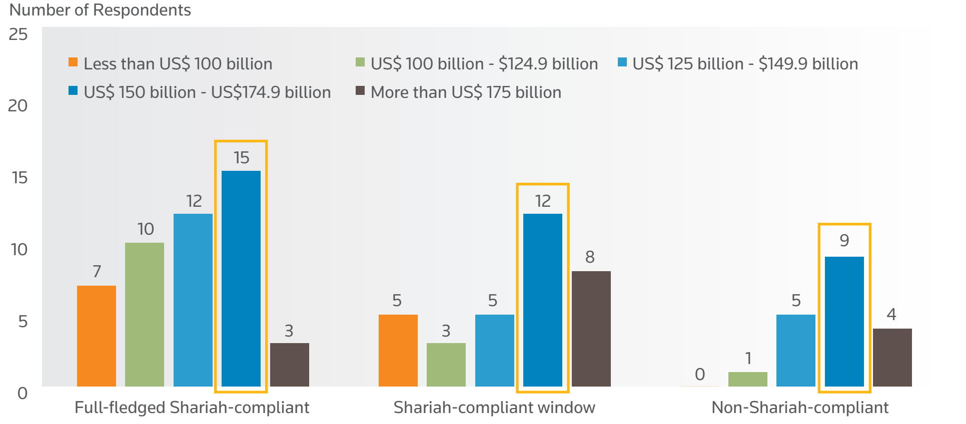
Most of these issuers are looking to lock in their funding needs at lower rates for the longest period possible. At the same time, investors are keen to lock their investments at high rates with reasonable credits while setting up rate swaps that guarantee securitization against expected market movement.

Survey	Respondents	Skipped
Buy Side	99	7
Sell Side	35	9
Others	46	8

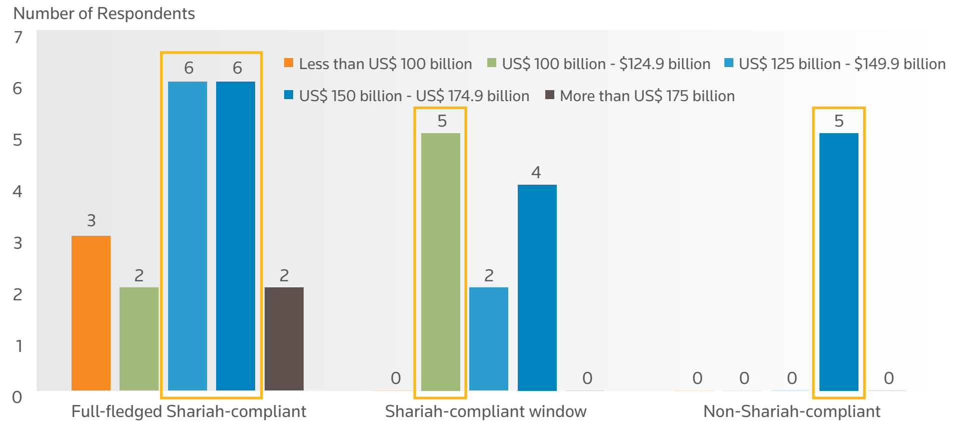
SURVEY FINDINGS – WHAT VOLUME OF GLOBAL SUKUK ISSUANCE DO YOU EXPECT IN 2015? THE TOTAL GLOBAL SUKUK ISSUANCE IN 2012 WAS US$ 135 BILLION AND 2013 WAS US$ 118 BILLION



SURVEY FINDINGS – WHAT VOLUME OF GLOBAL SUKUK ISSUANCE DO YOU EXPECT IN 2015? THE TOTAL GLOBAL SUKUK ISSUANCE IN 2012 WAS US$ 135 BILLION AND 2013 WAS US$ 118 BILLION. – BUY SIDE



SURVEY FINDINGS – WHAT VOLUME OF GLOBAL SUKUK ISSUANCE DO YOU EXPECT IN 2015? THE TOTAL GLOBAL SUKUK ISSUANCE IN 2012 WAS US$ 135 BILLION AND 2013 WAS US$ 118 BILLION. – SELL SIDE



Sukuk Demand and Supply Equilibrium

Market outlook: Supply & Demand Model Assumptions

DEMAND SIDE

Sukuk demand is driven by two types of investors – Shariah-sensitive investors, and other global investors seeking diversification and attractive yields. We project the demand from the broadest group of Shariah-sensitive investors – the Islamic financial institutions (IFIs), as the core base for continued sukuk investment. While there is a much wider group of investors beyond IFIs, it is this category that forms the most captive investor base that can be relied on regardless of market conditions. Other investors may tend to be cyclical or opportunistic.

According to data from the ICD-Thomson Reuters Islamic Finance Indicator 2014 (IFDI), total Islamic finance assets of banks, takaful, other Islamic financial institutions, funds and sukuk amounted to $1.658 billion in 2013 (this was generated by 993 institutions worldwide including Islamic windows).

For the last couple of years, we derived Shariah-compliant assets of all Islamic financial institutions from The Banker's Top 500 Islamic Financial Institutions database, including all Shariah-compliant assets and excluding Iran, which is not a direct investor in sukuk given the country's limited interaction with the broader global Islamic financial services industry. For 2012 and 2013 data, we have used IFDI data which includes all available financials across all countries (including Iran).

We then conservatively forecast that Shariah-compliant assets will grow by 15% on an annual basis; this is in line with growth estimates from Ernst & Young, Deutsche Bank and Kuwait Finance House, although their forecasts are higher at around 18-20%.

We assume that the average portfolio allocation of sukuk required by Shariah-sensitive investors is 25%. We have revised this assumption given the expectation of higher interest rates and the possible allocation to other more attractive instruments. This proportion is supported by data from Islamic commercial banks, which suggests that they hold, on average, 29% of liquid assets and securities, from 2005 to 2008 (source: Bankscope). We believe our estimation is conservative given that our Survey Findings in 2014 show that majority of investors hold between 5% to 25% of their investment portfolio in sukuk; our 25% estimation is just past the mid-mark for sukuk holdings.

SUPPLY SIDE

According to Thomson Reuters Zawya data, global sukuk issued in 2014 fell below market expectations, amounting to $102 billion as at October 20, 2014. For our modelling purposes, we have included all sukuk that are in the pipeline for 2014, we assume that sukuk issuance will increase over YTD amounts to $135 billion and come close to 2012's issuance level.

According to Thomson Reuters Zawya data, on average, the sukuk market grew 50% from 2002 to 2014. Last year's average stood at 13% due to a drop in issuance in 2013 compared to 2012. However, due to expected positive sukuk growth in 2014 (15%), the overall average increased from last year's growth of 47%.

As expected, despite the decline in 2013, the sukuk market picked up again in 2014 due to the high number of issuance, including from Hong Kong, South Africa and the UK. **Investors have raised their expectations for 2014 and 2015 based on recent market events and pipeline announcements, and they expect sukuk issuance to recover in 2014 to between $125 and $150 billion and for 2015 between $150 and $175 billion.**

Therefore, conservatively, we estimate total issuance growth rate to pick up again to 15% in 2014 and 2015, sliding down to 10% in 2016 and steady growth for the following four years (2017-2020) along the expected growth of Islamic financial assets. This increase was added to total global outstanding sukuk as per up-to-date sukuk issued for each year.

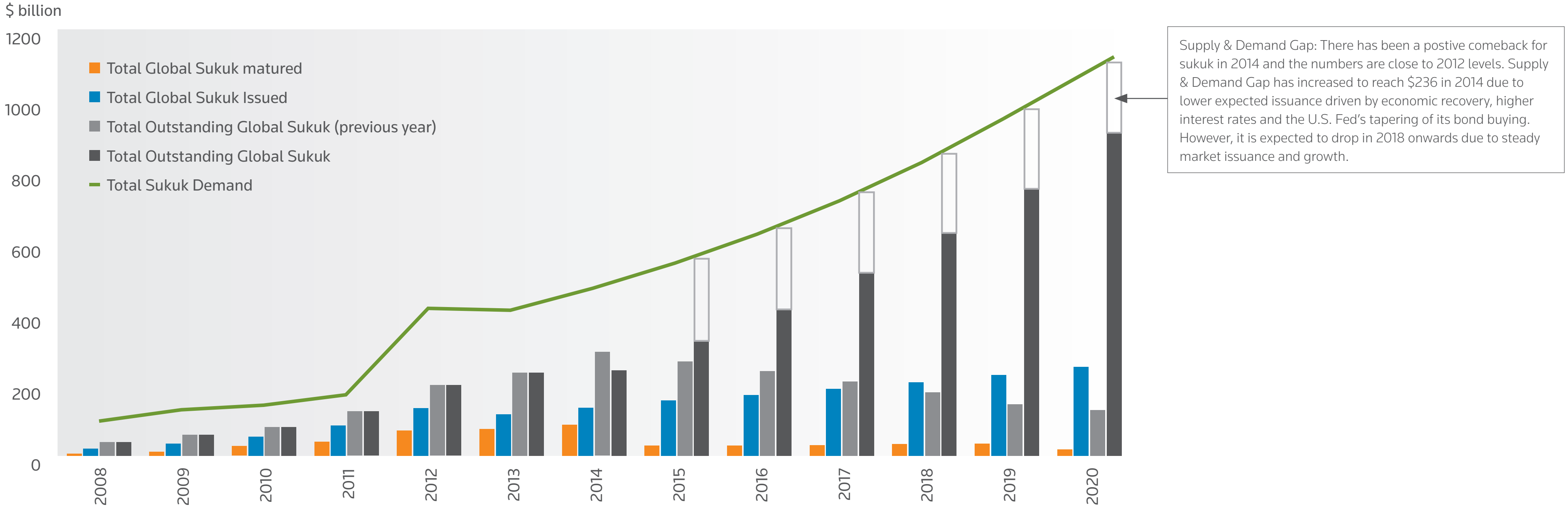
For total global sukuk matured, we derive the numbers from Thomson Reuters Zawya as per existing sukuk maturity profiles. In addition, we have calculated the average of short-term sukuk that are issued and matured at the same year for the last three years (2011-2014) equal to 30% and subtracted the amounts from the total.

2020: Easy road for sukuk with issuance surpassing $200 billion and demand reaching almost a trillion

Sukuk Demand and Supply Equilibrium

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Percentage Sukuk Growth	-48%	69%	57%	58%	57%	-13%	15%	15%	10%	10%	10%	10%	10%
Total Global Sukuk Issued	$20.2	$34.1	$53.7	$85.1	$133.7	$117.0	$135.0	$155.3	$170.8	$187.9	$206.6	$227.3	$250.0
Total Global Sukuk Matured	$6.3	$11.3	$27.0	$39.5	$71.0	$75.5	$87.4	$28.3	$28.7	$29.8	$33.2	$34.2	$18.1
Total Global Sukuk Outstanding	$38.1	$58.7	$81.2	$124.7	$198.6	$233.5	$240.6	$321.1	$411.9	$513.6	$625.0	$749.8	$906.8
Total Sukuk Demand	$99.8	$132.0	$145.0	$174.5	$419.8	$414.5	$476.7	$548.2	$630.4	$725.0	$833.7	$958.8	$1,102.6
Sukuk Supply & Demand Gap	$61.6	$73.3	$63.8	$49.8	$221.1	$181.0	$236.0	$227.1	$218.5	$211.4	$208.7	$208.9	$195.8

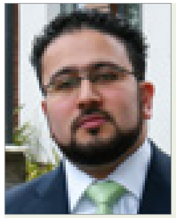
SUKUK DEMAND & SUPPLY LEVELS (2014 - 2020)



Market Opinion

Sukuk – An investor's perspective

By Sulaiman Moolla, Director, Sales & Distribution, Treasury & Investments Group – Barwa Bank



SULAIMAN MOOLLA

Sulaiman heads the Sales & Syndicate team for Barwa Bank's Treasury & Investment business. He is responsible for sales and distribution of the treasury & investment product range. Prior to joining Barwa Bank in 2012, he worked for HSBC Amanah's Global Markets business and held responsibility for their Islamic Sales & Structuring business.

Sulaiman began his career in London with HSBC Amanah and spent more than 7 years working in a number of different Structuring & Sales roles where he was responsible for the manufacture and distribution of HSBC's Islamic Treasury product range, including the global distribution of Sukuk.

Sulaiman holds a BSc in Physics and a Master's in Islamic Finance.

Islamic finance has enjoyed high double-digit growth rates for over a decade. A key contributing factor to this growth has been the sukuk sector which has seen significant expansion. According to EY total sukuk issuance in 2003 stood at $5 billion, growing to $120 billion in 2013. Whilst this growth is expected to continue industry experts argue that as investor sophistication deepens, product features need innovation to meet investor need. The sukuk market, as with other sectors of the Islamic finance industry, is not immune from these challenges.

DEMAND

2014 witnessed significant global interest in sukuk from across the board. When analysing demand, one does not have to look far for a credible sukuk investor base. Over one fifth of the global population is Muslim, and with Islam the fastest growing religion a business case for product provision is compelling. Case in point is the recent demand sukuk order books have received from High Net Worth Individuals and Private Banks notwithstanding the ever-growing demand from outside the Muslim world.

2014 saw many new sukuk from seasoned issuers. But we also witnessed a new phenomenon in issuances, primarily by sovereigns from outside the Muslim world. There were inaugural transactions by the United Kingdom, Hong Kong, the Republic of South Africa, Luxembourg and Goldman Sachs. Each of these transactions had geographically diversified and granular order books from investors across the spectrum. As such it is safe to say that sukuk is now considered an acceptable asset class in the majority of global financial centres.

One of the primary contributing factors for recent growth has been Private Banking demand. Where these investors historically focused on equity and real estate as asset classes for choice, the recent availability of Tier I sukuk has allowed diversification into alternative investments that delivers yield within acceptable risk environments.

CHALLENGES

However, there are a number of challenges that need addressing. Firstly, there's the issue of liquidity. Investors will only truly embrace a sector if depth exists in a market. Whilst sukuk liquidity has come a long way in the last few years, the market still needs to offer greater access to secondary market liquidity to provide investors with comfort of holding such assets. Greater liquidity would mean a larger investor base.

Secondly is the issue of structural innovation with the challenge to identify alternative and Shariah acceptable structures within the sukuk space. Given their structures, many of the existing sukuk do not allow for large size issuances due to a lack of a viable asset base. Larger issuance sizes would go a long way in meeting investors' demand and further increase acceptability.

Thirdly is the issue of geographical diversification. The issuances that we saw from Europe, Africa and the Far East address concentration risk. However, these were issuances largely by sovereign entities offering sovereign risk. Issuances from non-sovereign entities carry different risk profiles, would offer diversification and appeal to a greater pool of investors. In addition a wider distribution to a greater number of investors would tackle liquidity concerns.

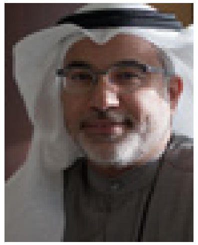
Finally, the market trend as of late has seen sukuk issuances that are longer in duration and issuers coming to market with 7-year, 10-year and 30-year transactions. Historically this had not been the case with the majority of issuers sticking to a 5-year tenor. As recent transactions have shown, investor demand for longer issuances does exist primarily driven by the associated pick up in yield. As such issuers should not be hesitant when looking to issue further down the curve.

HEALTHY OUTLOOK

In conclusion, a healthy outlook for the sukuk market exists. Large and growing pools of liquidity are looking for acceptable investments. Islamic-only investors, in addition to investors from outside the Muslim world, continue to see sukuk as a viable and acceptable asset class. If managed correctly, a huge potential exists within the sukuk market to promote growth and development within Emerging Market economies. If the challenges are addressed properly, there is no reason why the sukuk market would not see continued growth and improve depth and breadth of this relatively new sector.

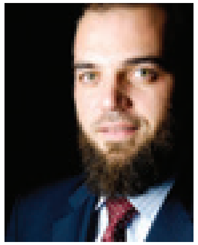
The Sukuk Debate

7 market leaders answer the big questions about global sukuk demand



ISSAM AL TAWARI

Chairman & Managing Director
Rasameel Structured Finance Company



LILIAN LE FALHER

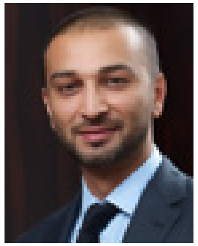
Executive Manager & Head of Treasury
Financial Institutions & Capital Markets
Kuwait Finance House

AHSAN ALI

Managing Director &
Head of Islamic Origination
Standard Chartered Bank (SCB) Saadiq

MOHIEDDINE KRONFOL

Chief Investment Officer - Global Sukuk and MENA Fixed Income – Franklin Templeton Investments (ME) – Dubai, United Arab Emirates



USMAN AHMED

Head of Fixed Income
Emirates NBD Asset Management

ALI MARSHAD

Portfolio Manager
SICO Investment Bank

HUSSAIN ABDULHAQ

CFA
Head of Treasury & Financial Markets
Al Salam Bank (Bahrain)

THE CONTENTION:

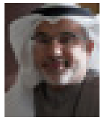
Sukuk market growth is slowing down and this "growth" is no more than mere market buzz. Is the fixed income party over or is it just starting again for the sukuk market?

1 Niche Market

The sukuk market represents a very small percentage of the fixed income market. Growth rates have been volatile in the past five years where it surged in 2012 then plunged in 2013 but is recovering in 2014. A few issuers and markets can impact the market dramatically, such as when all issuers in Malaysia held off market activity in early 2013 prior to the country's general elections.

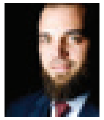
Global sukuk growth for the first 9 months (2011-2014)		
Period	Sukuk Amount	Growth Rate
YTD Q3, 2014	$99.27 billion	24.5%
YTD Q3, 2013	$79.7 billion	-26.8%
YTD Q3, 2012	$109 billion	68.4%
YTD Q3, 2011	$64.7 billion	48.4%
YTD Q3, 2010	$33.39 billion	Base Year

Q What are the main drivers for sukuk demand and is the growth sustainable?



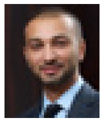
Issam Al Tawari

One driver for sukuk demand is cost savings versus conventional bonds. Moreover, from the perspective of issuers – especially regional (i.e. GCC) investors – issuers will favour the issuance of sukuk as opposed to conventional bonds because it gives them access to a broader investor base. Another driver is expectation for the market to maintain high levels of liquidity. This will continue to drive interest, especially for regional sovereign issuances and for some corporates currently sitting on the sidelines to venture into this market seeking alternative sources of funding to the traditional bank lending market.



Lilian Le Falher

One of the main drivers which will support the demand for quality sukuk issuance is the implementation from 2015 of Basel III and specifically the LCR ratio which will impose on banks to hold HQLAs. Non-financial Institutions, being sovereign or large quality corporate will certainly find a strong appetite from Islamic banks to invest in their sukuk issuance. A second driver is the development of Islamic Asset Management, which remains undeveloped but is an area of focus for many players of our industry looking to increase their fee-based income share.



Usman Ahmed

The main drivers for sukuk demand come from a mix of the growth in the Shariah investor base and the increase in sophistication of this pool. The erratic growth rates of the sukuk market is more a function of volatile credit markets rather than fading sukuk demand. In addition, the liquidity-rich Islamic banking sector has started to compete aggressively with the sukuk markets for new assets. The Shariah-compliant market has very deep pockets that are largely untapped. This will only facilitate the growth of the Shariah-compliant market, which in turn will lead to the growth of the sukuk market.

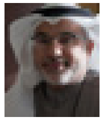
Hussain Abdulhaq

The sukuk market has attracted many new players for the past few years. This is why it has achieved the tremendous growth as indicated by market figures. However, I'm a bit skeptical that although new high-profile issuers have tapped the market during 2014, but, large maturities are already in the pipelines and it looks like most of them are going to be repaid or going to be refinanced through conventional means or direct loans. Generally speaking, the low interest rate environment and the large availability of funds in the hands of Islamic financial institutions have pushed up sukuk demand.

2 Government-driven

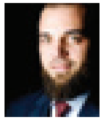
At Q3, 2014, more than 77% of sukuk issued were sovereign and quasi-sovereign. Most governments are either implementing their strategies to grow the sukuk market and widen their Islamic finance industries or they may be one-time issuers, depending on their spending needs and monetary policies. Another reason is to capitalise on high global sukuk demand. This might be unsustainable given the changing market environment.

Q Is government support necessary to accelerate sukuk demand? When will the current support in the sukuk markets be withdrawn?



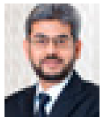
Issam Al Tawari

Government support is not only necessary but critical to accelerate sukuk demand. Additionally, investors' growing comfort with relatively complex Islamic instruments, increasing financing needs and leverage appetites of some regional countries as well as a desire for stronger investment links with the faster growing economies in the Gulf and Asia are driving this growth. Notwithstanding the strong growth momentum in sovereign sukuk issuances by governments in view of increasing support for their Islamic finance and debt capital market policy goals, we don't expect the current support to be withdrawn any time soon.



Lilian Le Falher

Governments are looking for new pools of investors and many financial centres are looking to position themselves as "Islamic finance hubs" or at least "Islamic finance friendly", hence a race towards issuing sovereign sukuk. The recent issuances from South Africa, UK and HK are good illustrations. Moreover, in countries with Islamic banks, sovereign sukuk is of paramount importance for pricing but also to allow banks to invest their extra liquidity in high quality local paper. I believe the "support" of the governments is necessary and it is a win-win situation as governments find competitive sources of alternative funding.



Ahsan Ali

While it is correct that governments and quasi-sovereign institutions currently dominate issuance volumes, it is wrong to draw the conclusion that all of it should be termed as 'government support'. While some of the recent issuers such as UK, Hong Kong and Luxembourg did have market-development motive as their main aim i.e. to demonstrate that their legal/regulatory/tax systems are amenable to issuance of sukuk and to serve as a benchmark, this may not be the only or main aim for most regular and repeat issuers. For example, many sovereign and quasi-sovereign issuers, especially from the Middle East and Southeast Asia (i.e. Malaysia and Indonesia) are repeat issuers whose aim is to use sukuk as a major financing instrument for their overall financing needs. These issuers therefore will continue to access the sukuk market in the long-term based on a commercial cost-benefit analysis. Also, many new issuers from Africa and Asia currently in the planning stages may also have investor diversification and access to the growing Islamic liquidity as one of their primary aims. These issuers may not be just one-time issuers. All these will help the sukuk market to grow in the long-term. So while the 'support' element may be true currently for a few sovereign issuances, we believe that the sukuk market is also commercially attractive to a majority of sovereign and quasi-sovereign issuers, and will continue to be so in the long-term given the sustainable growth of Islamic liquidity and the size and number of Islamic institutions.

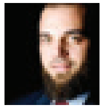
Ali Marshad

I would disagree with the above as government support is not necessary for the success of an Islamic issue as we have seen in the corporate issuances in the past and some high-yield issuances as well. Government support is probably more necessary to develop and enhance the Islamic business operations as that line continues to evolve and innovate and has a lot of room to grow in the future.

3 Oversubscription Deals

According to Thomson Reuters Zawya Sukuk Survey 2015, key lead arrangers, some sukuk buyers, particularly Shariah-compliant investors, request higher amounts than they truly demand in the primary markets because they expect to be allocated only a percentage of their bid. This then inflates oversubscription amounts dramatically which overstates actual sukuk demand.

Q Do sukuk continue to receive the oversubscription levels from recent issues? What drives sukuk oversubscription?



Lilian Le Falher

Oversubscription has always existed in financial markets. It is a natural tendency for investors to inflate their order in hopes of receiving their target. If you recall, inflation in orders was even more impressive and to an extent ridiculous at the time of the internet bubble IPOs in the late 90s/early 2000s. Of course, we all know that being 10 times oversubscribed doesn't mean that you could have issued as an issuer a sukuk 10 times bigger, but it certainly means that the sukuk demand is fundamentally solid.

Hussain Abdulhaq

Over-bidding for the sake of better allocation is a regular phenomenon in the sukuk market. This is largely due to the imbalance between demand and supply. Part of the reason is the bookrunner strategy in arbitrarily allocating the sukuk in a way that stimulates the potential trading of the paper and generating a good amount of liquidity in the secondary market to support the attractiveness of the issue.

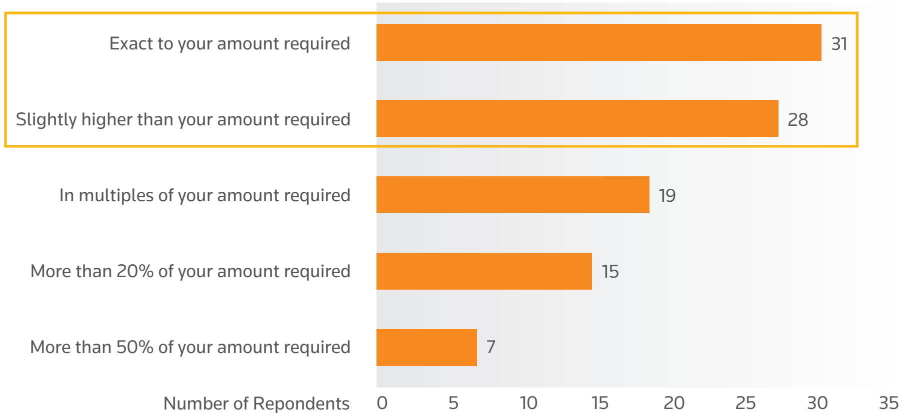
Ali Marshad

The oversubscription is driven by excess demand and limited opportunity set. This causes investors to inflate the orders. Add to that are the investors trying to benefit from a quick buck as they are aware of the success of primary issuances in the secondary market. This trend is set to continue until the opportunity sets in the sukuk space is saturated. It is also worth noting that many new issues are debut ones and therefore are providing a premium to market peers and also providing another factor that leads to the oversubscription.

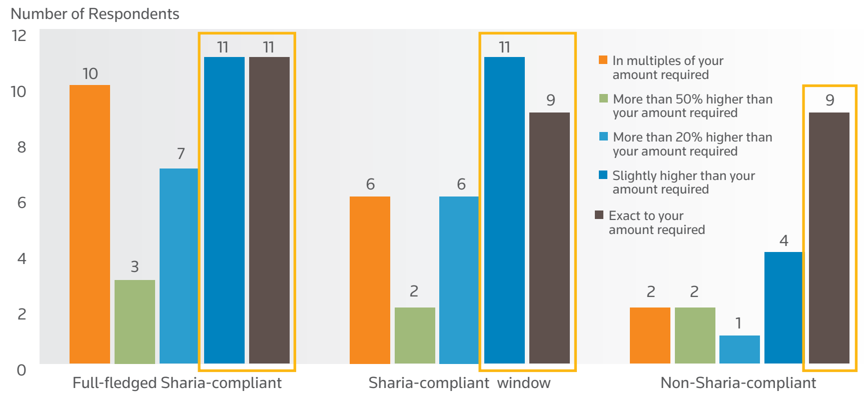
Suleman Muhammed Ali

The level of oversubscription depends on a variety of factors, including the credit quality of the issuer, the pricing on the deal and market factors such as competing deals in the market, volatility in the global markets etc. Hence it is hard to pin down one single factor. However, we have seen large oversubscriptions in many sukuk deals due to increased market liquidity in recent times.

SURVEY FINDINGS – AS A BUYER OF SUKUK, WILL YOU NORMALLY PLACE A SUKUK ORDER IN THE PRIMARY MARKET ?



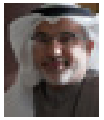
SURVEY FINDINGS – AS A BUYER OF SUKUK, WILL YOU NORMALLY PLACE A SUKUK ORDER IN THE PRIMARY MARKET? – BUY SIDE



4 Rates-driven

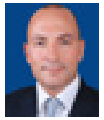
Higher demand due to higher returns once global market recovers, investors will look for alternatives such as real estate, funds, equities and sovereign bonds from developed countries which are viewed as safer than sukuk.

Q What is the outlook for emerging market fixed income (bonds and sukuk) given imminent rises in US Treasuries and global rates? Are sukuk affected by the Federal Reserve's tapering of bond purchases? Will it have a greater proportional impact on sukuk than bonds because of the sector's small size or less due to sukuk's equity features?



Issam Al Tawari

Anticipated rises in US Treasuries and global rates, or the Fed's tapering of bond purchases will have a limited effect on the regional (GCC/MENA) fixed income market and sukuk issuances in view of a sustained strong economic backdrop in the MENA and Southeast Asian markets (MENASA), the low correlation of MENASA sukuk issuances to major fixed income sectors and continued debt capital markets developments for both bond and sukuk issuances in the region. Most sukuk investors perceive sukuk to be the Shariah-compliant equivalent of conventional bonds – as debt instruments. This is also evidenced by the factors underpinning pricing fundamentals for both bonds and sukuk: the market uses the same interest rate benchmarks when pricing bonds and sukuk. Consequently, changes in global interest rates will have a proportional impact on sukuk as compared to bonds as they are perceived to be virtually the same from the investor's perspective.

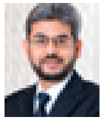


Mohieddine Kronfol

The outlook remains constructive and driven by much more than rising US treasury rates. Massive infrastructure spending across the GCC and budget financing across several emerging Asian and African markets will continue to drive issuance. The global sukuk market also has lower duration and correlation statistics compared to other fixed income sectors and an argument can be made that sukuk could outperform in a rising rate environment. Nothing is imminent. In a world with modest growth, low inflation and multiple sources of risk, fixed income, and credit in particular, remain suitable allocations. The global sukuk market has lower duration and correlation statistics compared to other fixed income sectors and an argument can be made that sukuk could outperform in a rising rate environment.

Hussain Abdulhaq

Sukuk, like any other fixed rate instrument, will be directly affected by the Fed Call on interest rate. Because of that, the timing of the issuance is directly linked to the market condition and whether the buyers are happy to acquire stakes from the new issues. It is worth highlighting that because of the limited hedging instruments available to Islamic banks, hedging of market risk is a bit difficult therefore, Islamic banks as a natural holder of sukuk are more hesitant to purchase sukuk during a period of potential interest rate rise especially with the fixed rate nature of most of the new sukuk offered. The ability of Islamic institutions to hedge interest rate risk is a vital factor here. Because of the lack of instruments that comply with Shariah, Islamic financial institutions will be more affected by any sharp movement with market rates, thus as a precaution, they hold fewer long duration papers and thus affect the long dated sukuk papers.



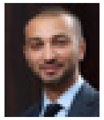
Ahsan Ali

A vast majority of sukuk are equivalent to conventional fixed income instruments in terms of pricing, listing and trading and hence will be affected by market factors to the same extent as conventional bonds from similar issuers in those markets. However, historically, we have observed that sukuk have shown less volatility than conventional bonds in times of volatility. This is because sukuk generally find a pricing bid from Islamic buyers in their home markets in case conventional buyers from Europe or Asia want to sell their holdings due to market movements. Therefore, the extent of volatility is reduced for sukuk compared to conventional bonds and we have even seen conventional buyers prefer sukuk over conventional bonds, especially if the issuer is from a GCC country. However, the long-term growth and development of sukuk will continue irrespective of short-term market movements. The reason is because as Islamic banking continues to grow at a rate faster than conventional banking, and therefore Islamic deposits and investments continue to grow, all this money will need to find some avenue for deployment. And since sukuk is an asset class which is now well-developed and well-understood, it can provide a ready deployment avenue for this liquidity.

5 Harder to Access & Higher Costs

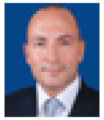
Given that some issuers don't have enough assets to back their issuance, it is harder for them, especially the conventional borrower, to access the market. In addition, sukuk is well known to have higher set-up costs and take a longer time to issue than conventional bonds, all of which discourage global issuers.

Q Given sukuk supply dynamics: Is the sukuk market attracting conventional issuers because of the acute shortage of sukuk? And if the supply-demand gap is filled, will conventional issuers and those not motivated by the desire for Shariah-compliant financing exit the sukuk market to return to conventional bond markets?



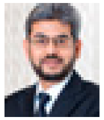
Usman Ahmed

It is important for conventional issuers to have access to multiple liquidity pools. During periods of market stress, we have observed conventional issuers in the GCC turning to the sukuk market to fulfill their funding requirements. Conventional issuers should ensure that the Islamic window remains open by regularly issuing sukuk.



Mohieddine Kronfol

I don't think so but I do think the sukuk market should cater to asset-light issuers by receiving sukuk with increased risk-sharing features and unconventional cash flow profiles – this would further diversify sukuk portfolios, increase their idiosyncratic risk, lower correlation to other asset classes and better serve the investment objectives of non-bank financial investors such as Shariah-compliant pension funds and takaful companies, all the while differentiating Islamic finance and improving its efficacy.



Ahsan Ali

Conventional issuers will always have commercial cost-benefit considerations at the top of their minds. So it is fair to expect them to access the sukuk market if the benefits of investor diversification exceed the costs and time involved in issuing a sukuk. Having said that, sukuk has now become a fairly standard product in most jurisdictions and therefore the costs and timeframe for execution have considerably reduced and are now more or less in line with issuing a conventional bond. In the long-term, the growing Islamic liquidity and therefore investor diversification rationale will still provide a reasonably attractive argument for conventional issuers to consider issuing a sukuk.

Ali Marshad

We believe that the attraction to the sukuk issuance by conventional entities is mainly driven by the attractive performance of such issues and the oversubscription which reflects well on the issuer. We believe that should that trend dry up the conventional entities will be less inclined to issue sukuk and should the supply-demand gap be filled conventional investors will be less interested in sukuk.

Chapter Two

Issuance Process: Why Sukuk

Why Sukuk?

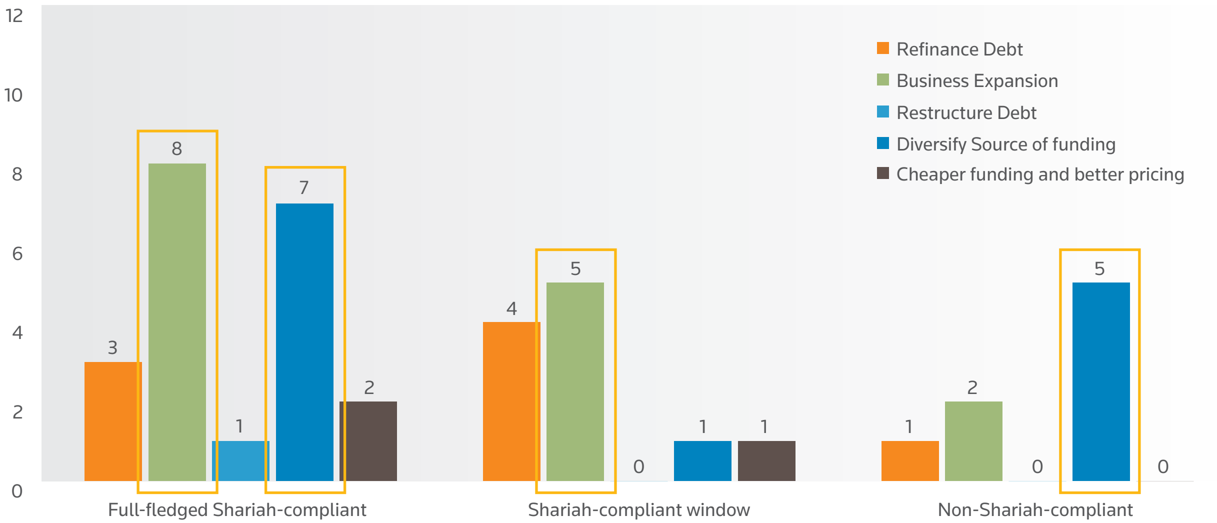
Has it become a fixture?

Our Sukuk Survey reveals that 37% of lead arrangers and issuers chose business expansion as their main reason to issue sukuk followed by diversifying their source of funding, which was investors' pick in last year's survey.

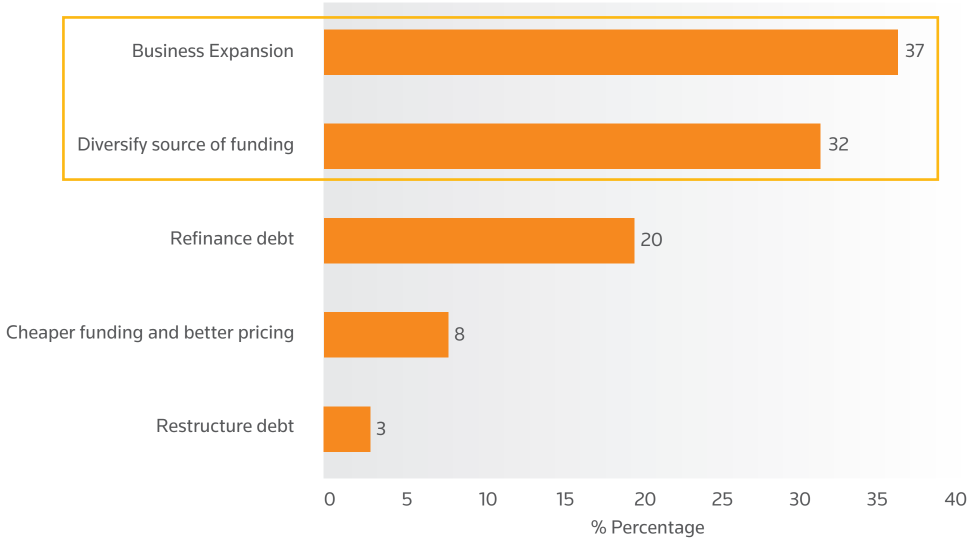
Ultimately, Shariah-compliant issuers suffer from limited suite of Islamic instruments and investments. Most of them have no other option but sukuk to raise capital from the fixed income market. Conventional issuers are attracted by the high demand for sukuk and look to sukuk as a way to diversify their source of funding and balance sheets. Issuers are looking to expand their scope to access more markets and widen their investor base in case they need to raise more capital in the future.

Survey	Respondents	Skipped
Sell side	40	4

SURVEY FINDINGS – WHAT IS YOUR PRIMARY REASON TO ISSUE SUKUK? – SELL SIDE



SURVEY FINDINGS – WHAT IS YOUR PRIMARY REASON TO ISSUE SUKUK?



> *Conventional issuers are attracted by the high demand for sukuk...*

Why Sukuk?

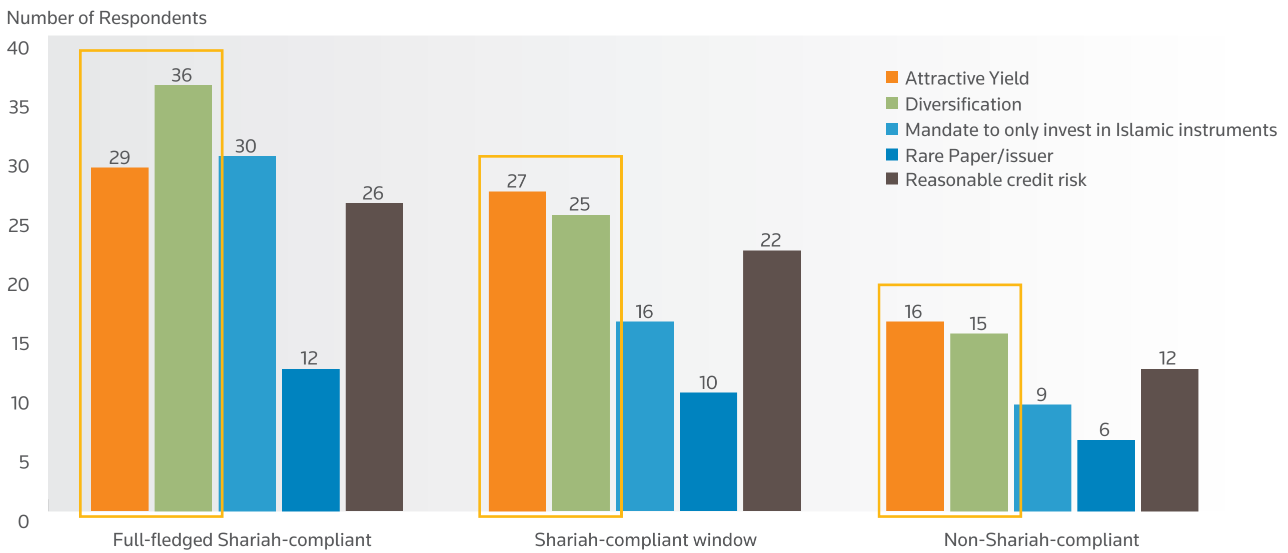
Higher yield attracts non-Shariah-sensitive investors

As sukuk yields grow more attractive with the combination of better pricing and solid credit, investors are keener to invest in sukuk.

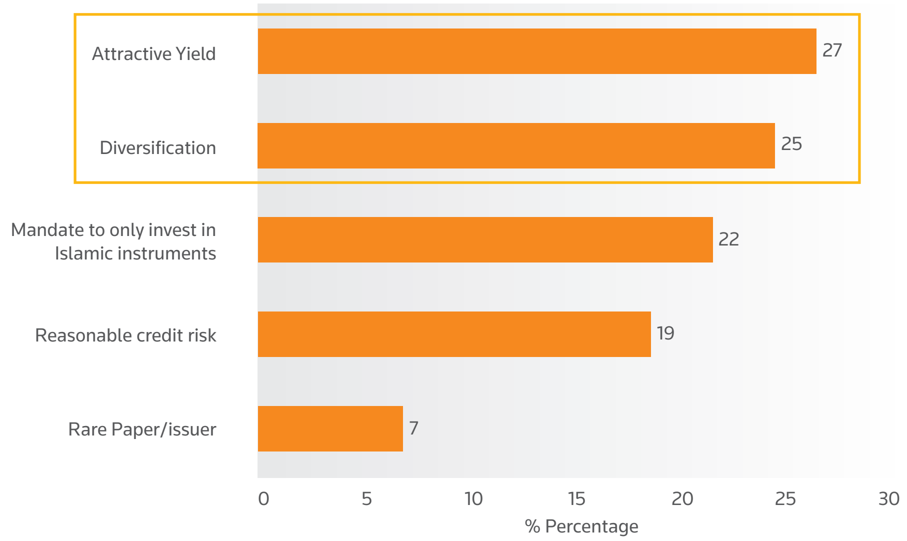
Investors from full-fledged Shariah-compliant institutions chose diversification as their main reason to invest in sukuk (note: survey option didn't specify type of diversification and so includes geographic, investor profiles and instrument types). Shariah-compliant windows and non-Islamic investors favoured the attractive yield; this, of course, is driven by prevailing interest rates and market conditions, and investors could turn to alternatives once the supply and demand gap narrows.

Survey	Respondents	Skipped
Buy side	106	0

SURVEY FINDINGS – WHAT ARE YOUR REASONS FOR INVESTING IN SUKUK? – BUY SIDE



SURVEY FINDINGS – WHAT ARE YOUR REASONS FOR INVESTING IN SUKUK?



> *"...with the combination of better pricing and solid credit, investors are keener to invest in sukuk."*

Raising Capital

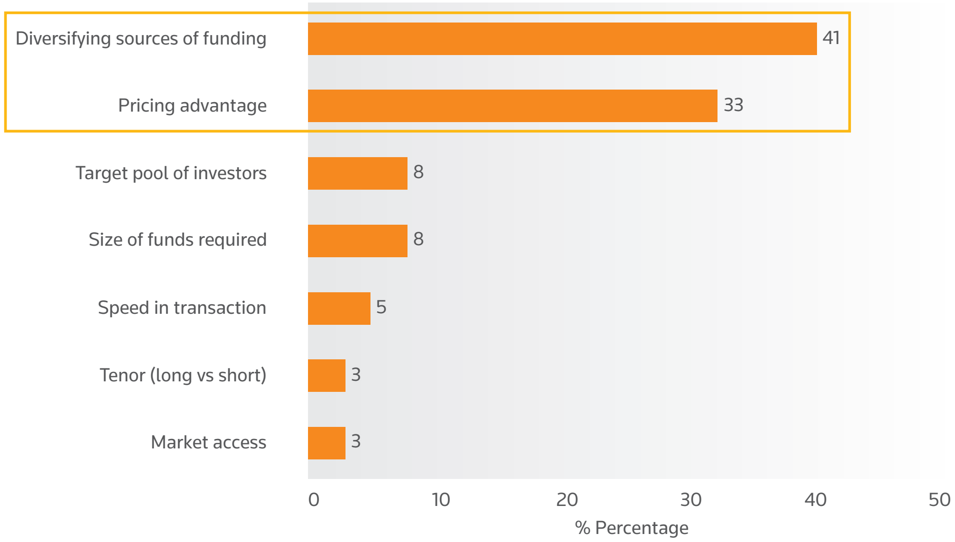
What's important?

Tenor and market access may seem the most substantial barriers to raising capital, but fewer investors from our Sukuk Survey selected them as important factors that affect raising capital.

Diversifying sources of funding (41%) and pricing advantage (33%) were the most important factors to select source of funding between equity, loans, bonds and sukuk. For full-fledged Shariah-compliant issuers, the pricing advantage is their main driver to choose between different funding options given that most of these institutions are relatively small and they would have high levels of cash in hand. On the other hand, non-Shariah-compliant investors would tap the sukuk market to diversify their source of funding and reach out to a wider range of investors, including Islamic institutions.

Survey	Respondents	Skipped
Sell side	39	5

SURVEY FINDINGS – WHAT IS THE MOST IMPORTANT FACTOR TO SELECT SOURCE OF RAISING CAPITAL BETWEEN EQUITY, LOANS, BONDS AND SUKUK?



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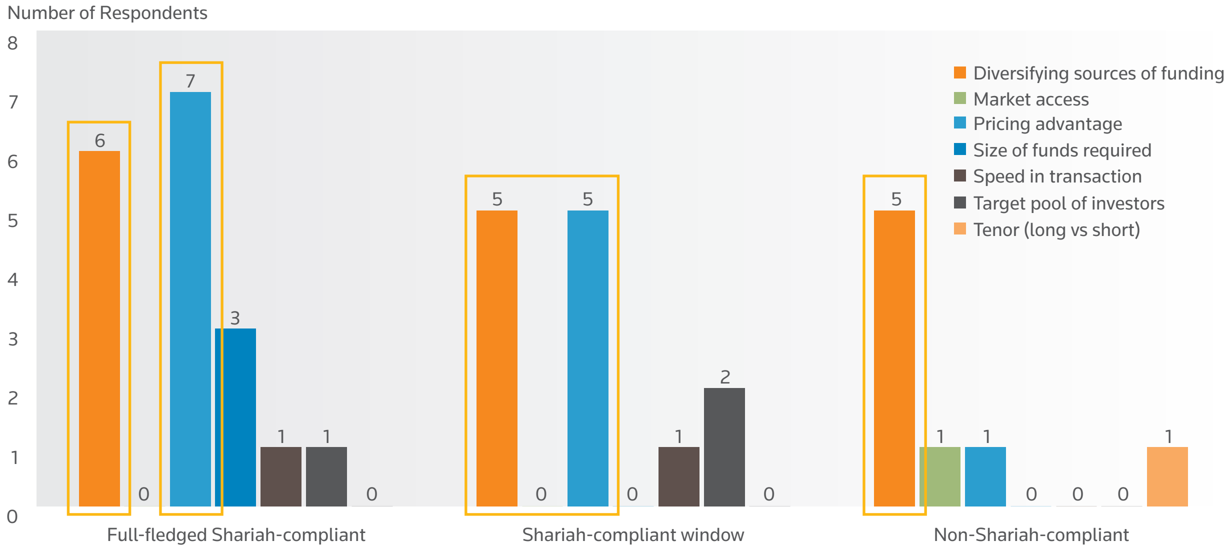


> *"Tenor and market access may seem the most substantial barriers to raising capital..."*

Sukuk Pricing

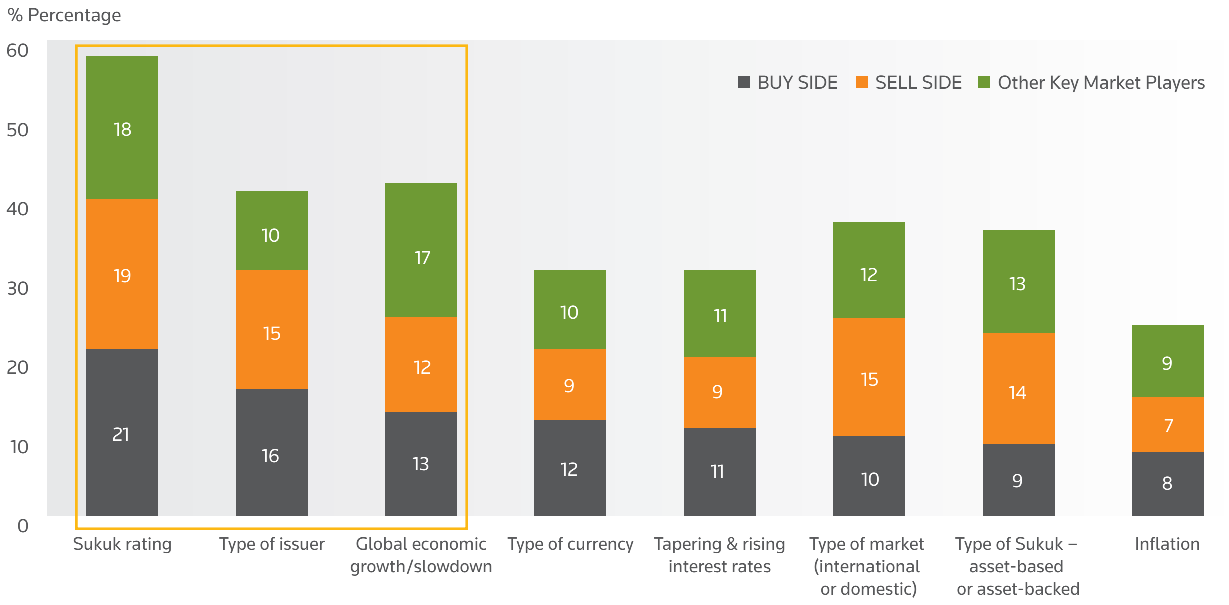
What determines pricing?

The sukuk market is still niche and doesn't have its own pricing mechanism. Sukuk pricing is heavily driven by the fixed income market based on treasuries, mid-swap rates and country CDS. The market still treats sukuk as a regular bond when it comes to pricing. A number of reasons affect the pricing of sukuk but the majority of market players believe that sukuk rating is the most significant factor to affect pricing.

16% of investors consider type of issuer as the second most significant factor affecting sukuk pricing followed by 13% for global market stability. 15% of lead arrangers and issuers believe that the type of market -- whether international or domestic -- is a significant factor.

In June 2014 Malaysia announced that it will drop the rating requirement for corporate sukuk from 2017. Despite the sukuk leader's move away from rating (the aim is to encourage more issuance by driving down costs), different market players from all sides still believe that rating is the most significant factor for pricing. (The Malaysian market is dominated by domestic sales, and rating assumes a different significance for international papers and investors.) Credit risk, then, is the main driver for sukuk pricing. (Type of issuer is the third most significant factor.) The second most significant factor is global market movement, which affects interest rates and also the credit risk of some countries (given their economic recovery from the financial crisis). The market is moving towards healthier economic indicators which have driven rates and equity share prices up while bond prices have deepened and yields widened.

SURVEY FINDINGS – RANK 5 FACTORS BELOW BASED ON THEIR SIGNIFICANCE TO SUKUK PRICING



Survey	Respondents	Skipped
Buy Side	96	10
Sell Side	39	5
Others	48	6

"Sukuk pricing is heavily driven by the fixed income market..."

Market Opinion

Capital Market Dilemma: Equity, Sukuk, or Bank Financing?

By Shamzani Hussain – Head of Islamic Banking, Wholesale Banking Group, FGB

The global Islamic finance industry has grown to $2.03 trillion as of June 2014. The industry's assets are held in the following sectors: 79.8% banking, 15% sukuk, 4% equities and 1.1% takaful (KFH Research, Feb 7, 2014). Aside from banking assets and financing, the sukuk market is the second fastest growing segment within the industry. The following brief analysis examines some of the key drivers for decision-makers determining the most suitable Islamic finance fundraising method to opt for.

Fund or capital raising in the Islamic finance industry can be done through a number of methods such as borrowing, issuance of sukuk or sale of equity e.g. issuance of shares. Each method has its own advantages and disadvantages, given the particular nature of the business concerned, in addition to the business segment, risk appetite and cash flow.

EQUITIES

Shariah-compliant equities such as company shares, securities, and other instruments are currently traded on many stock exchanges. This allows those with surplus funds to generate returns on their equity holdings and enables corporations to obtain funding to support growth. Apart from company shares, the Islamic equity markets have witnessed a growth of various fund instruments. This is evidenced by the emergence of unit trusts or mutual funds, real estate investment trusts (REITs), exchange traded funds (ETFs), venture capital funds, investment funds and structured products, based on Shariah indices.

Equity-based contracts involve partnerships and the sharing of risks as well as rewards. Profits are derived from capital gains and dividends. Equity finance may sometimes be more appropriate than other sources of finance as companies will not have to keep up with costs of servicing bank loans or debt finance, allowing them to fully utilise available capital for business activities.

The raising of capital via equity is done either through an initial public offering, or a secondary listing. The main benefit to issuers is that funds raised through an equity offering do not need to be repaid in exchange for a stake offered in the company. From an investor perspective, equities offer two clear benefits: capital gains and dividends.

SUKUK

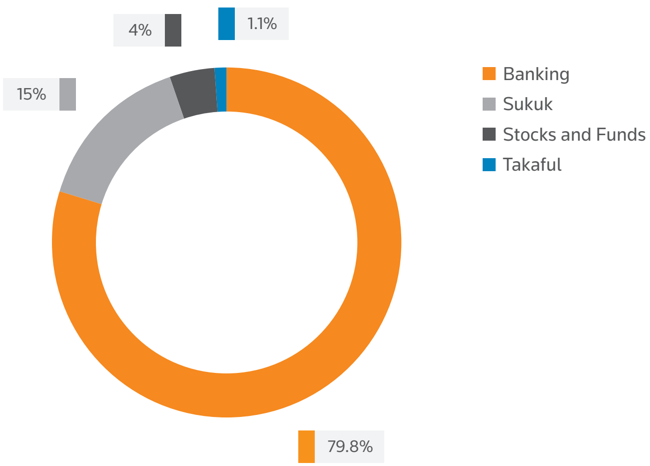
The emergence of sukuk has been one of the most significant developments in Islamic capital markets in recent years. Sukuk can link issuers with a wide pool of investors across segments and geographies, many of whom are seeking to diversify their holdings beyond traditional asset classes.

Since 2005, when issuances totaled only $11.5 billion globally, the sukuk market has grown at an average rate of 41.6% annually until 2012. Most recently, annual sukuk issuances totaled $119.7 billion in 2013 (CIMB Research, June 2014). This has in part been driven by new jurisdictions tapping the market, such as the UK, South Africa, Hong Kong, Singapore, Turkey, Kazakhstan, Mauritius and Luxembourg.

SHAMZANI HUSSAIN

Shamzani Hussain has 20 years of financial services experience across the Asia Pacific, Middle East, North Africa and Europe. He started his career with AIG before joining the HSBC Group for 16 years. He was assigned to Global Banking & Markets positions across HSBC which include Securities Services, Transaction Banking and Financial Institutions business. He joined HSBC Amanah in 2006 and has since focused on Islamic banking. Shamzani's last assignment with HSBC was as Director and Head of Islamic Financial Institutions, Middle East and North Africa. He joined FGB (formerly known as First Gulf Bank), United Arab Emirates as Head of Islamic Banking, Wholesale Banking Group in 2013 and is currently managing the global Wholesale Banking Islamic business.

ISLAMIC GLOBAL ASSETS 2013



Over the last ten years, sukuk issuances have become more attractive as a source of funding for government bodies, financial institutions and corporates. This is partly due to the considerable advantages such as active secondary markets which provide an excellent tool for liquidity management and lower cost of funds in comparison to traditional bank financing. Furthermore, different types of sukuk issuances which provide flexible structures, longer tenors and hybrid features attract various types of investors and issuers.

BANK FINANCING

Apart from sukuk and equity issuance, a more traditional approach towards acquiring funding is via bank financing which includes bilateral or multilateral transactions such as syndicated financing. Islamic syndicated financing refers to the participation of a group of institutions in a joint financing exercise through Shariah-compliant modes of financing. For instance, in the murabahah financing structure, an underlying asset is sold to the obligor on deferred payment terms, which enables conventional and Islamic financiers to work together on the same Shariah-compliant financing tranche.

Similarly in ijarah financing (leasing), both conventional and Islamic financiers can pool their funds to purchase an asset which can be subsequently leased to the obligor. This enables the obligor to tap into a larger liquidity base.

Over a period of 12 months between October 2013 and October 2014, 22 Islamic syndicated financing transactions were recorded globally totaling $9.2 billion. The top country issuing Islamic syndications year-to-date in 2014 is the UAE totaling $3.78 billion, followed by Saudi Arabia at $2.2 billion and Turkey at $961 million. The top sectors raising syndicated financing are Real Estate, Mining, Transportation, Finance and Telecommunications (Dealogic, October 1, 2014).

WHICH IS MOST SUITABLE?

A variety of factors may influence the selection of fund or capital raising and the options will have to be evaluated before deciding on the most suitable method. For instance, fundraising through syndicated finance is generally simpler than a sukuk issuance or equity offering exercise as it involves limited parties. However, financiers providing loans will find it more challenging to perform an accurate evaluation since the facility does not emphasise rating exercises such as sukuk and equity. Nevertheless, the tenor of a financing facility is often considered as 'short to medium term' which normally ranges between 3 to 7 years, compared to sukuk which could have longer maturities of up to 20 years or perpetual basis with a generally larger issuance amount. The table provides a comparison schedule between some of the items related to a syndication deal versus a sukuk.

An issuer considering raising funds through equity, sukuk, or syndicated financing should consider the repayment and asset or revenue stream that can be offered. Equity raising offers a method to raise funds without having to repay, but dilutes the issuer's ownership in the company and increases the amount of regulatory disclosure required.

Sukuk financing offers a method to apportion assets, services, or revenue to create a revenue generating stream that pays off investors. However, the additional process and costs involved would require potential issuers to have a proper funding strategy over a longer term.

Lastly, syndicated financing offers a quicker method of raising funds, but is generally constrained by tenor, size and credit appetite as well as covenants. It is worth noting that bilateral financing will remain as an important funding lifeline for startups as well as small and medium enterprises.

MARKET MOVING MORE TOWARDS SUKUK?

In summary, the decision to opt for either equity, sukuk or financing must be done after thorough consideration, taking into account all of the abovementioned factors, and depending on the nature of the business, risk appetite, and cash flows.

In recent years, the general trend amongst government bodies, financial institutions and large corporates with Islamic finance affinity seems to have more preference towards raising funds through sukuk issuances given the following key advantages:

(i) Diversification of investor base – enabling a wider source of funding across various investor profiles and geographies.

(ii) Longer tenor – allowing for a more consistent pricing level, particularly due to the shortage of long term Shariah-compliant assets.

(iii) Self-service structure – able to deploy existing assets, services, or investments to create a self-servicing vehicle throughout the tenor of the sukuk.

(iv) Cost advantage – allowing for economies of scale in terms of cost-effectiveness through a one-off sukuk program setup cost.

Banks offering the full suite of Islamic banking products are able to provide the appropriate advisory services and fundraising proposition in accordance with Shariah principles across industries and geographies.

Key Comparisons of Syndicated Financing against Sukuk		
	Syndicated Financing	Sukuk
Rating	Not required	Preferred particularly for Public issuances
Tenor	Short to medium terms i.e. between 3 to 7 years	Longer maturity up to 20/ 30 years, or perpetual basis
Investor	Primarily commercial banks	Include banks, fund managers and institutional investors
Pricing	Pricing determined earlier and subject to agreement between the Customer and banks	Pricing guidance prior to issuance and finalised subject to market demand
Process	Shorter process due to small pool of investors and existing banking relationship	Longer process including structuring, issuance, roadshow and regulatory approval
Covenants	Depending on the credit standing of the client	Emphasis on the monitoring of asset and revenue streams for maintenance of cashflow throughout the tenor of the issuance
Cost of Issuance	Lower, as standardised documentation is often used with minimal legal support	Higher, due to enhanced documentation, regulatory requirements, listing, registration and distribution activities

Market Opinion

Impact of oil prices on sukuk markets

By Blake Goud, Community Leader, Thomson Reuters Islamic Finance Gateway

The selloff in the price of oil of 25% from June to October 2014 has led to different perspectives on the impact of oil prices on the Islamic finance industry in general and sukuk markets in particular. One idea floated by Karim Nassif at Standard & Poor's is that sukuk represent an optionality for sovereigns particularly in the GCC and that "if there is to be a real change in the commodity [oil] pricing, it is very useful to have that market available to them". The conclusion by the post from which this quote is taken is that a fall in oil prices may "whet Gulf appetite for sukuk". Yet, based on some limited empirical data available, the relationship is likely to be the opposite.

HIGHER OIL PRICES

In research released in 2010 which was highlighted at the time for its conclusion that the growth of Islamic finance was not influenced in a significant way by the outflow of Muslim money from the West after September 11, 2001 (9/11), two IMF researchers studied the impact of oil prices on the diffusion of Islamic banking. The biggest conclusion from their research was that the growth starting after 9/11 was more coincidence than causal and the real driving factor was a rise in oil prices around the same time.

In empirical tests, a rise in oil prices was associated with a growth both in the number of Islamic banks and their share of the overall financial markets. The growth in Islamic banks and Islamic banking assets followed the inflow of money into the oil exporting markets in the Middle East (particularly GCC nations). To a much more limited extent, Malaysia also benefits as an oil producer with the share of its GDP coming from 'oil rents' being 6.0% in 2012 which puts it in the same league as Mexico (6.8% of GDP).

The way that the oil price rise flowed through to the banking system is similar in each country where the national oil company receives royalties or direct revenues from extracting and selling oil which are directed by the government into domestic banks. This swells the deposit base of the banking system which leads to a rise also in the assets of the banking system.

The degree to which these funds are absorbed efficiently and directed towards productive economic activities also has an impact on the growth of the Islamic banking system: the share of Islamic banking assets rises with the real interest rate but at a declining rate.

The link between the real interest rate and Islamic banking assets tells us a great deal about the growth after 2000 when oil prices rose. Islamic banking assets grew in countries that could harness the oil price rise to grow their economies without being subject to high inflation rates (or low growth rates with low inflation). And the growth in financial sector development, of which Islamic banks are a part, is also associated with higher share of Islamic banking assets.

This still doesn't account for the impact of oil prices on sukuk, at least directly. The link is more indirect but still quite important. As the financial system deepens, there will be higher levels of Islamic banking assets. Banks are traditionally large issuers of fixed income products, so the relationship between oil prices and sukuk should be positive. However, there are also impacts moving in the opposite direction because higher oil prices also means greater liquidity in the banks (and thus lower need to issue sukuk for their funding needs).

DROP IN OIL PRICES

Taking a look at the other side where oil prices drop, the supply of sukuk may rise as liquidity tightens in the market as issuers look to capital markets to fund their liquidity needs. However, the tightening liquidity at banks is also likely to create a significant drop in the demand for sukuk. As a result of the surplus liquidity flowing into the banking systems over the last 10 years, banks are net purchasers of sukuk. If oil prices were to fall, the demand from banks for sukuk, a significant share of overall demand, would likely fall off quite dramatically since banking assets are significantly larger than the total sukuk outstanding.

Government and government-related entities issue most of the sukuk and banks, typically the largest corporate issuers, are not as significant a share of issuance volume in contrast to most fixed income markets. If oil prices fall and remain depressed, the need to raise funds by sovereigns (which are largely funded by oil revenues in the GCC) will increase at the same time as demand from the banks is likely to decrease which will make sukuk relatively more expensive than conventional bonds where demand is less affected by regional liquidity.

Some market factors in the GCC could support an expectation that a fall in oil prices would be accompanied by a rise in sukuk issuance. However, unless the demand from extraregional investors is developed further and unless the oil price fall is expected to be temporary, the countervailing factor seems to be more likely to overwhelm the sources of growth. The recent growth of issuers from new 'exotic' locations like Hong Kong, the UK and South Africa are fuelling demand from outside of the GCC and Southeast Asia, but these issuers are attracted by large pools of liquidity in the GCC. The pull of the sukuk market as an appealing alternative source of funds will decrease if oil prices were not just to drop but be expected to stay low, which will also limit the availability of 'familiar' issuers that will help diversify the investor base for sukuk. Consequently, a fall in oil prices would be negative for sukuk both in terms of issuance and demand.

[1] Parasie, Nicholas. "Weaker Oil Receipts May Whet Gulf Appetite for Sukuk, S&P Says," WSJ Middle East Real Time, October 13, 2014. http://blogs.wsj.com/middleeast/2014/10/13/weaker-oil-receipts-may-whet-gulf-appetite-for-sukuk-sp-says/
[2] Imam, Patrick and Kangni Kpodar. 2010. "Islamic Banking: How Has It Diffused?," IMF Working Paper 10/195, August 2010.
[3] World Bank. "Oil Rents (% of GDP)," World Development Indicators http://data.worldbank.org/indicator/NY.GDP.PETR.RT.ZS

IIBR Outlook

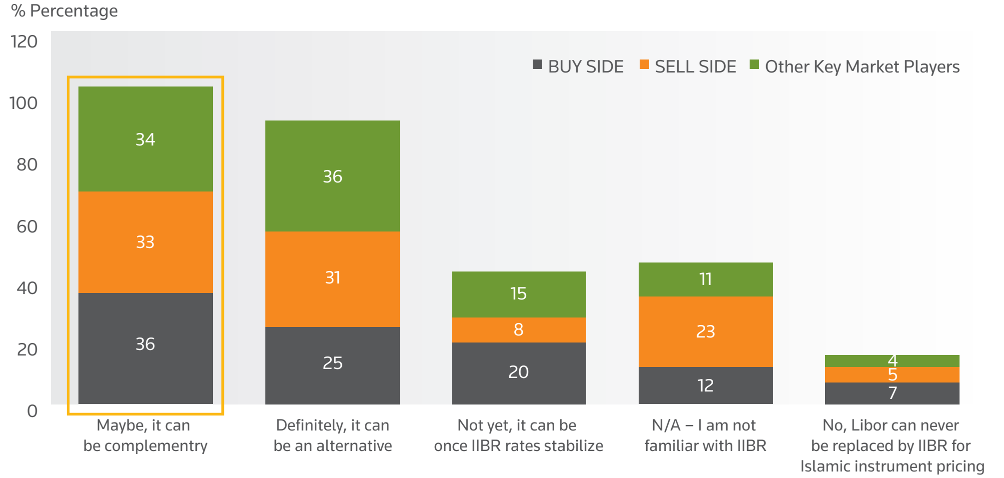
Could IIBR be a pricing alternative?

In 2012, Thomson Reuters in collaboration with independent stakeholders/associations and high-profile Islamic banks and Islamic banking windows introduced a landmark initiative – the first **Islamic Interbank Benchmark Rate (IIBR)**. Using contributions from up to 18 major Islamic banks and Islamic banking windows, the IIBR provides a robust indicator of the average expected cost of short-term interbank market funding for the Islamic finance industry. The aim is to shape the Islamic finance space as an independent industry that has its own pricing and rates mechanism based on murabahah and wakalah rates.

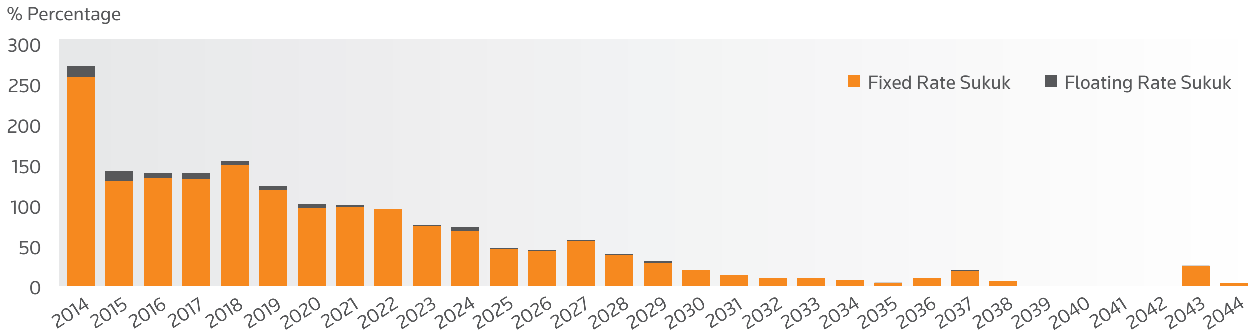
Issuers are using the low interest rate environment to secure funding at cheaper rates. This explains why most fixed income issuance are currently on fixed rates. However, once the market improves, issuers may have to shift to floating coupon sukuk which would need to be linked to a benchmark rate. After the LIBOR scandals, a benchmark such as IIBR could prove to be an alternative, or at least complementary, to pricing Islamic instruments, particularly sukuk.

Survey	Respondents	Skipped
Buy Side	98	8
Sell Side	39	5
Others	47	7

SURVEY FINDINGS – GIVEN THE RECENT RATE FIXING SCANDALS, COULD IIBR (ISLAMIC INTERBANK BENCHMARK RATE) EMERGE AS AN ALTERNATIVE PRICING MECHANISM BENCHMARK FOR ISLAMIC INSTRUMENTS PARTICULARLY SUKUK?

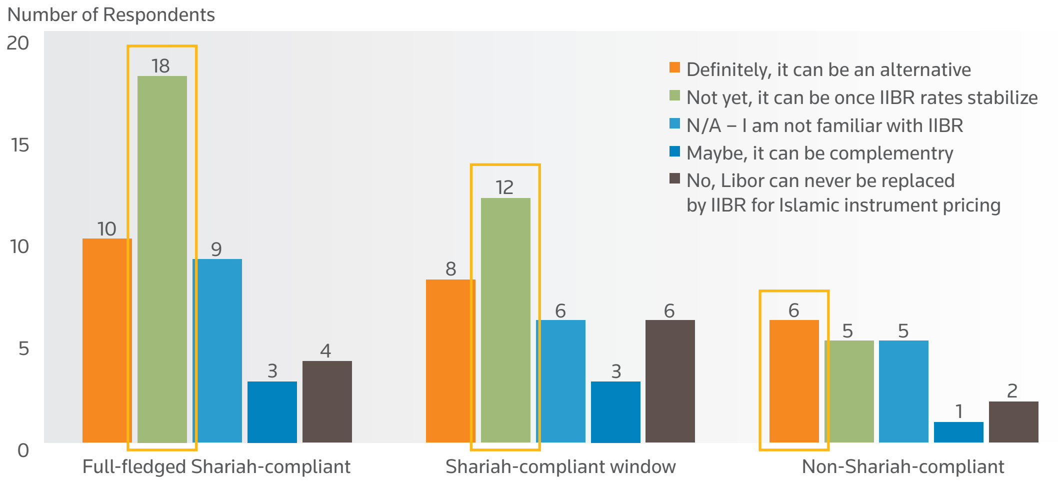


GLOBAL OUTSTANDING SUKUK MATURITY PROFILE BREAKDOWN BY TYPE OF COUPON

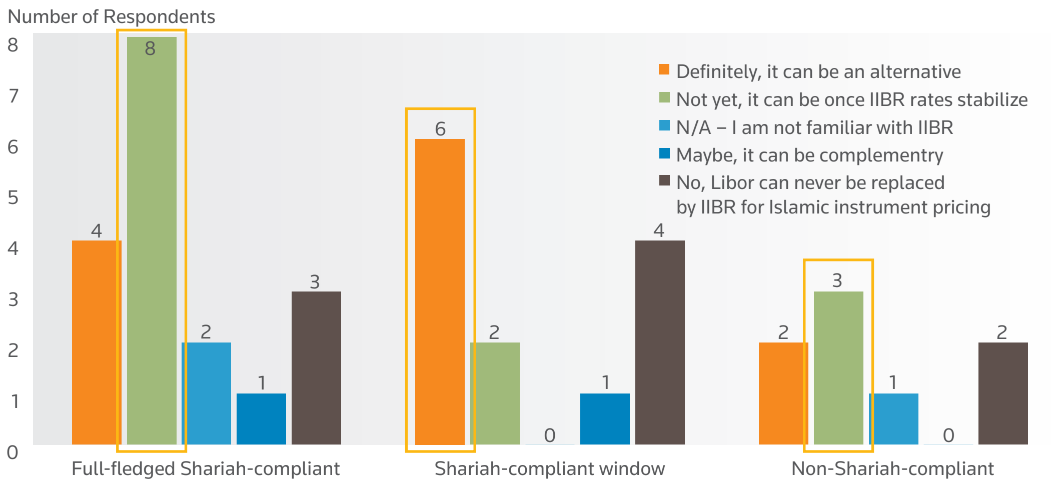


"Issuers are using the low interest rate environment to secure funding at cheaper rates."

SURVEY FINDINGS – GIVEN THE RECENT RATE FIXING SCANDALS, COULD IIBR (ISLAMIC INTERBANK BENCHMARK RATE) EMERGE AS AN ALTERNATIVE PRICING MECHANISM BENCHMARK FOR ISLAMIC INSTRUMENTS PARTICULARLY SUKUK? – BUY SIDE



SURVEY FINDINGS – GIVEN THE RECENT RATE FIXING SCANDALS, COULD IIBR (ISLAMIC INTERBANK BENCHMARK RATE) EMERGE AS AN ALTERNATIVE PRICING MECHANISM BENCHMARK FOR ISLAMIC INSTRUMENTS, PARTICULARLY SUKUK? – SELL SIDE



About one-third of all market players believe that IIBR could potentially complement LIBOR for sukuk issuance. 25% of investors and 31% of issuers think that IIBR can definitely replace LIBOR for sukuk issuance. However, 25% of issuers and 12% of investors have never come across IIBR. Considering that IIBR has only been around for three years this response from the market is encouraging because a benchmark would usually take longer than three years to be established. However, in order for IIBR to position itself as an independent Islamic interbank benchmark, it needs more time and support from the financial industry. For more information please visit the Thomson Reuters IIBR page http://thomsonreuters.com/iibr/

Market Opinion

The Islamic Interbank Benchmark Rate (IIBR) falls short of its goal

By Hussain Abdulhaq, Head of Treasury & Financial Markets, Al Salam Bank

HUSSAIN ABDULHAQ

Hussain has been an Islamic Banking practitioner for more than 12 years with a dedicated experience in Treasury and Capital market products. He started his career in Kuwait Finance House (Bahrain) as a supervisor of the dealing room where he was involved in establishing the full treasury set of products and services while establishing the external lines networks with most of the GCC FIs. He Joined Al Salam Bank (Bahrain) as head of the trading team in 2007 and was promoted to the Head of the Treasury and Capital market team in 2010 supervising the ALM, Trading, Sukuk, and FI activities. Hussain is accredited Instructor of Islamic Finance courses where he conducted courses and workshops in the same field in the MEAN and North Africa. He is a CFA holder and MBA graduate with distinction.

Since the start of the modern Islamic finance industry four decades ago, stakeholders have debated the relevance of using interest rate benchmarks within the Islamic economy. There have been mixed views based on the fact that interest rate benchmarks available in the market are all driven from conventional trades and thus reflect interest-based relationships. Although Shariah scholars and different Islamic modes of contracts technically do not specify how profit is calculated as part of any trade transaction (i.e. the mark up of murabahah or ijarah), the reliance of Islamic financial transactions on conventional benchmarks (i.e. LIBOR or US T. Notes) has attracted criticisms that have led to significant skeptical views about the authenticity of Islamic finance.

The development of Islamic financial markets and the massive rise in sukuk issuance have driven the need for the application of risk management techniques. Basel II and III have placed considerable demands on market risk driven by interest rates movements, and which thus requires a true benchmark to be used to quantify Risk Weighted Assets (RWA) and Capital Adequacy Ratio (CAR).

INTRODUCTION OF IIBR

The introduction of the Islamic Interbank Benchmark Rate (IIBR) in early 2012 was a milestone in the Islamic finance industry. For the first time Islamic finance had a benchmark profit rate derived from Islamic participants only, which to a large extent is meant to reflect the movement of funds in a Shariah-compliant way. In my opinion, the launch of this initiative was like a dream come true, given the technical difficulties in its implementation and the heavy reliance of interbank dealing between Islamic and conventional banks.

The IIBR must now be evaluated after almost three years of implementation. Has it achieved its goal as a benchmark and how much real transactions have been quoted using IIBR? Further, have the participants been providing the right quotes for the average cost of Islamic transactions or just the best of them?

To answer these questions, we would need to have more insight into how the Islamic Treasury unit functions and how much freedom it really has to choose between practical prospective rates for non-treasury transactions (i.e. mortgage finance, trade finance or corporate financing facilities).

The true size of the Islamic interbank market is quite small and contains a large number of lower- or non-rated institutions. Thus most of the Islamic interbank trades that are counted in the IIBR are driven by conventional trades (one of the entities is a conventional bank, mostly a taker of funds) conducted on a daily basis as part of treasury management. These types of trades form the major part of the interbank business and thus the IIBR in reality does not reflect the concept of the Islamic economy rather it reflects the conduct of Shariah-compliant trades.

Further, the scale of Islamic interbank transactions vary from one institution to another, from country to country, and from region to region. The growth of IIBR to cover a longer list of institutions with the aim to capture a fragmented industry has led to more volatile rates as an outcome of the benchmark in comparison to LIBOR, for instance. This results in higher standard deviation in cases where IIBR is meant to be used for evaluation or discounting securities and thus derived lower value for Islamic assets in comparison to use of other benchmarks. A volatile benchmark is difficult to be used for other non-treasury transactions as it offers less certainty about the pattern of future cashflows, which makes it difficult to secure client approval.

“...the scale of Islamic interbank transactions vary from one institution to another, from country to country, and from region to region.”

Market Opinion

The End of US Federal Reserve's Quantitative Easing Programme and its Impact on Sukuk and Bond Markets in the Middle East and Asia

By Aminvestment Management

As we write, investors are bracing themselves for prospects of the eventual "lift-off", the US Federal Reserve's (Fed) first rate hike after years of ultra-accommodative monetary easing. Within the investment world, the market's initial expectation was for US Treasury yields to increase, as evidenced by the steeper yield curve in the run up to the September 2014 Federal Open Market Committee (FOMC) meeting. In emerging markets (EM), sharp currency swings made investors wonder about the safety of local currency sukuk and bonds, and whether the sell-offs seen in May/June 2013 and January 2014 will be repeated.

Against this backdrop, it is worthwhile to watch US Treasury yield movements, as it is a major variable influencing inflows and outflows into both the Middle East and Asian debt markets. (See Chart 1)

We note that since the Fed's September 2014 meeting, US Treasury yields have resumed a downward trend – regardless of the bullish chatter on how US growth has exceeded expectations at 4.6% QoQ in 2Q 2014, or how monthly job creation has averaged 226,000 over the first nine months of 2014. Yet, although the Fed appears to have been successful in engineering a smooth exit from its unprecedented monetary policy, to many investors, the Fed's communications policy had been most perplexing.

THE FED'S FORWARD GUIDANCE AS PART OF ITS COMMUNICATIONS POLICY AND TAPERING QE

Here, we need to understand the mechanics of the Fed's communications policy as it tries to maintain financial market stability. To begin, the Federal Reserve, or any other central bank, can influence economic conditions by shaping the market's expectations of the future. Specifically, this can be done by helping the public understand how the Fed intends to conduct monetary policy over time, and what its implications may look like for the economy.

Since 2000, the FOMC had begun issuing information about its economic outlook. Such information about intentions and expectations for the future is also known as **forward guidance**. Since the onset of the global financial crisis, the Fed increasingly relies on these tools – extensive new communications, along with large scale asset purchases, were used to push **long term yields** lower.

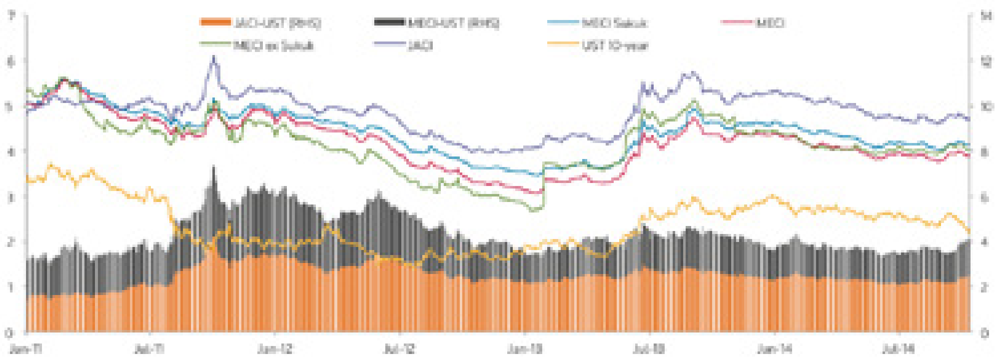
Over time, the Fed has taken a general commitment to increase the level of transparency – or explicitness in their interpretation of economic conditions – with a goal to further stabilize monetary policy.

AMINVESTMENT MANAGEMENT

AmInvest a leading Islamic funds management house headquartered in Malaysia, with offices in Brunei and Indonesia. It's global Shariah-compliant fund management capabilities have a proven track record spanning more than 30 years. The company serves global investors and manages funds for pension providers, sovereign funds, private banks, corporates and takaful institutions, as well as third party distributors for unit trust funds. The company's investment professionals help investors manage and provide expertise at every stage of the investment lifecycle. Some areas of specialization include managing Shariah-compliant funds – with a niche in Asian equities and global sukuk, as well as customization and innovation of Shariah-compliant investment solutions.

Chart 1: J.P. Morgan Asia Credit Index (JACI) and J. Morgan Middle Composite East Index (MECI) move in tandem with the 10-year US Treasury. Although JACI returns higher yield, MECI, especially MECI Sukuk yields, are less volatile. Conventional Middle Eastern credits excluding Sukuk (MECI ex Sukuk) prove to be much more volatile than JACI

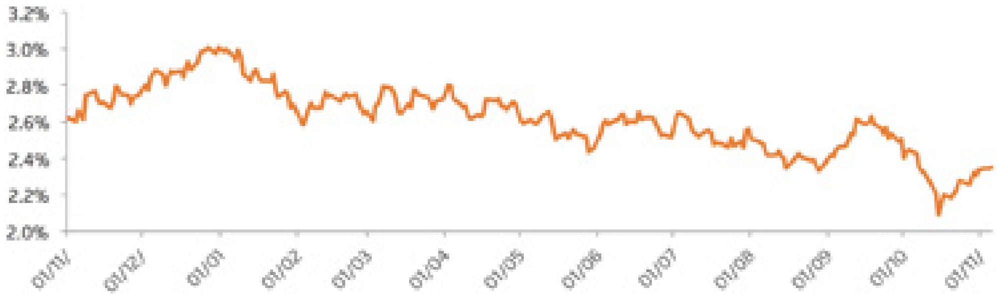
JACI, MECI YIELD-TO-MATURITY AND UST 10-YEAR YIELD



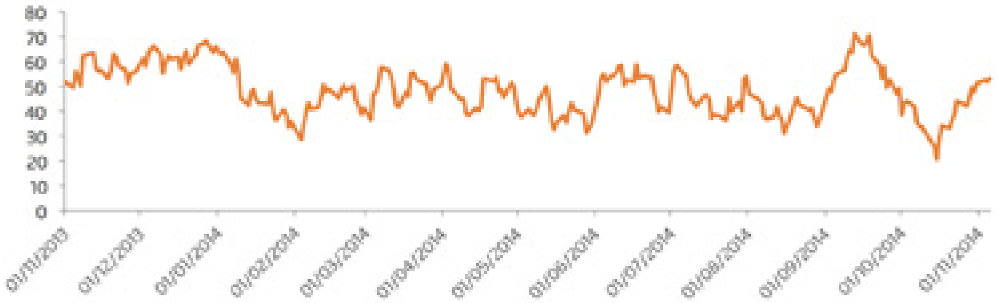
Source: J.P. Morgan Indices, BLoomberg, AmInvestment

Chart 2: The 10-year US Treasury yield continued on a downtrend despite improving data.

10 YEAR US TREASURY



RSI 10 YEAR US TREASURY



For this matter, the Fed provided explicit targets – that it will keep rates low for as long as unemployment rate remains above 6.5% and core PCE inflation, over the shorter term, does not exceed 2.5%. But when volatility spiked in the months of May and June 2013, following indications that the Fed would gradually reduce or "taper" asset purchases, Fed officials resorted to communications strategy – communications aimed to guide investors on what they most need to know. This could explain why the former Fed Chairman, Ben Bernanke, and now his successor Janet Yellen, frequently offered deep explanations on why markets should not perceive improving jobs, or other economic data, as an imminent sign for interest rate normalisation. It is perhaps this communications strategy that had led to the downward bias for US Treasury yields – even after the Fed had commenced with asset purchase reductions beginning January 2014.

In fact, the taper was deliberated as FOMC members grew concerned about excessive demand in risk assets. Specifically, they were worried that quantitative easing if prolonged, would only fuel increasing risk to **financial stability** especially in terms of **valuation pressures** in certain credit/equity markets. Given that the Fed's balance of risks has tilted on the side of financial stability – beyond the Fed's **dual mandate** of maximum employment and price stability – price corrections which restore market discipline would be given tacit approvals by the Fed.

As quantitative easing draws to a close, investors fear that higher interest rates would trigger sharp and sudden withdrawals out of fixed income funds. The Fed described this as **liquidity risk**, a panic which could deliver severe knock-on effects on the housing sector, or worse, a credit crisis.

In this response, the Fed abolished its explicit 6.5% unemployment threshold at the March 2014 FOMC meeting, and changed its communications policy. The Fed's new forward guidance, according to former Fed Governor Jeremy Stein, will now be less commitment-like, and a less precise guide to the Fed's actions than has been in the past. This new forward guidance, Professor Stein continued, works to settle the market into a self-sustaining equilibrium whereby the Fed acts gradually and to which the market has come to expect. That way, the Fed ensures its path to lessen financial market volatility. But as Professor Stein admitted, there remain very real limits to even the most careful and deliberate communications strategy to temper market volatility.

THE FED'S PREPARATION FOR MONETARY POLICY NORMALISATION

In the meantime, the Fed continues to make progress in preparation for the eventual normalisation of monetary policy. Yet, operational readiness remains work in progress.

For the Fed to commence with policy normalisation, it must reduce the size of its balance sheet at the same time. Why? Increases in Treasury yields will erode the market value of the Fed's portfolio, and result in capital losses. While the portfolio is not marked to market, the attendant political fallout from large realised or unrealised capital losses, or cessation in the Fed's remittances to Treasury, raises great concern to FOMC members. Such concerns were highlighted in the March 2013 FOMC statement.

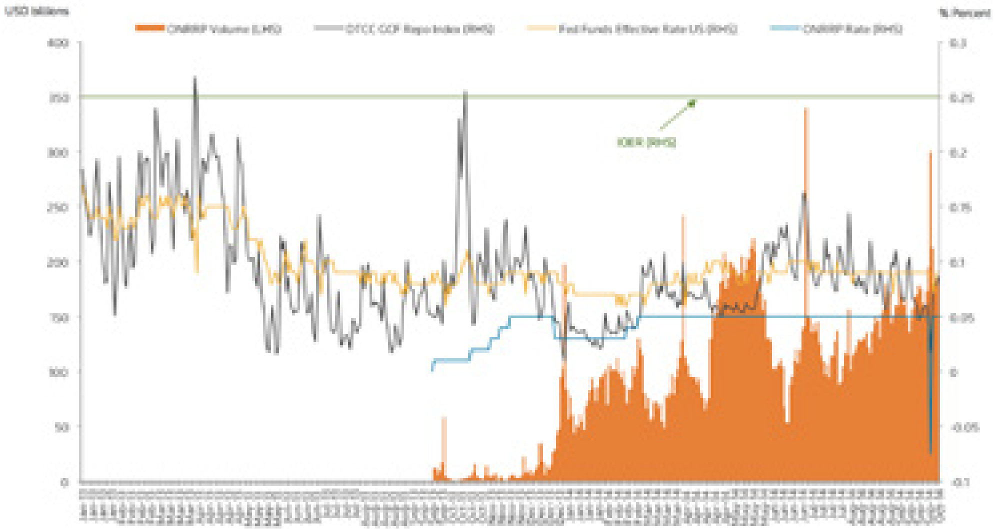
To reduce the size of its balance sheet, the Fed introduced the **Overnight Fixed Rate Reverse Repos (ONRRP)** facility where it could roll over its reverse repos continuously until the underlying asset matures, and this effectively results in a permanent reserves drain. The operations, which started since September 2013, will reduce the aggregate level of reserve balances over the term of the reverse repo, as any increase in reverse repos will have no impact on the overall level of the Fed's liabilities.

IMF reports indicated that the ONRRP rate has proven to be effective in establishing a floor for other overnight market rates when tested at fixed rates from 1 to 5 bps. As of July 2014, the IMF noted that the number of counterparties increased to 139, with a cap of $30 billion per counterparty – according to the New York Fed. This tells us that with a fully functional facility, the Fed will manage to reduce some $4.17 trillion off its balance sheet; the current size of the Fed's balance sheet is $4.4 trillion. Yet, the current volume of daily ONRRP transactions amounts to slightly less than $200 billion and is far from able to reduce the Fed's balance sheet to the lowest desired level, and one that is consistent with an efficient implementation of monetary policy. (See Chart 3). This desired balance sheet approximates $800 billion – level before the Fed began purchasing assets in 2008.

Given the scale of the overnight reverse repurchase operations, FOMC members have expressed fears over their growing role in financial intermediation and especially potential operational risks during periods of financial stress. Moreover, there has been a pronounced increase in failed transactions involving borrowed Treasury securities in the period of June to September 2014 – factors reminiscent of fire sales during the global financial crisis. (See Charts 4 and 5) In other words, the Fed is far from being operationally prepared to hike the Fed Funds Target Rate (FFTR).

Note that since quantitative easing began in November 2008, the FFTR has not been used as the primary monetary policy tool. Rather, it was the Fed's Interest paid on Excess Reserves (IOER), at 0.25%, that put downward pressure on money market rates. At the September 2014 FOMC meeting, Fed officials agreed that future interest rate normalisation will be executed as follows: The FFTR will be moved into the target range by first adjusting the IOER, while the ONRRP rate helps control the FFTR.

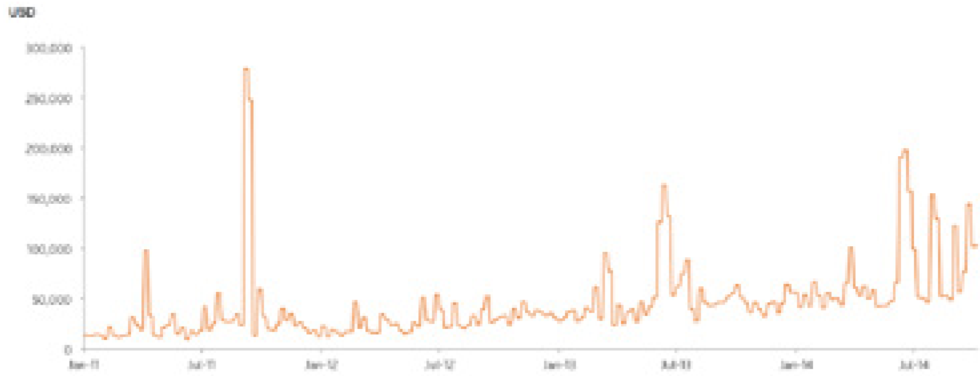
Chart 3: Selected interest rates. Depending on the scale of Fed's ONRRP facility, the Fed could also exert control over the Treasury general collateral repo rate, approximated here by the FICC-GCF repo rate. The ONRRP rate has proven to be effective in establishing a floor for overnight market rates.



Source: Federal Reserve, NY Fed, AmInvestment.
Note: Fixed Income Clearing Operation (FICC) – General Collateral Finance (GCF) repos are transactions between dealers.

Chart 4: Failed transactions involving borrowed Treasury securities rose in the period of June to September 2014.

US TREASURY SECURITIES FAILS TO DELIVER EXCLUDING TIPS (MID PRICE)



Source: Federal Reserve Bank of New York, AmInvestment.

"...there has been a pronounced increase in failed transactions involving borrowed Treasury securities in the period of June to September 2014..."

YET, THE QUESTION REMAINS ON HOW LONG, FROM THE TIME AFTER ASSET PURCHASES HAVE ENDED, WILL IT TAKE BEFORE THE FED ASSUMES AN INITIAL HIKE IN THE FFTR?

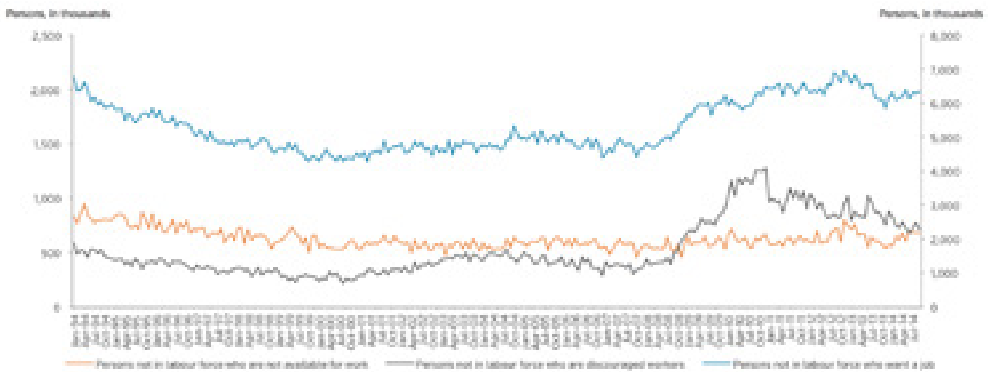
Professor Michael Woodford of Columbia University, in his work on optimal policy commitment, indicated that even after financial conditions have normalised, and the Fed has achieved its inflation target as well as a zero output gap, it may still be necessary for the central bank to maintain low interest rates for somewhat longer. The reason, Professor Woodford cited, is to allow the output gap-adjusted price level to reach its targeted path. In other words, the criterion for lift-off will depend on productivity growth which translates to a higher share of labour compensation in national income that eventually puts inflation rate on a firm footing.

Broadly, this means that the Fed is likely to maintain low interest rates for longer. In this relation, it is worthwhile to note that Chair Yellen pointed out, at the press conference following the September 2014 FOMC meeting, that it is not that the Fed is **behind the curve** in failing to return the FFTR to normal levels when the economy is recovered. Rather, she remarked that it is because the headwinds caused by the financial crisis that necessitate low interest rates. She went on to say that the residual effects from the crisis had led to persistently slow productivity growth, abnormally tight credit conditions, while household expectations of their likely income paths remained depressed.

Where the labour market is concerned, although the unemployment rate has edged lower, further declines may not necessarily reflect a diminishing **slack in the labour market**. The Fed expects that as growth gradually improves, workers will return to the labour market. This means that there remains plenty of slack – before wages, and by extension inflation, would see any upward pressure. This also supports accommodative policy for longer, without the Fed worrying about spikes in inflation.

Chart 5: Even as the number of discouraged workers declined, people not in labour force who wants a job have risen since the beginning of 2014. These returning workers could explain the continued decline in labour force participation rate.

US PERSONS NOT IN LABOUR FORCE



Source: US Bureau of Statistics, AmInvestment.

WHAT DO ALL THESE MEAN FOR SUKUK AND BOND MARKETS IN THE MIDDLE EAST AND ASIA?

As highlighted earlier, emerging debt markets are susceptible to movements in US Treasury yields as investors often take advantage of low US yields to perform a carry trade – borrowing at low and stable interest rates in order to invest in higher-yielding assets. Any sharp changes in US interest rates, or expectations of interest rate for that matter, will raise questions on whether these trades are still profitable. In addition, investor preference for EM debt hinges on near term exchange rate expectations – countries which currencies are expected to strengthen often see strong capital inflows.

Such flows have sharply and swiftly reversed in the months of May/June 2013 and January 2014, as investors no longer deem the interest carry as attractive. A decline in EM currencies provide further reasons to reduce positions; investors who have difficulties in liquidating positions are forced to sell more liquid assets in unrelated markets and in so doing, spark a contagion. GCC sukuk, on the other hand, are less vulnerable to swift capital flows but are not included in major EM indices. This allows for a relatively less volatile performance compared to its Asian peers during times of financial market stress. Chart 1 shows that while the J.P. Morgan MECI Sukuk index is not relatively attractive compared to its Asian peer, the conventional JACI Index, the former offers good diversification benefits to a defensive portfolio.

We remain mindful that Middle East and Asian sukuk/bond markets remain susceptible to headwinds, including slower growth in China – especially since prospects of default continues to haunt and with the $2.1 trillion shadow banking sector at stake. Markets' uncertainty in rates direction could also arise as the US Federal Reserve's decision to hike the FFTR remains data dependent. Any stronger-than-expected data releases or return of inflation could lift consensus expectations of imminent interest rate hikes. Invariably, the key question remains whether the Fed's forward guidance will be effective in reducing market volatility.

Against this backdrop, periods of volatility could resurface in emerging economies with significant exposure to large external financing requirements, as well as those with significant exposure to China commodities. Regional policy makers may step up policy buffers in the form of structural reforms, liquidity management, as well as other prudential measures to manage risks of any renewed capital outflows.

Having said that, there may still be scope for relative outperformance for Middle East and Asian sukuk/bonds as loose monetary policy from major central banks – including the European Central Bank, Bank of England, and Bank of Japan – should be supportive of risk assets selectively.

Over the long run from a macro perspective, for as long as Middle East and Asian countries are seen doing the right things in terms of structural reforms, macroeconomic mix of policies and debt management, these countries will continue to be on the radar of investors seeking value. From an issuance perspective, expect demand for Middle East and Asian bonds to remain supported, on account of higher participation from Middle Eastern as well as Asian retail/private banks, insurance and pension funds. Global banking regulatory changes could push for further demand. The introduction of liquidity buffers via Basel III's liquidity coverage ratio, for instance, can be expected to support demand for Middle Eastern/Asian investment grade sovereign and corporate papers.

Market Opinion

The important role of sukuk in the Basel III era

By Dr. Sutan Emir Hidayat – Director of the MBA Program – University College of Bahrain

DR. SUTAN EMIR HIDAYAT

Dr. Sutan Emir Hidayat is Assistant Professor and Director of the MBA Program at University College of Bahrain (UCB). He joined UCB in September 2007 after spending two years at International Islamic College Malaysia (IIC) as lecturer and subject coordinator for Islamic finance courses. Dr. Hidayat obtained his PhD and MBA in Islamic Banking and Finance from the International Islamic University of Malaysia (IIUM).

The implementation of Basel III rules has created several challenges to Islamic financial institutions (IFIs) especially with regards to capital adequacy and liquidity requirements. Basel III primarily requires all banks, including Islamic banks, to strengthen their capital and liquidity positions by holding higher quality capital, which would enable banks to absorb financial shocks, and maintain higher level of liquidity, which enables banks to reduce their dependency on money market instruments.

Basel III requires all banks to maintain the minimum ratio of 4.5% for Tier 1 common equity capital, an increase from 2% required by Basel II. Basel III also changed the minimum requirement for additional Tier 1 capital and Tier 2 capital to 1.5% and 2%, respectively, from 2% and 4% previously required by Basel II. In addition, Basel III requires banks to maintain 2.5% capital preservation buffer and 0-2.5% countercyclical capital buffer.

In addition, Basel III also redefines the meaning of capital. According to Basel III, the components of Tier 1 capital consist of common equity as core capital, and preferred stock and hybrid securities as additional capital. Subordinated bonds and loans are counted as Tier 2 capital.

Given the uniqueness of Islamic banks' products and operations, the implementation of Basel III rules for Islamic banks and other IFIs requires more clarification. The Islamic Financial Services Board (IFSB) released IFSB-15 in December 2013 with the purpose of introducing a framework for capital adequacy and liquidity requirements to suit the uniqueness of IFIs.

IFSB-15

The IFSB-15 is an amended and improved version of two previous IFSB standards on capital adequacy, namely IFSB-2 and IFSB-7. IFSB-2 focused on capital adequacy standards for IFIs while IFSB-7 focused on capital adequacy requirements for sukūk, securitisations and real estate investments. IFSB-15 also provides guidelines for the components of regulatory capital (Tier 1 and Tier 2). Like Basel III, IFSB-15 also defines common equity as the Tier 1 core capital and preferred stock as the additional Tier 1 capital. However, it is important to note that preferred stock is only considered a Shariah-compliant instrument in some jurisdictions such as Malaysia.

In addition, perpetual musharakah sukuk is also counted as additional Tier 1 capital, while mudarabah and wakalah sukuk with maturity of five years or more are counted by IFSB-15 as components of IFIs' Tier 2 capital. However, in practice, other types of sukuk may also be classified as either additional Tier 1 or the component of Tier 2 capital as long as the sukuk fulfill IFSB-15 requirements for each category of capital. In summary, the IFSB-15 has stressed the important role of sukuk in the Basel III era.

BASEL III-COMPLIANT SUKUK

From the above explanation, it is clear that the implementation of Basel III and IFSB-15 has opened the way for sukuk to be used by Islamic banks and other IFIs as the alternative instrument to comply with regulatory requirements. Certainly, the adoption of Basel III will boost the number of sukuk issuance and their transactions value.

Basel III has already created a new trend in the sukuk market with the birth of so-called "Basel III-compliant sukuk". There have been nine issuances of such instruments since Basel III's initial implementation which kicked off in January 2013 with total deals worth more than $4.93 billion, according to Zawya Sukuk Monitor.

The first issuance of Basel III-compliant sukuk came from Abu Dhabi Islamic Bank (ADIB) in November 2012, even before the initial implementation of the accord. ADIB issued perpetual mudarabah sukuk with the purpose of raising its additional Tier 1 capital. Following ADIB's success, Dubai Islamic Bank (DIB) issued the second Basel III-compliant sukuk in March 2013 for the same purpose. At the end of 2013 and at the beginning of 2014, three issuances of such sukuk occurred in Saudi Arabia, from Saudi Hollandi Bank (SHB), Saudi British Bank (SAAB) and National Commercial Bank (NCB). Unlike the Emirati banks, the Saudi banks issued the sukuk to increase their Tier 2 capitals.

The successful experience in the GCC has been followed by Islamic banks in Southeast Asia especially in Malaysia with the issuances of Basel III-compliant sukuk by AmIslamic Bank, Maybank Islamic, RHB Islamic and Public Islamic (using the murabahah structure) which aim to boost the banks' Tier 2 capital. Many more issuances of such sukuk are expected in the years to come.

SUKUK FOR LIQUIDITY MANAGEMENT

The implementation of Basel III also poses challenges to the liquidity position of Islamic banks. For example, Basel III and IFSB-15 demand Islamic banks manage their liquidity through holding highly-rated sovereign and corporate sukuk (investment grade). This should be done in order to comply with the Liquidity Coverage Ratio (LCR) introduced by Basel III. However, currently there is only limited number of these sukuk available in the market. Investment grade sukuk are much more liquid than junk or unrated sukuk, and they can only be issued by highly-rated governments and companies (which are lacking across Muslim-majority countries).

As the demand for these sukuk increases due to Basel III requirements, the opportunity opens up for highly-rated governments and companies to issue sukuk. In fact, this is already becoming a trend. The UK government issued £200 million of sovereign sukuk in June 2014, which, among other reasons, aimed to capture the strong demand for highly-rated sukuk. The issuance was oversubscribed. The latest AAA-rated non-Muslim government which issued sovereign sukuk was Hong Kong.

Issued in September 2014, the sukuk was oversubscribed 4.7 times, indicating very strong demand for the security. The sukuk from these countries are very important for IFIs' liquidity management and will be a driver for global sukuk market growth.

The strong demand for highly liquid sukuk by IFIs in order to comply with Basel III requirements has also pushed the International Islamic Liquidity Management (IILM) to issue its first $490 million worth of three-month sukuk in August 2013 (the sale was oversubscribed). About a year later, the IILM issued its second $400 million worth of six-month sukuk in order to accommodate market need and preference; the issue was again oversubscribed.

However, despite this encouraging trend, more effort is needed to develop more highly-rated liquidity management instruments to help Islamic banks and other IFIs fulfill their liquidity regulatory requirements. With more issuances of sukuk expected in the years to come, the cost of sukuk issuance is also expected to fall. One factor contributing to this drop in cost is that more countries are expected to amend their regulatory and tax laws to ensure sukuk have the same advantages as conventional bonds.


LOCAL BANK,
INTERNATIONAL REACH.

Chapter Three

Issuance Process: Structuring Sukuk

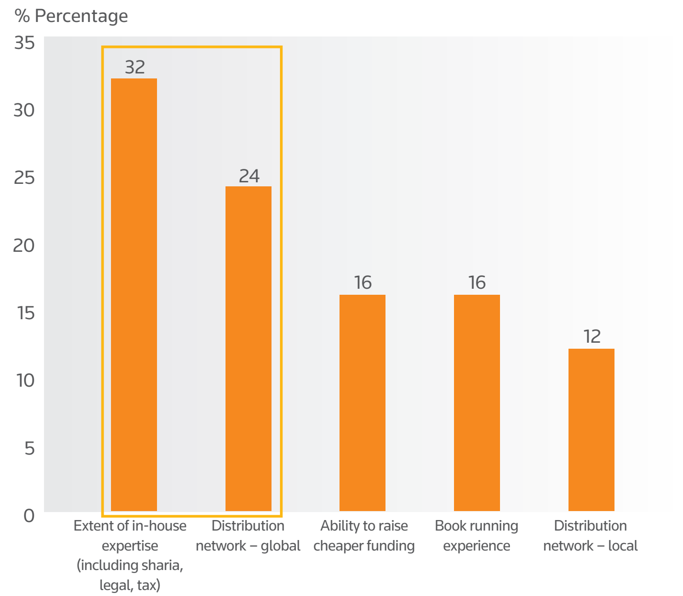
Lead Arrangers

Who to choose?

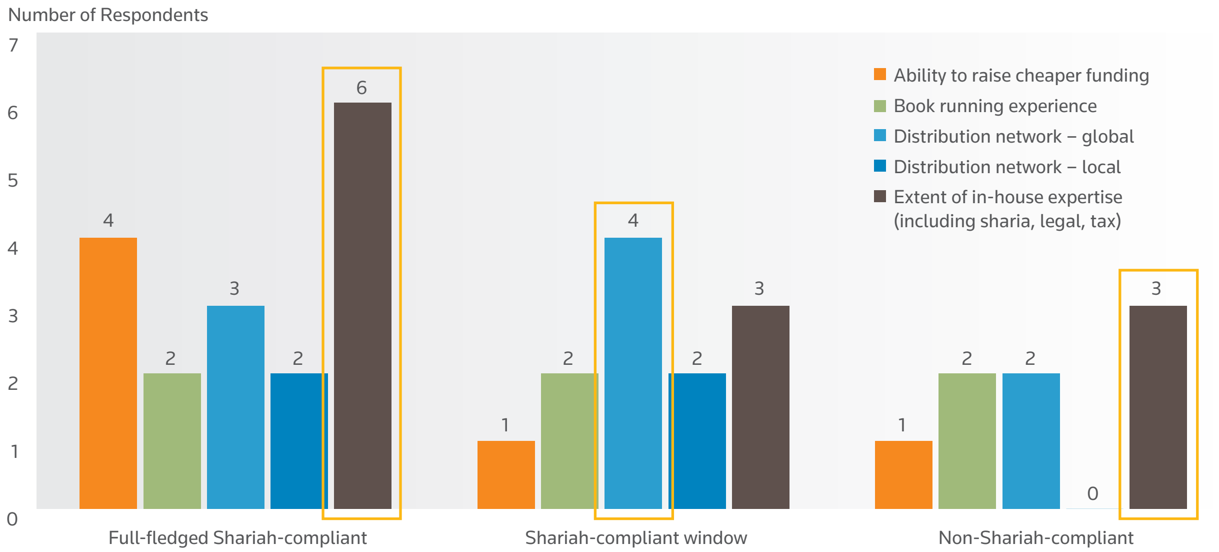
The track record and level of expertise of a lead arranger is significant for many issuers, our Sukuk Survey results indicate. One-third of issuers believe that the extent of in-house expertise would be the key driver of selecting a lead arranger while 24% of issuers would choose a lead arranger based on their global distribution network. At the end of Sept 30, 2014, the top lead arrangers were HSBC with 18.6% market share having lead arranged 15 deals, followed by Standard Chartered (12.8% and 13 deals), and Emirates NBD (7.8% and 10 deals).

Survey	Respondents	Skipped
Sell side	37	7

SURVEY FINDINGS – AS A SUKUK ISSUER, WHAT DRIVES SELECTION OF LEAD ARRANGERS?



SURVEY FINDINGS – AS A SUKUK ISSUER, WHAT DRIVES SELECTION OF LEAD ARRANGERS? – SELL SIDE



"One-third of issuers believe that the extent of in-house expertise would be the key driver of selecting a lead arranger..."

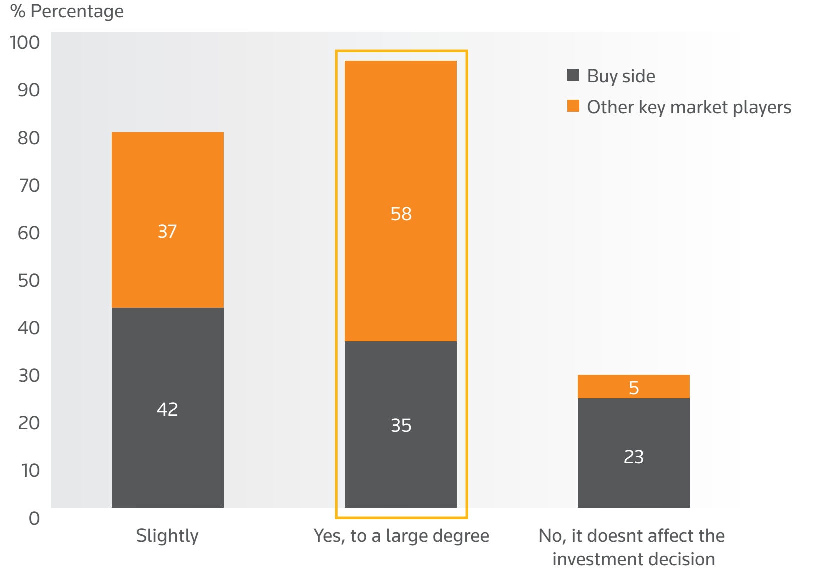
35% of investors and 59% of other key market players strongly agree that the selection of lead arrangers affect investing in sukuk in the primary market while 42% of investors believe that it would slightly affect the sukuk investment.

There is no doubt that a seasoned lead arranger would have a better distribution network that would contribute to better performance and increased market demand.

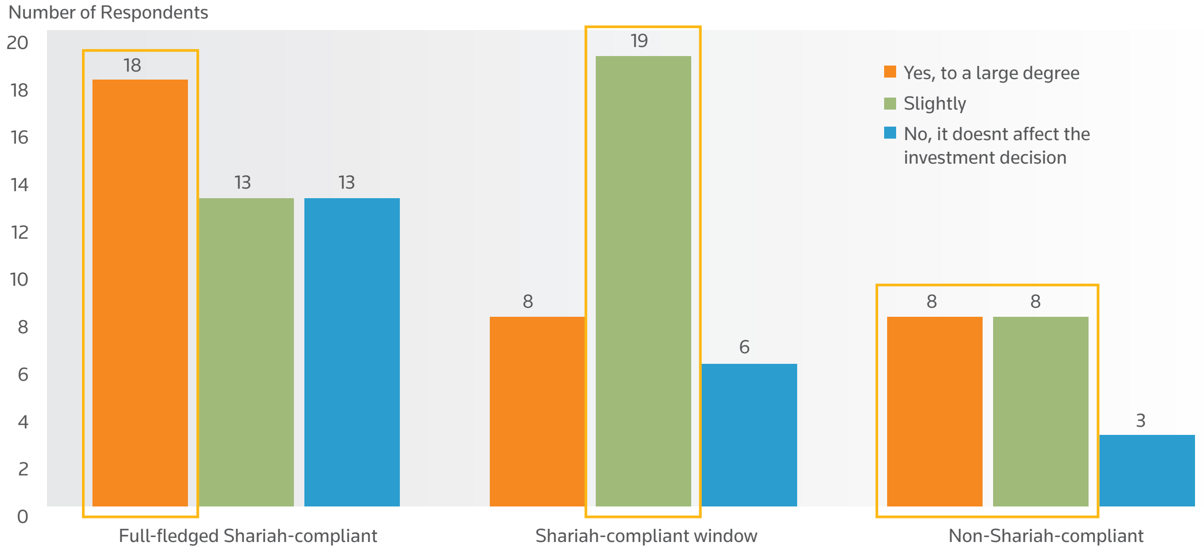
Apart from their credit risk and attractiveness, the choice of lead arranger was important to attract high demand for Sharjah's 10 times oversubscribed $750 million sukuk, Dubai's 3 times oversubscribed $750 million deal, and Hong Kong's 4.7 times oversubscribed $1 billion sukuk. Sharjah's and Dubai's deals were led by HSBC and Standard Chartered, while Hong Kong's sukuk was led by CIMB in addition to HSBC and Standard Chartered.

Survey	Respondents	Skipped
Buy Side	96	10
Others	41	13

SURVEY FINDINGS – DOES SELECTION OF LEAD ARRANGERS AFFECT INVESTING IN SUKUK IN THE PRIMARY MARKET/ DOES IT AFFECT THE PERFORMANCE VS OVERSUBSCRIPTION?



SURVEY FINDINGS – DOES SELECTION OF LEAD ARRANGERS AFFECT INVESTING IN SUKUK IN THE PRIMARY MARKET/ DOES IT AFFECT THE PERFORMANCE VS OVERSUBSCRIPTION? – BUY SIDE



> *"There is no doubt that a seasoned lead arranger would have a better distribution network..."*

Structure-driven

What's the trend?

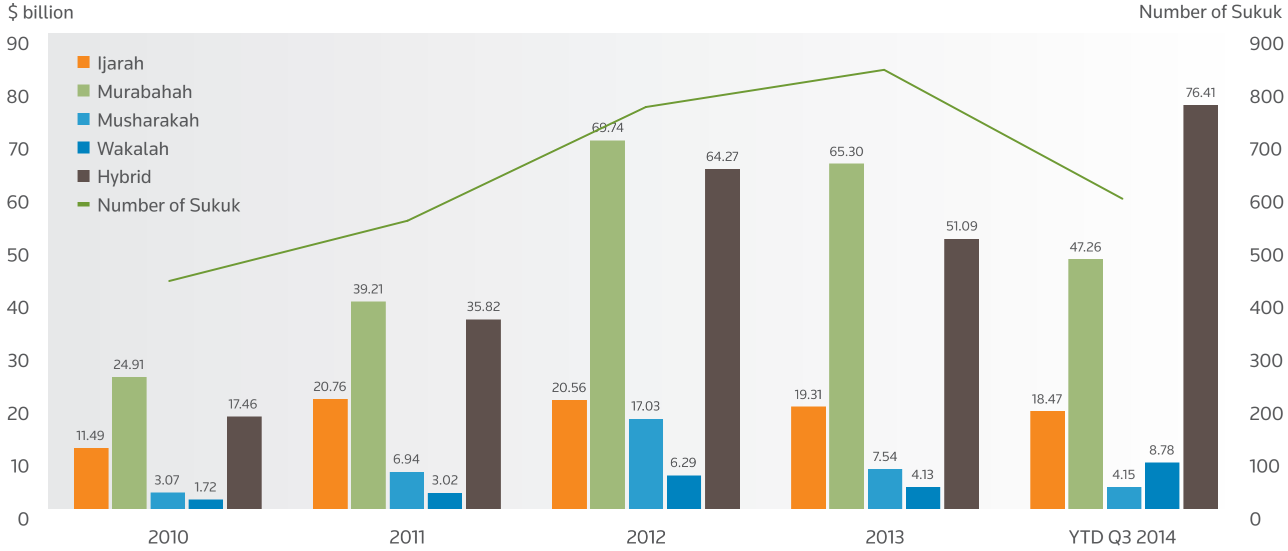
Murabahah, Malaysia's favourite structure, was the most-used structure in the first 9 months of 2014; the total value of 224 murabahah sukuk amounted to $48.3 billion. Of the 224 issuances, only 2 murabahah sukuk were issued outside Malaysia: 1 in Turkey by TF Varlik and the other in Indonesia by Golden Assets International Finance. The remaining 222 issues were sold in Malaysia.

Trading of murabahah sukuk in the Middle East, or countries that follow AAOIFI standards, is prohibited. In Malaysia, however, investors can trade murabahah sukuk in the secondary markets.

GCC countries prefer the ijarah structure and the consistent use of ijarah sukuk has been the trend for the past 5 years. It is expected that the ijarah structure will be used more extensively given its attractiveness and tradability. Further, Malaysia's extended tax deductions (up to 2018) for ijarah and wakalah sukuk (and not murabahah) is likely to increase the use of ijarah and wakalah, away from murabahah, in Malaysia.

Global Sukuk Issued in 2014 Breakdown by Structure		
Sukuk Structure	Amount Issued ($ million)	Number of Sukuk
Murabahah	$48,317.35	224
Ijarah	$18,465.12	92
Wakalah	$8,779.70	42
Bai Bithaman Ajil	$8,253.09	10
Musharakah	$4,150.29	69
Al-Wakala Bel-Istithmar	$4,048.11	5
Mudarabah	$1,880.32	5
Mudarabah-Murabahah	$1,732.92	4
Al-Istithmar	$1,519.64	2
Ijarah-Wakalah	$1,500.00	1
Al Salaam	$887.02	119
Bai Inah	$427.94	14
Wakalah-Murabahah	$350.00	1
Murabahah-Musharakah	$9.77	2

GLOBAL SUKUK HISTROICAL TREND TOP SUKUK STRUCTURES (2008-YTD Q3, 2014)



Of the 224 issuances, only 2 murabahah sukuk were issued outside Malaysia...

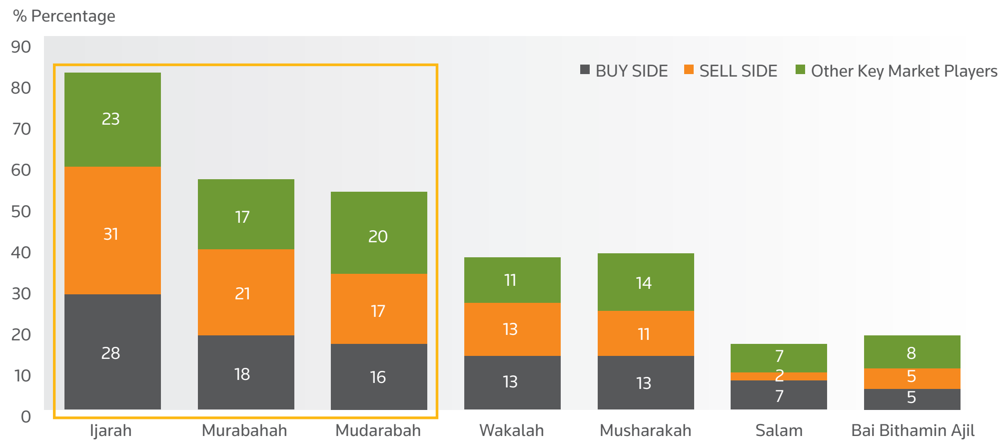
Similar to last year's survey results, all market players prefer the ijarah structure for sukuk issuance and investment.

Despite the tradability issue with murabahah sukuk under AAOIFI standards, murabahah continues to be popular with both issuers and investors, at 21% and 18%, respectively.

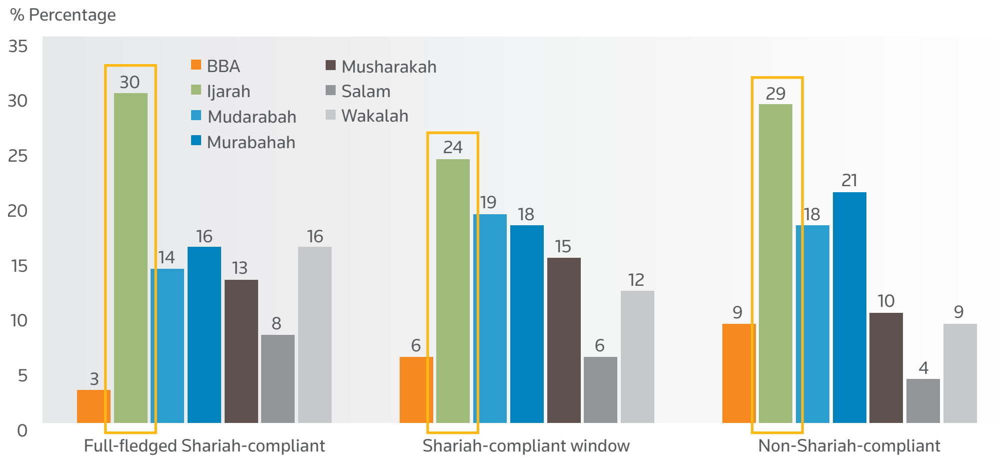
Interestingly, this year wakalah fell out of favour relative to last year's survey findings.

Survey	Respondents	Skipped
Buy Side	98	8
Sell Side	39	5
Others	46	8

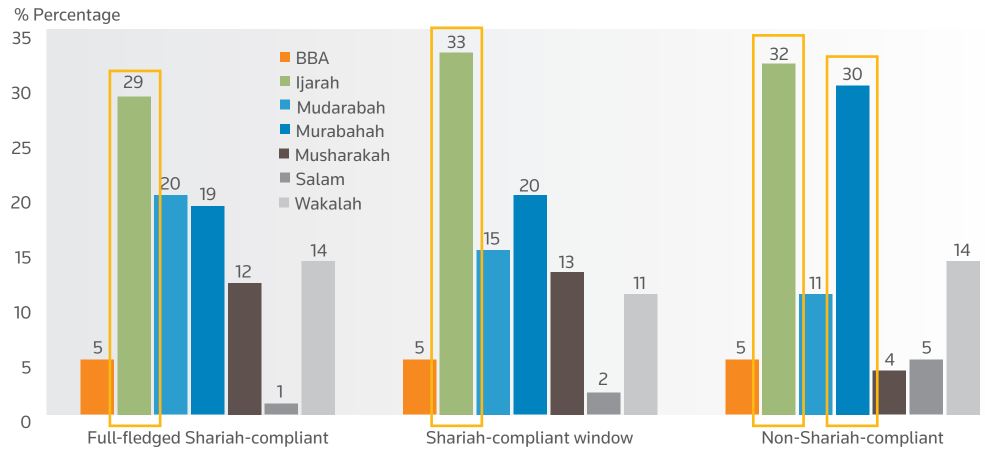
SURVEY FINDINGS – SUKUK STRUCTURE PREFERENCE



SURVEY FINDINGS – STRUCTURE PREFERENCE – BUY SIDE



SURVEY FINDINGS – STRUCTURE PREFERENCE – SELL SIDE



Market Opinion

Capital agenda for Islamic banks

By Nida Raza – Director, Islamic Financial Services, Ernst & Young
The findings, interpretations and conclusions expressed herein are those of the author and do not necessarily reflect the views of Ernst & Young.

NIDA RAZA
Nida is a Director at the Islamic Finance Center of Excellence at Ernst & Young and is based in Bahrain. She has 13 years of professional experience. Nida brings global investment banking experience having worked in the UK, USA and Middle East for international investment banks. Her expertise lie in fixed income products both Islamic and conventional. During her career she has led and successfully completed over 75 transactions raising $100 billion + of fixed income capital for her clients. Nida holds a first class BSc (Hons) in Physics & Space Science from University College London, and she has an MSc in International Securities Investment & Banking from ICMA Center in the UK.

Since Abu Dhabi Islamic Bank (ADIB) became the first financial institution in the world in November 2012 to issue a hybrid sukuk which qualified as Tier I capital per Basel III guidelines, several other Islamic banks have followed suit – namely Dubai Islamic Bank (DIB) in March 2013 and most recently Al Hilal Bank in July 2014.

ADIB and DIB each raised $1 billion and Al Hilal tapped the market for $500 million after successful roadshows which saw order books of over $15 billion, $14 billion and $4.5 billion, respectively. All three issuers saw over 200 investors globally placing orders.

Interestingly the new restriction under Basel III requires that non-core equity is not only perpetual but at any call date there must not be any pressure/incentive for the issuer to call the security. Hence the maximum 100bp step-up provision allowed under Basel II has disappeared. All other features have remained largely the same for this type of security, but until late 2012 the GCC banks had not focused on this option as part of their capital structure.

TIER I, TIER II SUKUK

Malaysia has issued Basel III-compliant Tier II sukuk but have yet to issue Hybrid Tier I. Under Basel III for Tier II capital the step-up provision has been eliminated as well. From the cheapest form of capital perspective, Malaysian banks are doing the right thing by filling up the cheapest level of capital bucket before entering the more expensive hybrid Tier I arena.

It must be said, however, the market for hybrid Tier I can be flaky and closely follows the direction and sentiment of the equity market whereas the Tier II is more debt-like and the market for this is always liquid and deep throughout the economic cycle.

As Islamic banks globally look to grow their balance sheets and with the impending rollout of Basel III in many countries, capital management is top of the agenda as competition increases and margins are squeezed.

A key priority for most is the lowering of cost of capital to defend market share and compete effectively against larger conventional peers, many of which are already ahead with non-equity Tier I transactions in the capital markets.

The time for Islamic banks to take action is now, through prudent capital planning and optimisation, while liquidity is present in this part of the capital structure. Despite this analysis we have only seen three transactions from the financial services sector and that, too, only from the GCC, although it is interesting to note that two corporates (Saudi's Almarai and Dubai's GEMS) have adapted this structure to issue hybrid sukuk in the local and international market.

MUDARABAH STRUCTURE

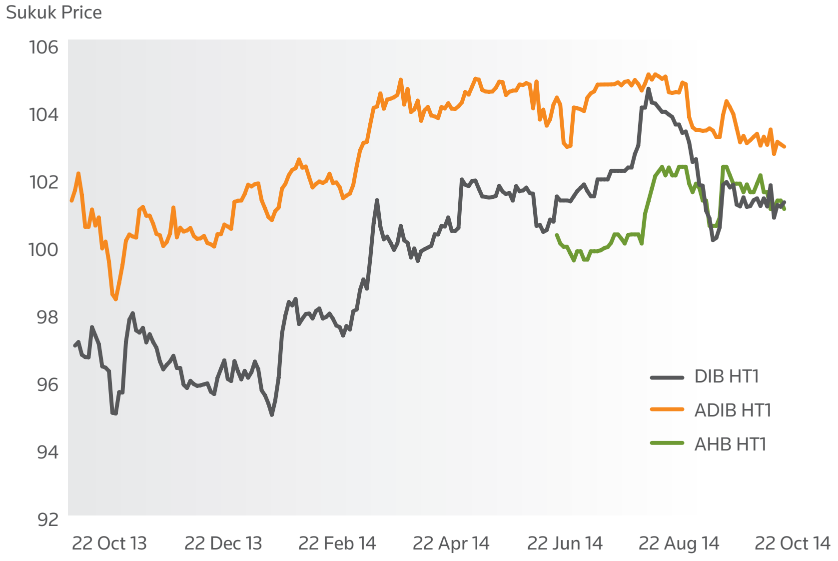
The three GCC Tier 1 Basel III-compliant sukuk have been based on the mudarabah contract which allows all the flexibility of non-payment, non-accrual as well as writedown of the capital under certain circumstances without triggering any breach or non-payment event. However, in order for there to be the full return of capital, if there has been no "Capital Event" which would cause a writedown of the initial capital, there is a clever solution which has emerged – a mudarib has the option to indemnify the sukuk holders if the liquidated mudarabah assets are lower than the original mudarabah capital, and pay the shortfall under certain circumstances.

In the courts, this type of indemnity provision is legally enforceable in the case of these outstanding sukuk they give the mudarib the right but not the obligation to make whole any shortfall in the liquidated mudarabah assets at any call date. This puts the onus on the issuer/mudarib to perform and fulfill this shortfall if any, whilst there remains a small risk where the shortfall is not covered by the mudarib and the investors are exposed.

INVESTORS PERSPECTIVE

From an investor's analysis perspective this is a slightly riskier proposition versus its conventional counterpart. However, in practice it will be highly unusual for the mudarib not to cover the shortfall as this would be a huge reputational and credit risk for future issuances. Nevertheless one would think that the pricing of such a sukuk would bear a slight premium. In the market so far, though, we have seen staggering demand and this point has not been raised in any but academic and legal circles of the Islamic finance community. What remains to be seen is what the mudarib actually does if and when such a shortfall occurs, and more importantly what effect this has on other similar outstanding paper.

TIER I SUKUK PRICE TREND 2013/14 (DIB - ADIB - HILAL BANK)



Source: Thomson Reuters

Corporates are not subject to Basel III and do not have to follow the requirement that the paper must not have profit accrual features or adhere to any restrictions on the step-up provisions at the call date. Both these features, the cumulative profit payments and step-up of 500bp, have been seen in the GEMS Hybrid Sukuk.

If the indemnity clause as accepted by the scholars are acceptable as a solution for enticing issuers to protect the nudarabah assets, one could imagine that this same solution could be extended to the musharakah structures, potentially paving the way once again for issuers to issue a more fixed income security using the flexible mudarabah and musharakah structures.

CREDIT PERSPECTIVE

From a credit analysis perspective this deeply subordinated capital security would be the most junior and is only above common equity, so if it were to be rated one would expect a 2-3 notch lower than senior unsecured credit rating.

We have found that this type of security is not typically rated in the GCC region and perhaps not often internationally either. Mostly, the pricing discovery is benchmarked to the dividend yield of the common equity of the issuer.

ISLAMIC STRUCTURING PERSPECTIVE

From an Islamic structuring perspective, this type of security most closely matches the substance over form issues and criticisms that the industry has faced over the last few years. It has equal profit- and loss-sharing features, and per certain restrictions and conditions, depending on the bank's profitability, it allows for non-payment of profits. Further, there is no accrual feature, which most resembles a true equitable relationship.

This security is senior only to common equity in ranking and payments. Since the release of Basel II guidelines in 2002 which allowed "innovative Tier I" issuance as part of total Tier I issuance, the banks in the developed countries in Europe, U.S. and Asia have all raised many billions of US Dollars to shore up their core capital requirements.

However, the Gulf region remained conservative, mainly due to a lack of guidelines being provided by central banks which took the stance that since there is no demand from their banks to issue these guidelines, they would remain mute till approached. All this changed in 2008/9 when demand from banks allowed central banks to publish rules on Innovative Tier I capital, and in line with Basel II/III, it is limited to 15% of the original core Tier I capital.

With the new enhanced core equity rules, innovative Tier I issuance limit is smaller, but nevertheless, still a cheaper option to common equity, as well as not being dilutive to shareholders.

DEMAND

Based on the three banks issuances (i.e. ADIB, DIB and Al Hilal), this type of security is driven by a broad demand across three regions, with average allocations of 36% to Asia, 33% to the Middle East, 28% to Europe, and 3% to U.S. offshore investors. By investor type, 55% of the sukuk were sold to private banks; asset and fund managers bought 30%, commercial banks 10% and others 5%. This is a typical investor trend for this type of subordinated paper issued by a high quality quasi-governmental credit institution. Private banks are always looking for enhanced yield on high quality paper for their clients and this structure suits them best. Banks will never hold a large portion of this type of investment as it attracts a large amount of capital reserve requirement, hence rendering the investment too expensive to hold on their books.

"All three issuers saw over 200 investors globally placing orders."

New Sukuk Structures

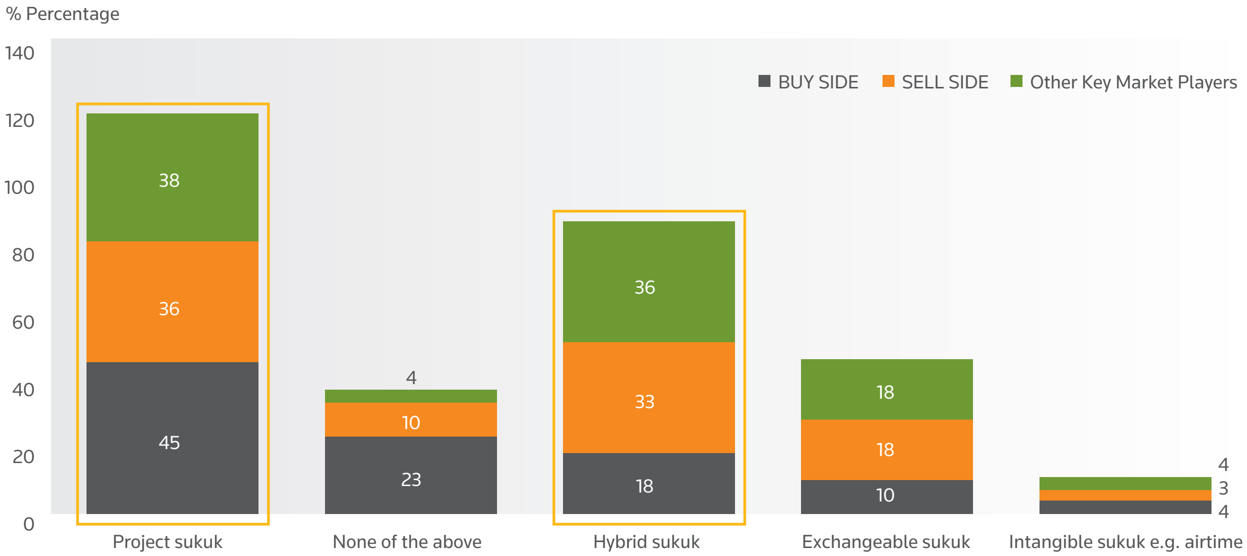
What will change?

Survey	Respondents	Skipped
Buy Side	97	9
Sell Side	39	5
Others	45	9

Although project sukuk remains significantly underused, sukuk survey participants prefer it over other new structures, which the market may be more unfamiliar with. Project sukuk could work well for countries with a large volume of infrastructure projects such as Morocco, Oman and Tunisia. Historically, project sukuk was tapped twice to finance projects: the General Authority of Civil Aviation (GACA) in 2012 and Saudi Aramco Total Refining and Petrochemical Co (SATORP) in 2011. SATORP sukuk had a tenor of 14 years which is considered untypical as majority of sukuk issuances generally have tenors of 5 to 7 years. Yet, the paper was met with high demand and was 3.5 times oversubscribed.

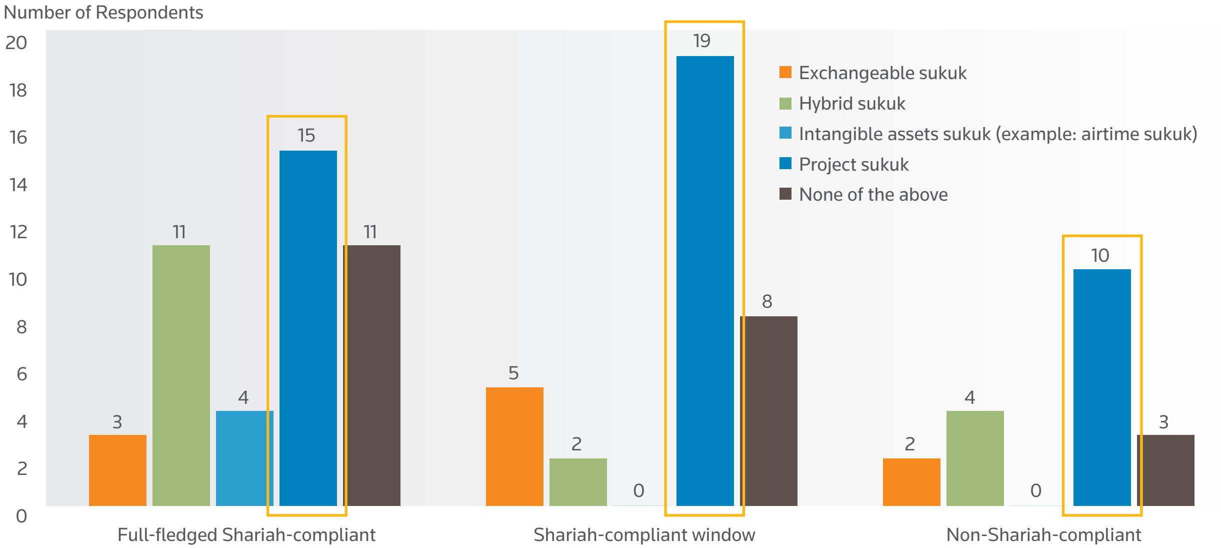
Interestingly, the Sukuk Survey results reveal that 23% of investors are either reluctant to invest in new structures or they remain unconvinced of the new structures. From the survey results we sense that the sukuk market is moving very cautiously and slowly in terms of adopting new structures. The new structures have been used very sparingly and considering the conservative nature of the market, we foresee slow take-up; market players will need time to familiarise themselves with all aspects of the new structures.

SURVEY FINDINGS – NEW SUKUK STRUCTURES PREFERENCE

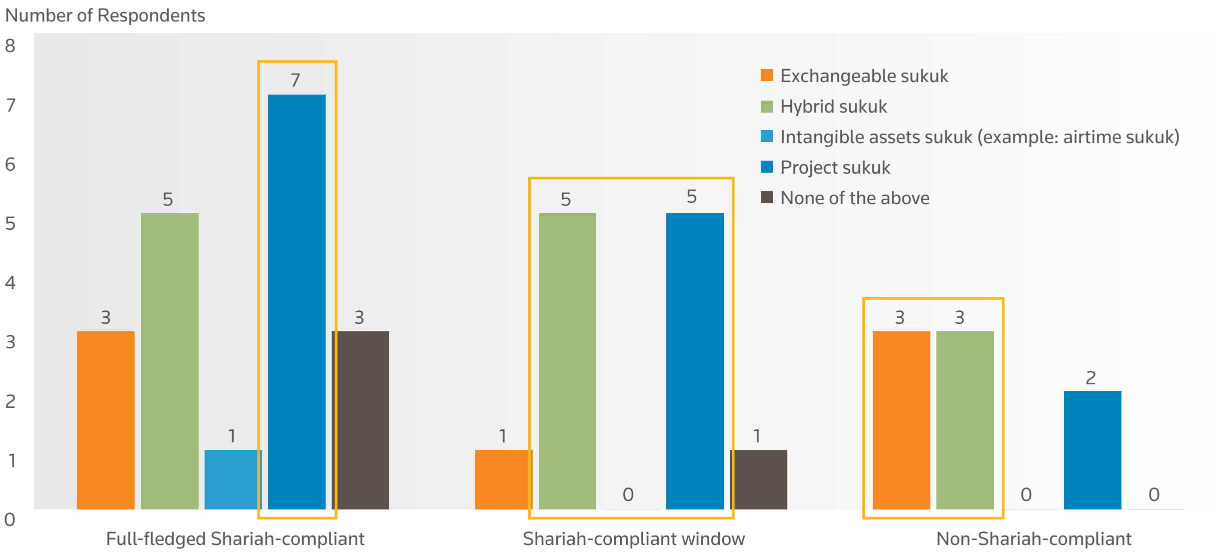


"From the survey results we sense that the sukuk market is moving very cautiously and slowly in terms of adopting new structures."

SURVEY FINDINGS – NEW STRUCTURES PREFERENCE – BUY SIDE



SURVEY FINDINGS – AS AN ISSUER, WHICH OF THE FOLLOWING NEW SUKUK STRUCTURES WILL YOU USE FOR THE REST OF 2014 AND 2015? – SELL SIDE



Of all the new structures offered in the market, project finance stood out for all market players.

Investors strongly preferred project sukuk at 45%; however, 23% of investors were not interested in any of the new structures.

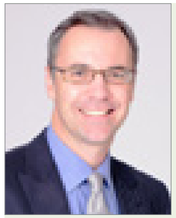
Lead arrangers and issuers also chose project sukuk as their number one preferred structure at 36% followed by hybrid sukuk at 33%.

> *"Investors strongly preferred project sukuk at 45%; however, 23% of investors were not interested in any of the new structures."*

Market Opinion

The Opportunity for Ethical Sukuk

By Michael Bennett – Head of Derivatives and Structured Finance – World Bank Treasury
The findings, interpretations and conclusions expressed herein are those of the author and do not necessarily reflect the views of the World Bank or its affiliated organisations.



MICHAEL BENNETT

Michael Bennett is the Head of Derivatives and Structured Finance in the World Bank Treasury. Among other areas, his team is responsible for the World Bank's transactional work in the area of Islamic finance. Prior to joining the World Bank, he worked in the private sector in the capital markets field in New York, Tokyo and Hong Kong, and he is a graduate of the Columbia University School of Law in New York.

Islamic finance shares a strong similarity with ethical investing. Like ethical investors, Shariah-compliant investors demand that their investments not only be attractive in economic terms, but that they meet certain non-financial criteria as well. In the case of Shariah-compliant investors, these non-financial criteria involve compliance with Islamic law and principles.

GROWTH OF ETHICAL INVESTING

The concept of ethical investing – investors using their money to promote ethical activities and social good – has deep roots in the doctrine of many religions. Islam, Christianity and Judaism, for example, all share a focus on the individual's moral responsibility to use money in a way that betters one's community and is consistent with one's faith. These religious prescriptions have impacted individual investment decisions for centuries.

Over the past few decades, ethical investing has grown from being just a matter of individuals exercising their faith to become a comprehensive investment strategy. A large and growing number of individual and institutional investors, including asset managers, pension funds and university endowments, now include achieving certain social, environmental or corporate governance objectives as a part of their money management process. In making investment decisions, these investors overlay a qualitative analysis of a company's policies or practices in the specific area or areas of concern to the investor onto their quantitative analysis of the company's financial condition and prospects.

ETHICAL BOND MARKET

The conventional bond market has been used to channel investment to worthy causes for decades. The World Bank pioneered this use of the bond market when it issued its first bond in 1947. The World Bank, and other supra-national institutions, issue bonds and use the proceeds of those issues to fund sustainable development projects in developing countries. Only recently, however, with the growth of the ethical investing movement, have investors sought to invest in bonds in which the proceeds will be used to promote specific ethical activities. Driven by this investor demand, the ethical segment of the conventional bond market has begun to expand rapidly, with supra-national "theme bonds" (linked to specific development themes such as women's empowerment or access to water) and "green bonds" (bonds for which the proceeds support specified environmental projects or activities) leading the way. Table 1 on the next page illustrates the growth trajectory of the green bond segment of the ethical bond market.

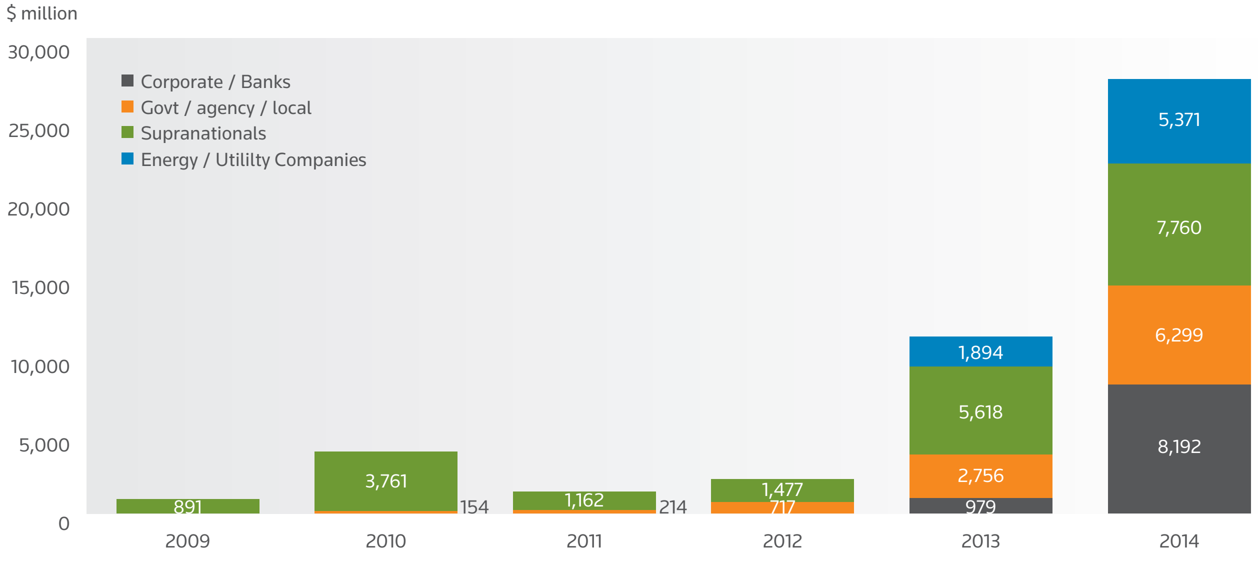
THE OPPORTUNITY FOR ETHICAL SUKUK

Since 2000, Islamic finance has grown at a pace that far exceeds that of conventional finance, and within Islamic finance, sukuk has been one of the fastest growing segments. Global sukuk issuance has increased rapidly since the financial crisis, driven by the high liquidity of Islamic banks and the increasing comfort of both Islamic and conventional investors and issuers with sukuk structures.

The sukuk market appears to be well-suited to ethical issuance. Since one of the central tenets of Islam is for individuals to promote economic and social justice in their community, purchasing sukuk in which the proceeds are earmarked for certain ethical projects or activities should have great appeal to a religious Muslim investor. Moreover, Shariah-compliant investors already apply a religion-based screen to the structure of their sukuk investments – i.e., the sukuk must not involve the payment of any interest and otherwise must be found to be in compliance with Shariah by a committee of scholars.

Adding another non-financial objective to their investment decision - related in this case to the use of proceeds – would seem to be a relatively small, additional step, and would mean they would be investing in products for which both the structure and the use of the proceeds would be affirming Islamic religious principles.

ANNUAL GREEN BOND ISSUANCES (2009 - 2014)



In addition, conventional fixed income ethical investors – which are largely located in the United States and Western Europe – have an incentive to consider purchasing ethical sukuk, because they face a lack of sufficient supply of ethical fixed income products. The majority of corporate and sovereign bonds are general, unsecured obligations of the issuer, which have limited appeal to ethical investors unless all of the activities of the issuer meet the investor's ethical standards. While the issuance of ethical bonds, such as theme bonds and green bonds, is increasing rapidly, the supply of such bonds is still less than the potential demand from ethical investors.

With these two potential sources of demand – religious Muslim investors and conventional ethical investors – ethical sukuk should have a bright future. To date, this potential has not been realised, primarily because the size of the pool of Islamic bank liquidity is currently so large relative to the volume of outstanding sukuk that sukuk issuers have had no pressing need to take on the additional burden of earmarking their issues for specific ethical purposes.

However, a few successful ethical sukuk issues that bring together both Shariah-compliant and conventional ethical investors should be enough to spur other issuers to consider ethical sukuk. The pricing efficiency and investor diversity that could be achieved from combining these two currently very separate investor bases should make ethical sukuk an attractive opportunity for issuers. Additionally, by bringing these two investor groups together, ethical sukuk can play an important part in more tightly aligning Islamic and conventional finance.

"The concept of ethical investing – investors using their money to promote ethical activities and social good – has deep roots in the doctrine of many religions."

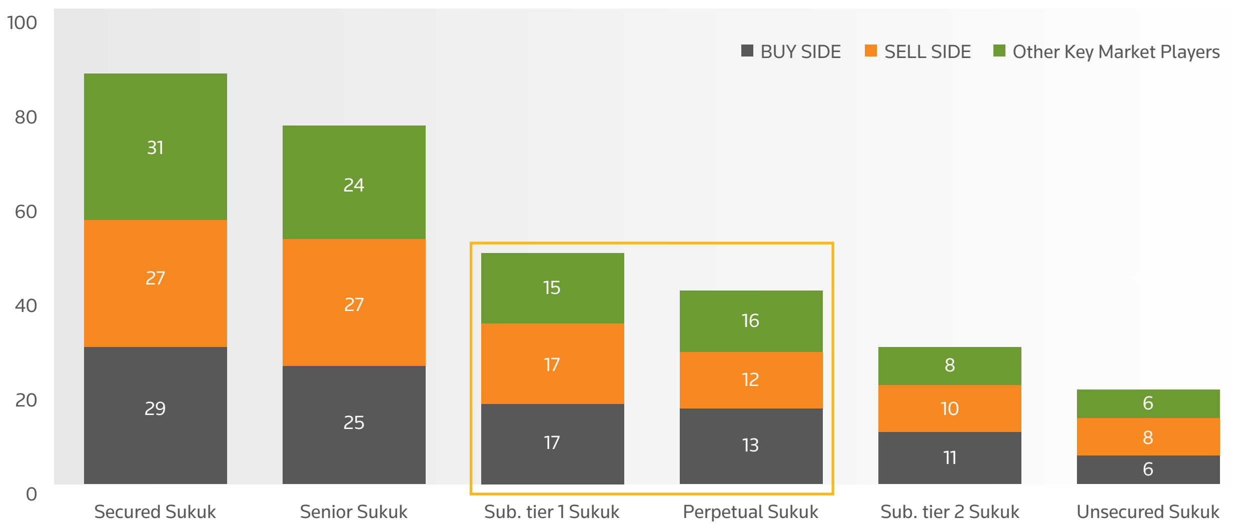
Risk Classification

How much risk can investors take?

The risk classification of the majority of issued and outstanding sukuk is secured sukuk followed by senior sukuk. A few banks have recently issued Tier 1 sukuk mainly to enhance their capital positions. In Nov 2012 the world's first hybrid sukuk comprising of perpetual and Tier 1 was issued by Abu Dhabi Islamic Bank; the sale was significantly oversubscribed by 30 times. This was followed by Dubai Islamic Bank's Tier 1 sukuk in Mar 2013. In addition, Al Hilal Bank opted for Tier 1 issuance of $2.5 billion. Taking Basel III requirements into account to enhance capital quality, the impact will be very minimal for Islamic banks as their capital is mainly comprised of common equity. However, Basel III requirements could benefit the Islamic industry in terms of capitalization and liquidity management. Therefore, the outlook is positive for more issuance of Tier 1 sukuk in the short- to mid-term as countries start to implement Basel III. Also the oversubscription levels of the three Tier 1 sukuk and their tight pricing gives a good indication of market interest and appetite.

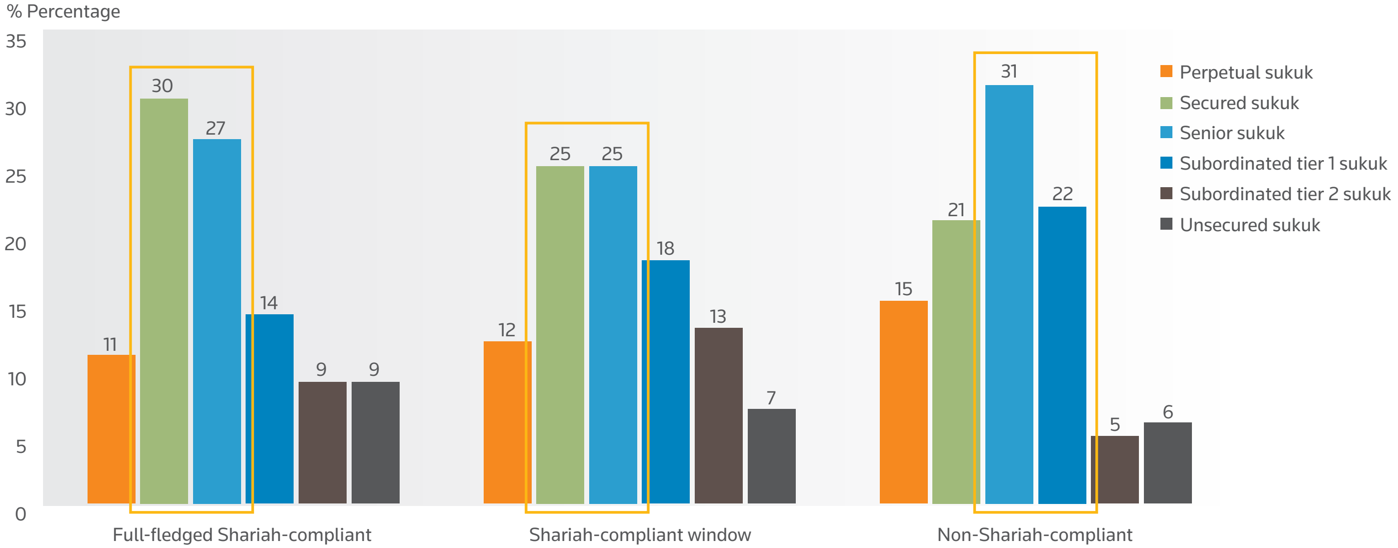
Survey	Respondents	Skipped
Buy Side	100	6
Sell Side	40	4
Others	43	11

SURVEY FINDINGS – RISK CLASSIFICATION PREFERENCE

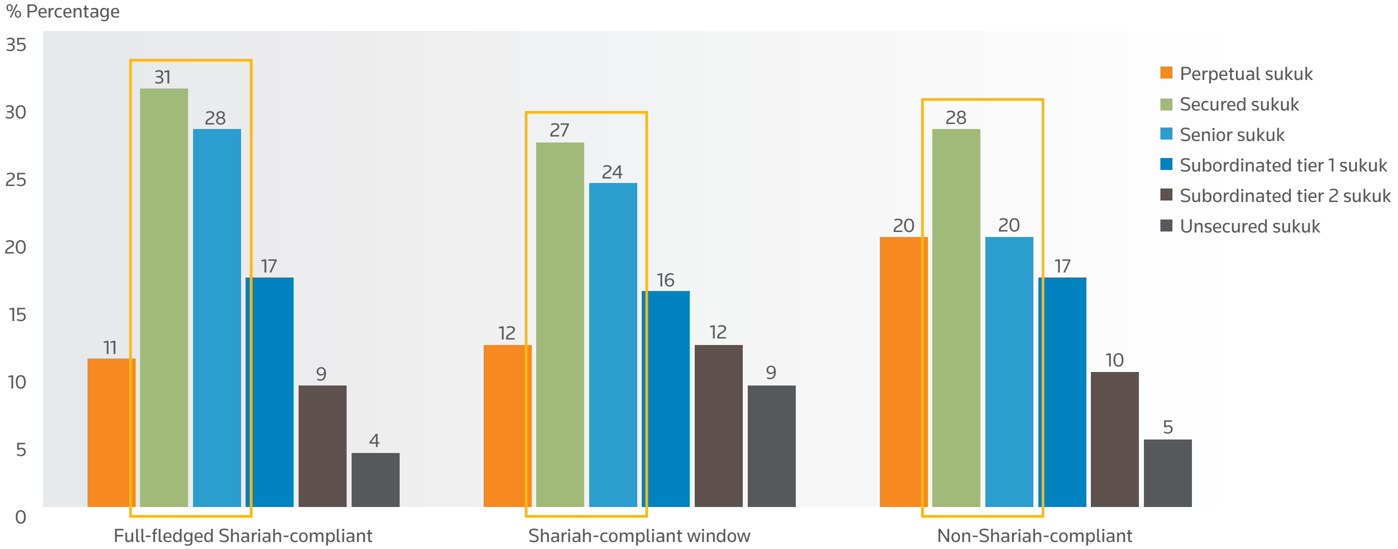


"A few banks have recently issued Tier 1 sukuk mainly to enhance their capital positions."

SURVEY FINDINGS – RISK CLASSIFICATION – SELL SIDE



SURVEY FINDINGS – RISK CLASSIFICATION PREFERENCE – BUY SIDE



Majority of investors and issuers are expecting more secured sukuk issuances followed by senior sukuk.

Tier 1 sukuk is also attractive to 17% of both investors and issuers as banks can benefit from sukuk to comply with Basel III capital requirements.

> *“Majority of investors and issuers are expecting more secured sukuk issuances followed by senior sukuk.”*

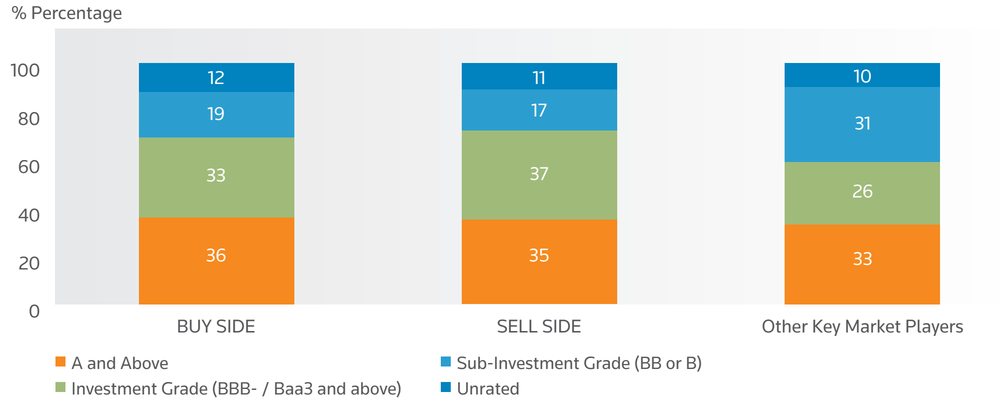
Sukuk Credit Rating

Do they really measure risk?

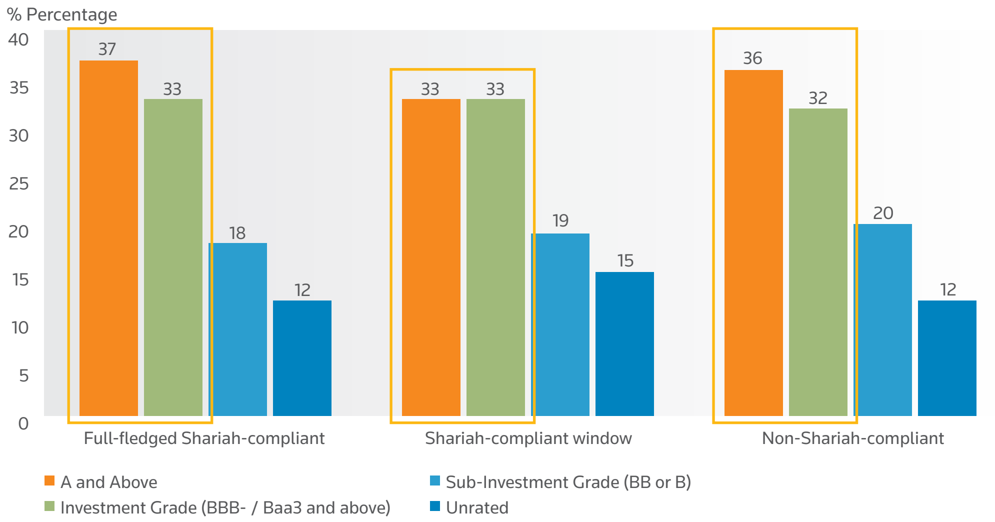
High quality investments are preferred over investment grades (BBB-/Baa3 and above) as market players choose investing in companies with lower risk and adequate returns. Investors' preference is changing towards higher quality papers as opposed to last year's Sukuk Survey where investors were interested in Investment grades (BBB-/Baa3 and above). The shift indicates that the returns investors get from A and above rated sukuk is satisfactory.

Survey	Respondents	Skipped
Buy Side	102	2
Sell Side	42	2
Others	50	4

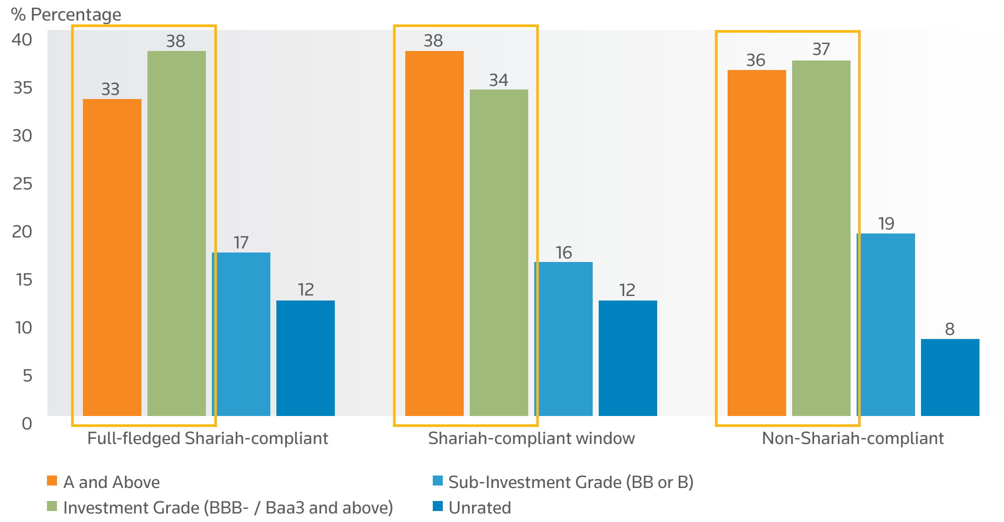
SURVEY FINDINGS – RATING PREFERENCE



SURVEY FINDINGS – RATING PREFERENCE – BUY SIDE



SURVEY FINDINGS – RATING PREFERENCE – SELL SIDE



Rating Mechanism

What should be considered?

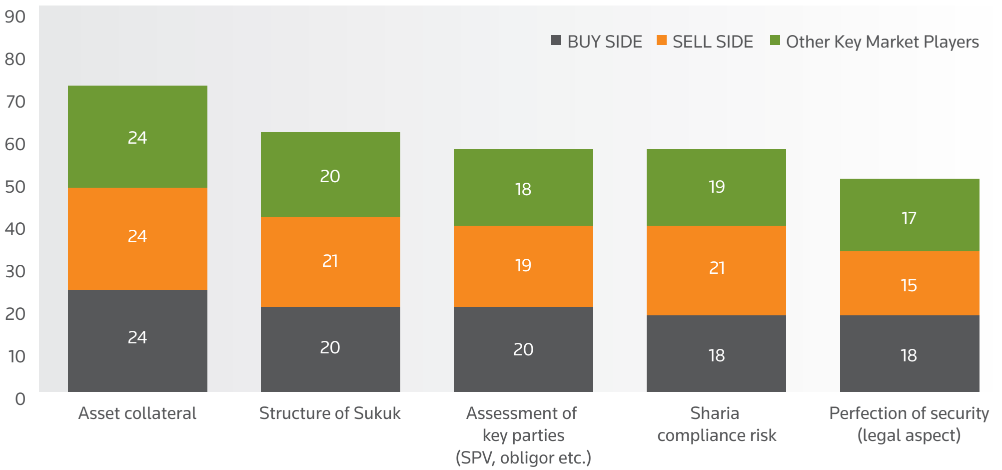
The majority of market players believe that, apart from credit rating, asset collateral should be considered by a rating agency when rating sukuk.

Apart from asset collateral, an equal percentage of investors, 20%, believe that the structure of sukuk and the assessment of key parties are equally important.

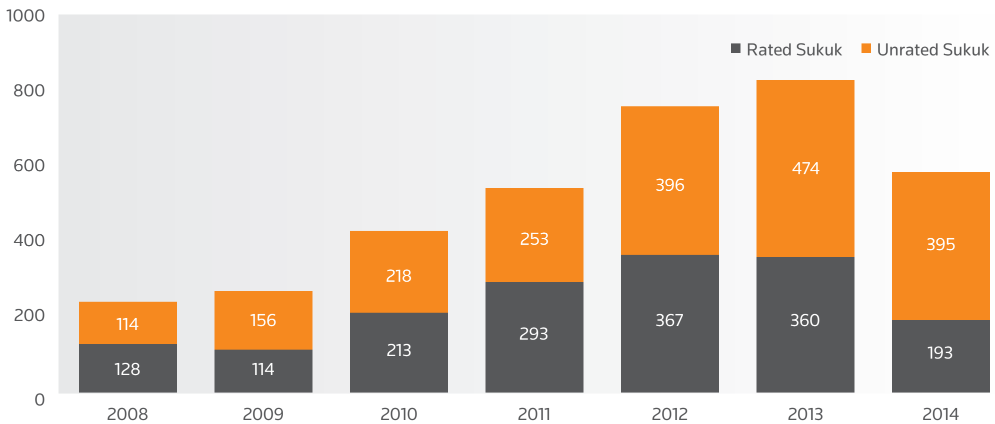
However, 22% of issuers believe that Shariah compliance risk should also be considered.

Survey	Respondents	Skipped
Buy Side	100	6
Sell Side	40	4
Others	48	6

SURVEY FINDINGS – WHAT CONSIDERATIONS SHOULD A RATING AGENCY TAKE INTO ACCOUNT FOR RATING SUKUK, APART FROM CREDIT RISK?



SURVEY FINDINGS – GLOBAL SUKUK HISTORICAL TREND BREAKDOWN BY RATING (2008-YTD Q3 2014)



> *"22% of issuers believe that Shariah compliance risk should also be considered."*

Market Opinion

Why do issuers seek sukuk credit ratings?

By Dr. Khalid Howladar
Global Head – Islamic Finance, Moody's Investor Service

DR. KHALID HOWLADAR

Khalid Howladar is the Global Head of Moody's Islamic Finance Group and also leads the GCC Banking team in Dubai. He is a leading figure in the fields of sukuk and Islamic banking as well as in conventional GCC credit and securitisation markets. He joined Moody's in London in 2001 and was initially an analyst. Subsequently he took lead roles in the MENA Business Development team with responsibility for new markets and client outreach before taking leadership of the Dubai-based banking team in 2010.

Q The market for sukuk is growing rapidly and requests for credit ratings from sukuk issuers are multiplying in tandem. Why would sukuk need a global credit rating?

Part of the answer is the same as for conventional bonds; to provide an independent, objective opinion on a sukuk's credit risk for potential investors. However, the need for a credit rating is even greater for sukuk than for conventional bonds in many ways. This is because, firstly, the complexity of the legal documents that form the basis of sukuk makes credit risk harder to assess in the majority of instances, and, secondly, because credit ratings (and the associated research) provide a valued and additional piece of information for international investors unfamiliar with Middle Eastern or Asian sukuk issuers.

Regular credit ratings assess the risk that a borrower will default on its debt by failing to make any payments that are due. Where a sukuk is being rated, ratings agencies analyse the extent to which the bond or the sukuk will pay financial obligations as and when the payments become due. For asset-based or unsecured sukuk[1] this usually matches the sukuk issuer's rating. For asset-backed or securitisation sukuk[2], this depends more on the performance of the assets themselves. Ratings analysts try to answer the two-part question: What is the likelihood that the issuer or sukuk will default and, if it does default, what is the level of losses that the investor should expect?

Market participants who are making investment decisions need as much information as they can get beforehand. They will usually conduct their own analysis using in-house credit analysts and they may also seek an independent view. A credit rating provides this independent view. In addition, it provides a credit benchmark to financial instruments and issuers in other markets. This global comparability is a key aspect of a rating's value. Moody's rating methodology provides a global standard that helps an investor compare, for example, U.S. Treasuries versus Hong Kong's sukuk, or property company Emaar's sukuk versus a sukuk from investment house Goldman Sachs.

Credit ratings also provide investors with access into unfamiliar markets. An international investor who wants to diversify their portfolio and enter emerging markets in the Gulf and Asia won't be familiar with the local companies, or banks that are issuing bonds or sukuk in those markets. Ratings greatly facilitate the increasing participation of conventional investors in the sukuk market. Moody's, for example, has analysts on the ground with deep knowledge of individual markets, who combine their local knowledge with credit expertise to measure the likely risk of default, so allowing international investors to make more informed credit decisions.

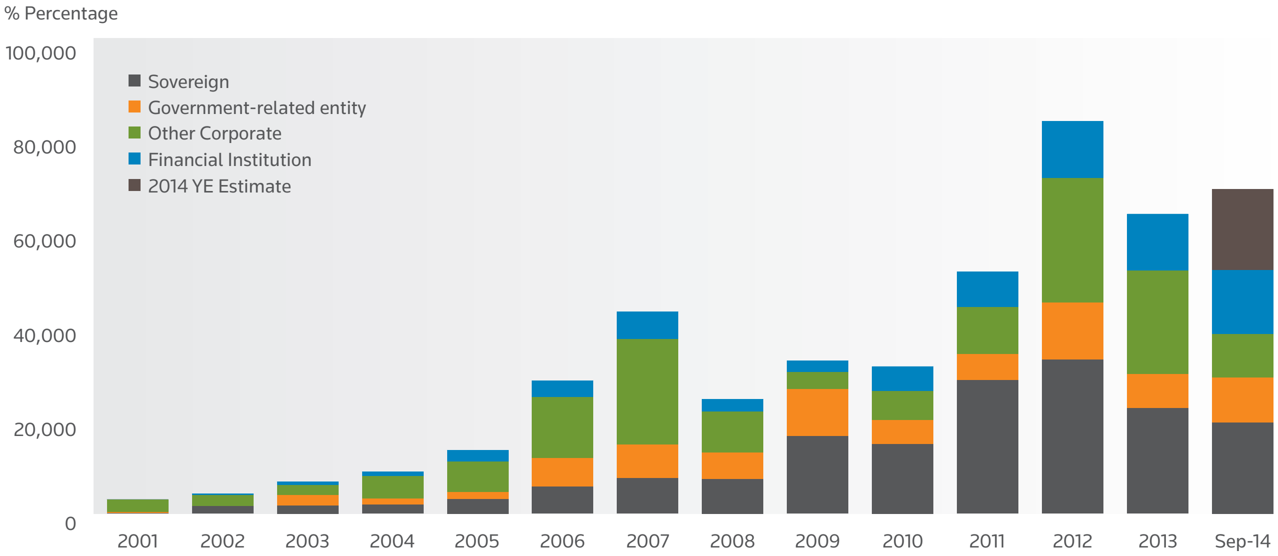
Ratings are also an important tool to create secondary trading channels. Once a sukuk is assigned a rating, it is freely accessible by the public markets via our website and via media outlets. This improves the availability of information and usually enhances the tradability or liquidity of the instrument and, by extension, the efficiency of the capital markets.

International credit ratings have an additional attraction for sukuk issuers because, while the sukuk market is growing fast, it remains relatively small. As of September 2014, the cumulative sum of outstanding sukuk was around $300 billion, with around $70 billion of issuance expected for 2014. But this figure still remains dwarfed by the conventional bond market which issued $5.6 trillion in 2013[3]. Sovereign governments are frequent issuers and this year saw landmark issuances from UK, South Africa, Hong Kong, and Luxembourg. The small and esoteric nature of the sukuk market magnifies the need for credit ratings because most global investors are unfamiliar with such instruments.

Another incentive for seeking a sukuk rating is the complexity of sukuk compared to conventional bonds, which makes them more difficult to analyse. When a multinational conglomerate like General Electric or a global bank like Barclays issues a conventional, plain vanilla Eurobond, their bonds are likely to have the same legal structure, default events, payment obligations, investor rankings in case of default etc. In contrast, sukuk securities are structured to comply with Islamic law and its investment principles. The interpretation and hence application in financial transactions is subjective and lead to wide and crucial variations in the legal structure and documentation. A credit analyst has to dig deeply into this documentation to accurately assess the creditworthiness of the instrument.

The bulk of demand for global sukuk ratings comes from the Gulf. While Malaysia is the biggest market for sukuk issuance, it is domestically focussed and issues most of its sukuk in the local currency – Malaysian Ringgit. Malaysia has a deep base of investors from large pension funds and mutual funds to corporate treasuries that are well-accquainted with their local companies. Most sukuk issuers in Malaysia are therefore not actively seeking international investors and so mostly use local ratings agencies. This contrasts with the Gulf, where – apart from in Saudi Arabia – there is not as yet a strong local currency domestic investor base. The Gulf has a limited pool of institutional investors, pension funds and insurance companies (keen buyers of fixed income assets). The Gulf Cooperation Council's U.S. dollar pegs make them natural issuers of U.S. dollar denominated sukuk which then opens the market to global investors. As a result, a great number of bonds (conventional

GLOBAL SUKUK ISSUANCE – MOODY'S ESTIMATES (2001-YTD Q3, 2014)



and sukuk) issued in the Gulf are sold outside the region to investors in Europe, Asia and the Americas. These international investors – as noted earlier – are often unfamiliar with the local names but are keen to take exposure to Gulf credit. Our research and investor events raise awareness of these sukuk issuers in the international markets.

Q How do issuers go about getting a sukuk credit rating?

At Moody's we have a commercial group that is entirely separated (via a Chinese wall) from the analytical teams that assign ratings. Issuers considering a credit rating will often discuss the matter with the analytical group to find out about the methodologies we apply and the credit issues involved. If they decide to go ahead, we pass them over to the commercial group who will deal with the business aspects of the transaction. Analysts are strictly excluded from all commercial discussions and communications.

We cannot assign a credit rating for an asset-based or unsecured sukuk instrument1 if the issuing bank or corporate doesn't have a rating of its own. This is because the creditworthiness of the sukuk will usually be driven by the creditworthiness of the issuer. The issuer will need to be rated first. In the case of an asset-backed or securitisation sukuk,[2] the assets will need to be analysed and, while important, an issuer rating is not critical unless there is some link in the sukuk documentation back to the issuer. This process is very different and we apply the relevant securitisation methodologies dependent on the nature of the assets.

Once a rating is assigned, credit analysts monitor the market and creditworthiness of the issuer and instrument and update the market of any changes in the credit view.

> *"We cannot assign a credit rating for an asset-based or unsecured sukuk instrument if the issuing bank or corporate doesn't have a rating of its own."*

1. When sukuk credit risk is driven by the sukuk issuer, not the assets.
2. Where sukuk credit risk is driven by the sukuk assets not the issuer
3. Source: Thomson Reuters Debt Capital Market Review Full Year 2013

PRU.L 0.688
SHP.L 1.028
VOD.L 5.557
Financials -1.652
Health Care -1.178
1.178 Industrials
0.990 Energy
-0.333 Consumer Discretionary
-0.465 Utilities
-0.525 Information Technology
Daily
Range
05/06/2013 - 18/12/2013
Price
GBP
6,700

REUTERS/Eduardo Munoz

Chapter Four

Issuance Process: Post-Issuance

Sukuk Listing

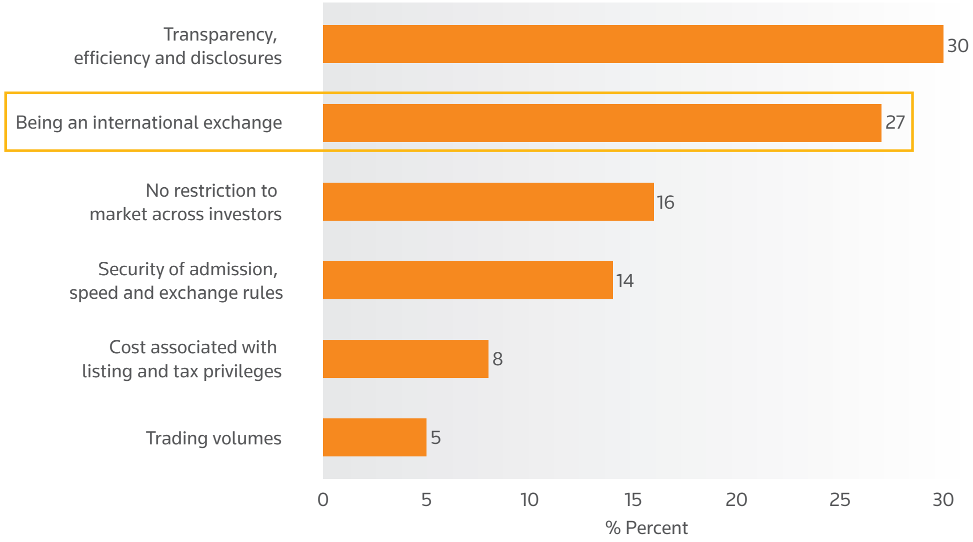
How to choose the best exchange to list sukuk?

56% OF OUTSTANDING LISTED SUKUK ARE ON THE LSE, NASDAQ DUBAI AND BURSA MALAYSIA

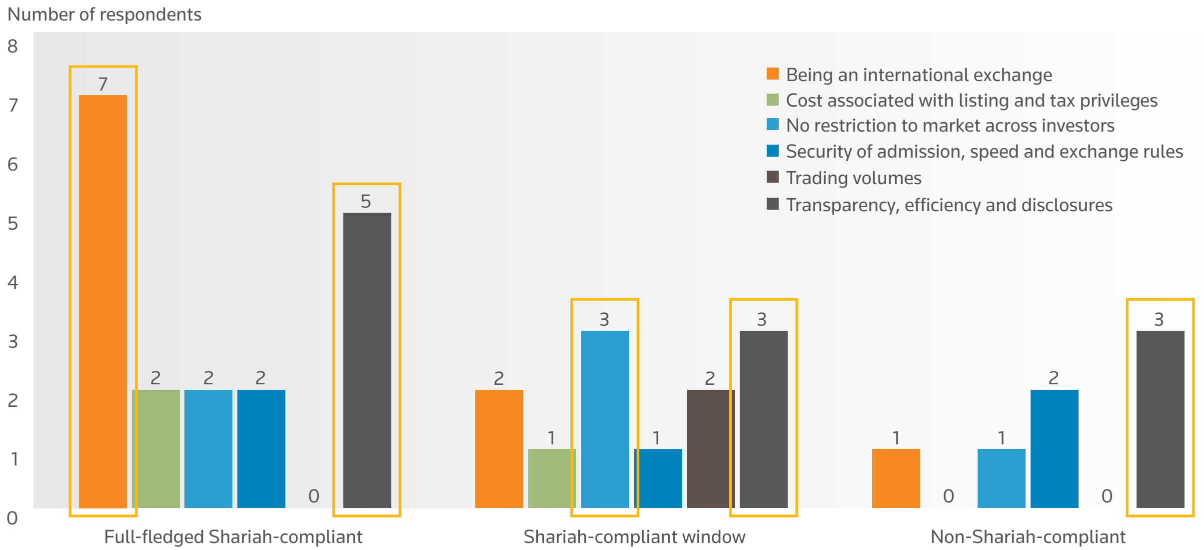
Our Sukuk Survey results reveal that 30% of issuers would choose an exchange for its transparency, efficiency and disclosures, which are the main objectives for listing. Being an international exchange was the main driver for 27% of issuers. As at Oct, 2014, the LSE was home to $29.9 billion (45 issues) of all outstanding sukuk, according to the Zawya Islamic Sukuk Monitor. Bursa Malaysia has one more listed sukuk (46) than the LSE, amounting to $21.6 billion. Nasdaq Dubai has 41 listed sukuk worth $22.6 billion.

Survey	Respondents	Skipped
Sell side	37	7

SURVEY FINDINGS – AS AN ISSUER, WHAT WOULD BE THE MAIN DRIVER FOR YOU TO CHOOSE AN EXCHANGE TO LIST YOUR SUKUK?



SURVEY FINDINGS – AS AN ISSUER, WHAT WOULD BE THE MAIN DRIVER FOR YOU TO CHOOSE AN EXCHANGE TO LIST YOUR SUKUK? – SELL SIDE

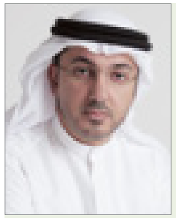


> *“Nasdaq Dubai has 41 listed sukuk worth $22.6 billion.”*

Market Opinion

To list or not to list?

By Hamed Ali, Chief Executive, NASDAQ Dubai



Hamed Ali

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The great majority of sukuk issuers have traditionally opted not to list their securities on an exchange. For a variety of reasons, they have not felt it necessary or even desirable. There are clear signs, however, that the appeal of a listing is growing, as the sector matures, new actors become involved, and attitudes change.

In 2012 and 2013 only about 6% by value of newly-issued sukuk were listed, and in previous years the figures were similar. One of the main explanations for this is that many issuers have had little difficulty in selling their securities to a small number of investors who knew them well, and whose interest was clear from an early stage. In such circumstances, some issuers have not felt that a listing would necessarily add significant value. This attitude is understandable, and perfectly normal in a market that is in its relative infancy and involves a limited pool of participants.

ADVANTAGES OF LISTING

As the sector expands however, a wider range of issuers and investors are becoming involved. The advantages of regulation, transparency and high visibility become clearer in a larger market place where participants expect capital market norms to apply. It is no coincidence that three of the most high profile issuers of 2014 - the governments of Britain, Hong Kong and South Africa – chose to list their sukuk. All three were stepping into the market for the first time and offering their securities to a wide range of international investors. And it is not just new entrants who see the value of a listing. Many established Islamic issuers, such as Dar Al Arkan of Saudi Arabia and the Islamic Development Bank, have also listed sukuk this year.

The advantages of listing include:

1. **Affirming the quality of the issuer**
   The new sovereign entrants to the market and many other issuers, whatever their stature, understand that listing on a high quality exchange provides comfort to everyone involved. Mandatory disclosures of company announcements, from financial results to changes in the Board of Directors, keep investors up to date with key information. An effective enforcement structure, provided by a respected regulator, supports proper conduct and efficient management by an issuer. This framework creates broad trust among the public for all business transactions carried out by the issuer.

2. **Raising profile in new markets**
   Issuers benefit from the global visibility that a listing on a world class exchange provides. This enables them to attract more investors in their sukuk in the primary and secondary market, especially because many fund managers and other institutional investors are required by mandate to select listed securities for a certain percentage of their holdings. A listing also supports the expansion of an issuer's general business activities into new geographic areas and new markets, by raising the profile of the brand.

3. **Efficiency of listing process**
   Many issuers wrongly believe that listing is an arduous process. In fact the documentation process on a well-run exchange is efficient and streamlined, and can be carried out swiftly to fit in with the preferred issuance date. Post-listing, it can be convenient to use an exchange's infrastructure to make announcements to investors, many of which even a non-listed issuer would make anyway as part of their investor relations outreach.

I believe that the proportion of sukuk that are listed will rise substantially in the coming years. A presence on an exchange will not be appropriate for all sukuk, of course; some are too short-term, while in other cases an issuance by a small company to a limited group of investors might still not justify the limited time spent on the listing process and associated fees. But for the others, a listing looks increasingly sensible. It will be particularly desirable if, as many industry participants expect, the supply of sukuk starts to catch up with demand. Issuers for the most part have found plenty of interest in their securities in recent years, but in a more competitive environment a listed instrument will have a distinct advantage over an unlisted one in the eyes of discerning investors.

As sukuk listings become more common, exchanges will work harder to attract them. Three listing centres currently dominate the scene, by total sukuk nominal value – Dubai, London and Kuala Lumpur -- each with more than $20 billion of listings. Dublin and Riyadh are also prominent. Issuers and investors will no doubt push all the exchanges to streamline their listing procedures and offer enhanced service to the market. The competition can only be good for the industry.

Overall, I believe that listing a sukuk provides significant visibility and opens doors into new markets. It is an advantage that is not to be missed. Sukuk issuances should be viewed as part of an issuer's business plan, not merely financial plan, aiding the broad success of the entity as well as meeting its capital-raising needs.

Liquidity & Tradability

How can we activate the market?

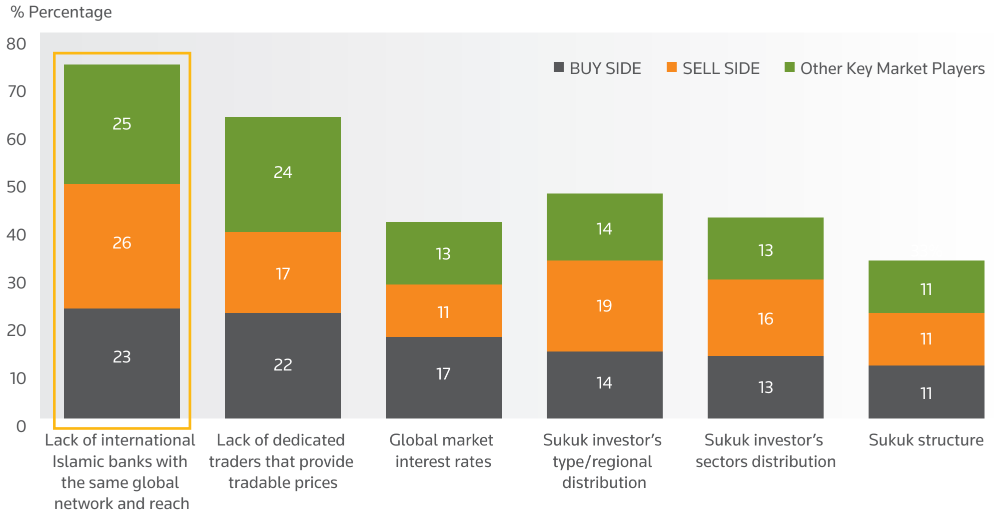
23% of investors from our Sukuk Survey believe that the lack of international Islamic banks with global networks is the most significant obstacle to greater sukuk tradability and liquidity. 26% of issuers believe the same.

Overall, a lack of dedicated traders that provide tradable prices is the second most significant obstacle in the way of tradability and liquidity. Issuers, however, find that sukuk investor type is a more significant obstacle than the dearth of dedicated traders.

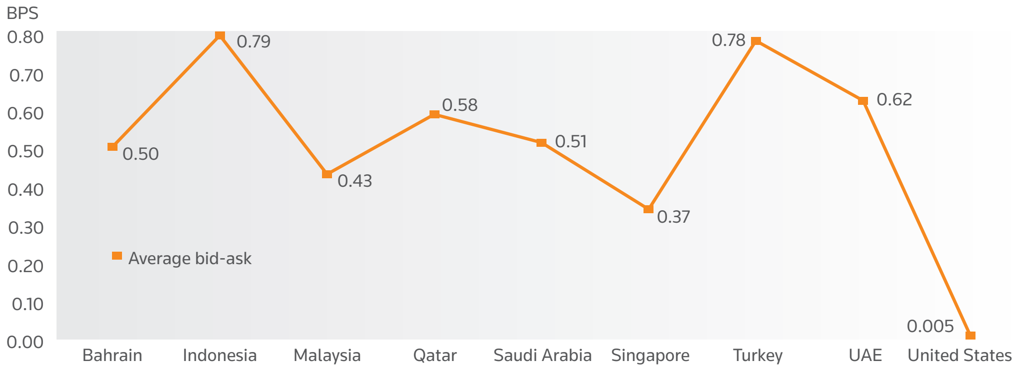
As the sector gets bigger, it would need big market players to move and activate the market, as is the case in the conventional space with big traders such as HSBC, Deutsche, JPMorgan, Standard Chartered and many others. The Islamic finance space lacks big international Islamic banks with dedicated traders to activate the secondary market.

Survey	Respondents	Skipped
Buy Side	96	10
Sell Side	39	5
Others	44	10

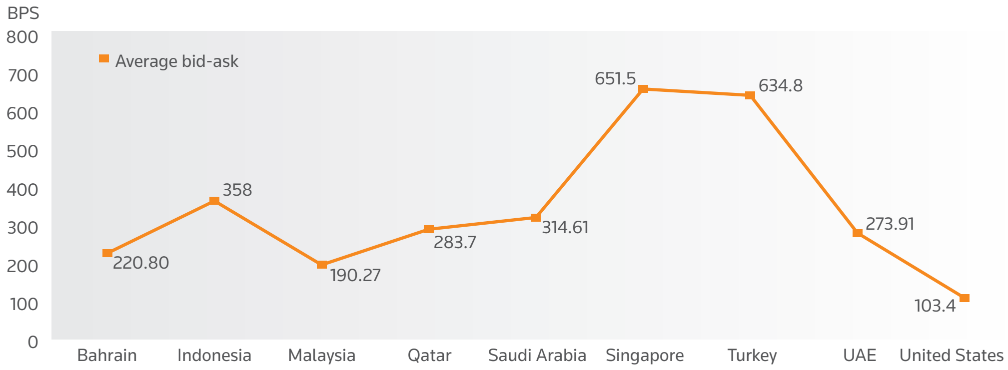
SURVEY FINDINGS – WHAT IS THE MOST SIGNIFICANT OBSTACLE TO GREATER SUKUK TRADABILITY & LIQUIDITY?



SURVEY FINDINGS – INTERNATIONAL SUKUK AVERAGE BID-ASK SPREAD BREAKDOWN BY COUNTRY AS AT END SEPTEMBER 2014



SURVEY FINDINGS – INTERNATIONAL SUKUK AVERAGE BID YIELD BREAKDOWN BY COUNTRY AS AT END SEPTEMBER 2014



SUKUK ALLOCATION

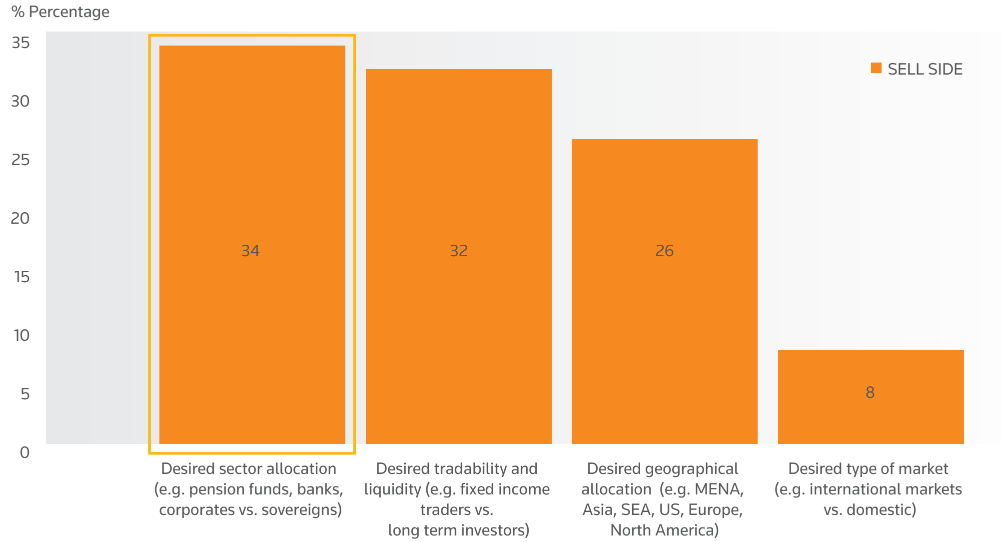
About two-thirds of lead arrangers and issuers would allocate sukuk in the primary market by desired sector (34%) and desired tradability and liquidity (32%).

26% of lead arrangers and issuers would consider allocation by desired regions and only 8% by type of market, such as international vs. domestic market. Normally, issuers bother less about tradability and post-issuance activities compared to investors, as investors are the ultimate stakeholders.

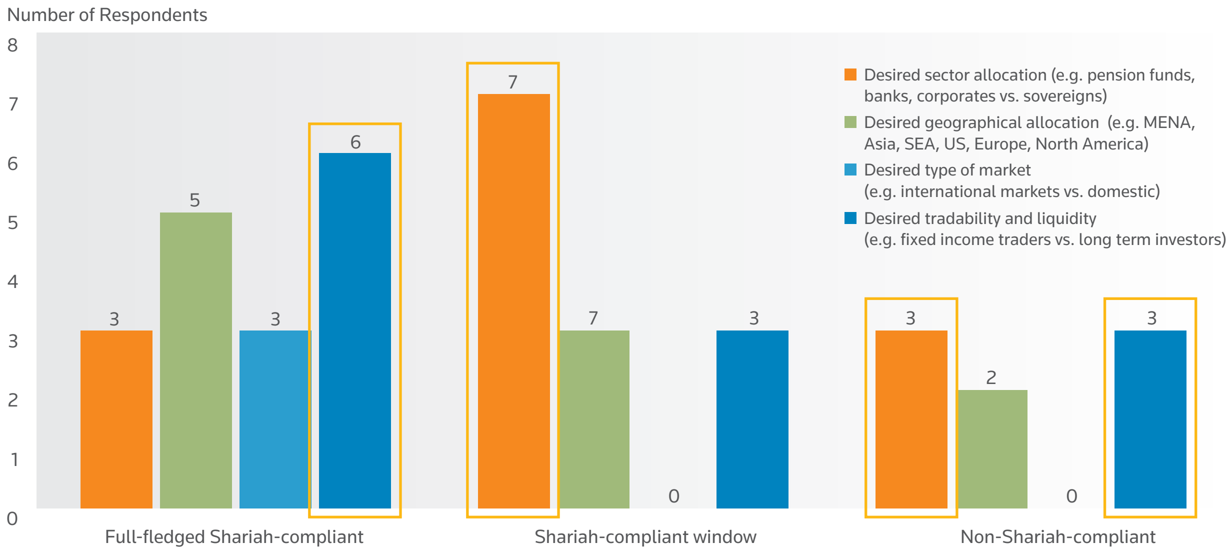
But allocation of sukuk in the primary market is very important for a number of reasons: a) global attraction, b) diversity of orders in terms of region and sectors, and c) the type of investors for post-issuance tradability.

Survey	Respondents	Skipped
Buy Side	38	6

SURVEY FINDINGS – AS LEAD ARRANGERS/ISSUERS, WHAT DRIVES YOUR ALLOCATION OF SUKUK IN THE PRIMARY MARKET?



SURVEY FINDINGS – AS LEAD ARRANGERS/ISSUERS, WHAT DRIVES YOUR ALLOCATION OF SUKUK IN THE PRIMARY MARKET? – SELL SIDE



> *"26% of lead arrangers and issuers would consider allocation by desired regions..."*

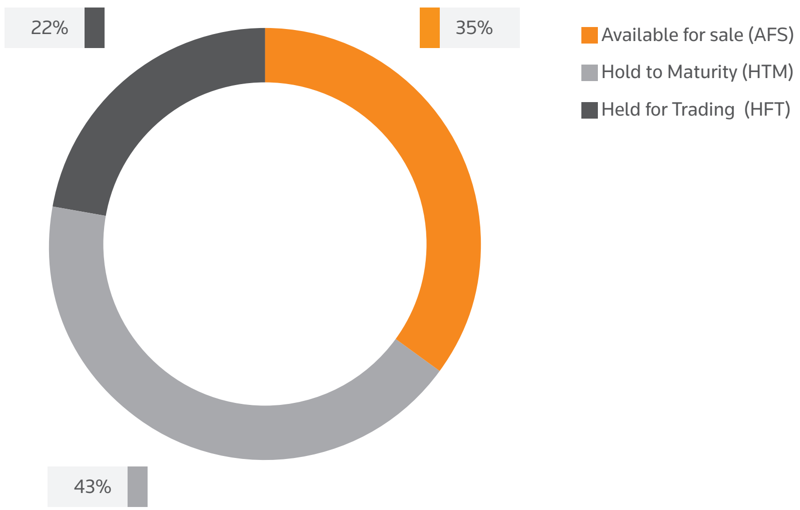
CATEGORISING SUKUK

The tradability of sukuk is limited by certain accounting constraints or Shariah restrictions in trading some type of sukuk structures. In addition, fewer papers to trade in the secondary market will naturally increase the bid-ask spread and subsequently lower the liquidity activity. 43% of investors from our Sukuk Survey want to classify their investment in sukuk as hold to maturity (HTM). The type of investors differ; 50% of the Islamic banks, which were the majority of the respondents to this question, would classify their sukuk as AFS, followed by 42.5% classifying as HTM and only a minority would classify as HFT. Our survey results also show that majority of governments, corporates and regulators would hold their sukuk to maturity. Holding a sukuk to maturity would result in an illiquid market and hence affect the tradability and secondary market of sukuk.

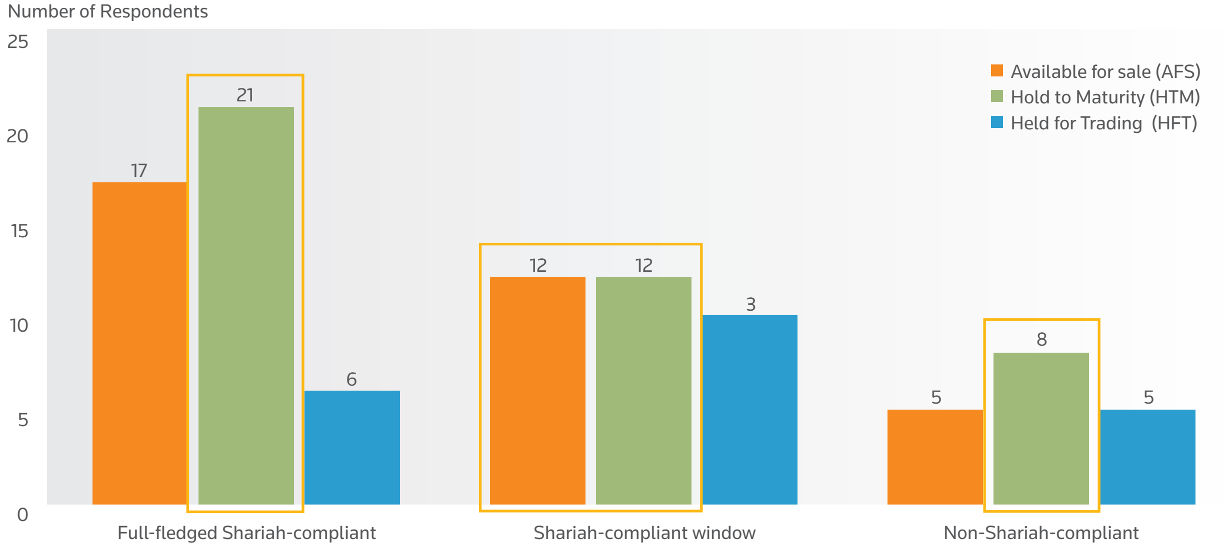
35% of investors classify their sukuk as available for sale (AFS) and 22% as held for trading (HFT).

Survey	Respondents	Skipped
Buy Side	96	10

SURVEY FINDINGS – HOW DO INVESTORS NORMALLY CATEGORISE SUKUK IN THEIR BALANCE SHEETS?



SURVEY FINDINGS – HOW DO YOU NORMALLY CATEGORISE SUKUK IN YOUR BALANCE SHEET? – BUY SIDE



"43% of investors from our Sukuk Survey want to classify their investment in sukuk as hold to maturity (HTM)."

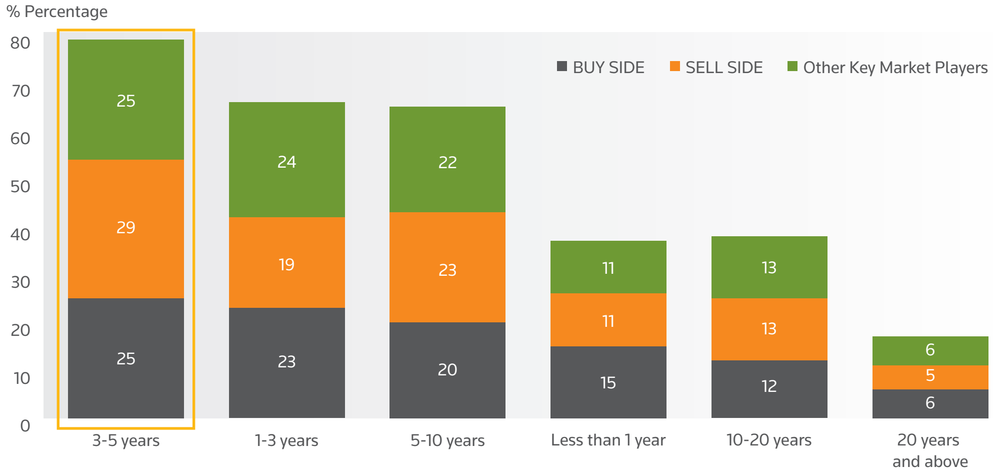
TENOR PREFERENCE

Our Sukuk Survey findings indicate that investors and lead arrangers are increasingly moving towards mid-term sukuk. Investors most prefer tenors between 3 and 5 years followed by 1 and 3 years as this will give them the opportunity to better control reinvestment risk. Lead arrangers and issuers prefer to issue with slightly longer tenors, with the most preferred being 3-5 years followed by 5-10 years.

The intention of sukuk holders affects tradability in the secondary market and the number of available tradable papers.

Survey	Respondents	Skipped
Buy Side	104	4
Sell Side	43	1
Others	50	4

SURVEY FINDINGS – TENOR PREFERENCE



SURVEY FINDINGS – TENOR PREFERENCE – BUY SIDE

SURVEY FINDINGS – TENOR PREFERENCE – SELL SIDE

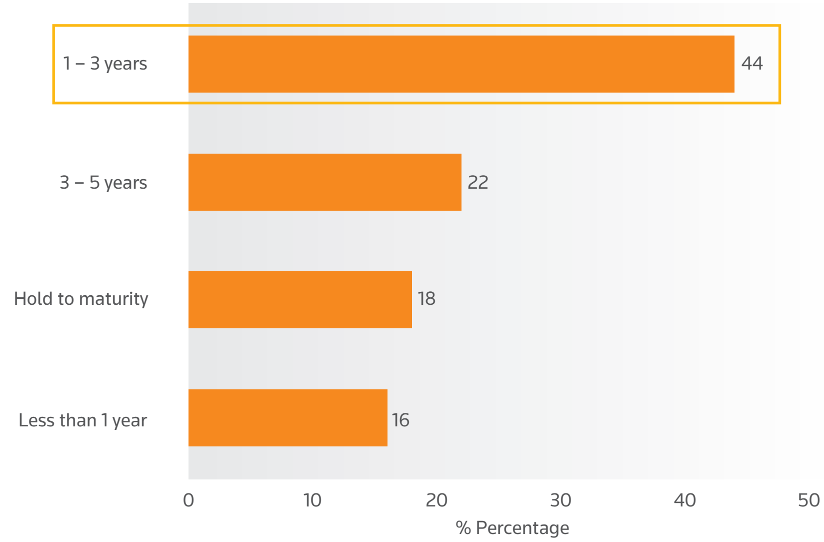
HOLDING PERIOD

The average holding period is 1-3 years for 45% of investors from our Sukuk Survey, while 22% of the investors would hold for 3-5 years. As a result 67% of investors would liquidate their sukuk investments in less than 5 years. Investors are still not confident of holding their sukuk investments to maturity, except for those Islamic banks whose Shariah boards prohibit trading sukuk and they are thus obliged to hold them to maturity.

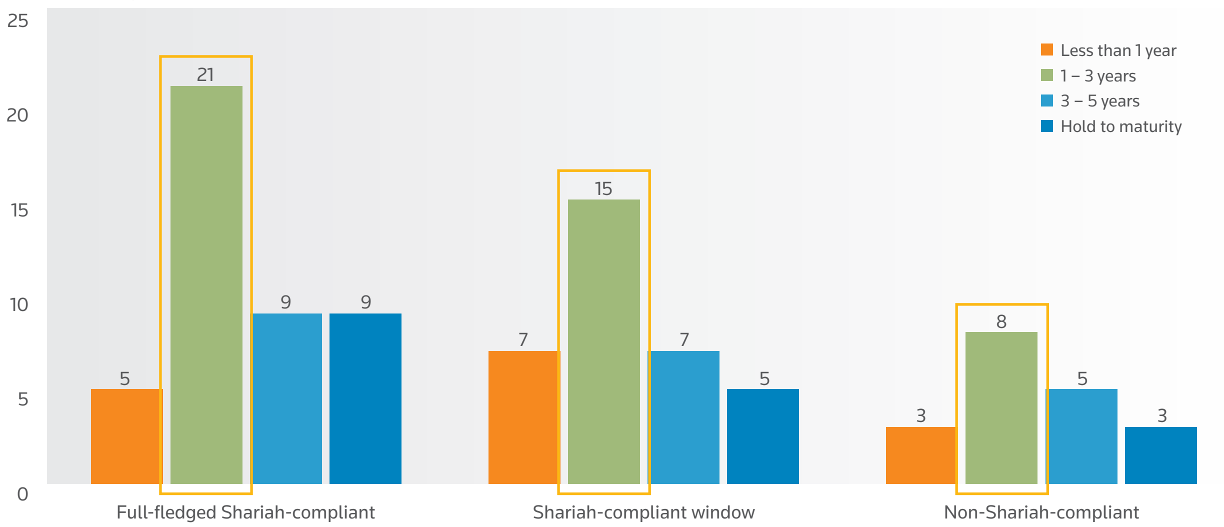
Governments, unlike financial institutions, will generally prefer trading their sukuk investments to enhance tradability, particularly in the local markets. By their longer-term horizons, corporates and pension funds would prefer holding their sukuk investments a bit longer to enjoy stable returns.

Survey	Respondents	Skipped
Buy Side	97	9

SURVEY FINDINGS – AS AN INVESTOR, WHAT IS YOUR AVERAGE HOLDING PERIOD FOR THE SUKUK YOU BUY?



SURVEY FINDINGS – IF YOU INVEST IN SUKUK, WHAT IS YOUR AVERAGE HOLDING PERIOD FOR THE SUKUK YOU BUY? – BUY SIDE



"...67% of investors would liquidate their sukuk investments in less than 5 years."

Market Opinion

Sukuk investors eye on-exchange trading

By Hamed Ali, Chief Executive, NASDAQ Dubai

Like conventional bonds, sukuk are traded overwhelmingly over the counter (OTC). This pattern has been established since the first sukuk issuances nearly 15 years ago. However, efforts to provide investors with attractive alternatives are well underway, including initiatives by several exchanges to bring trading on to their platforms. I believe that on-exchange trading will steadily become more popular in the coming years, as it offers several clear advantages over the OTC model.

But this will not happen overnight. To understand why, it is worth looking at the reasons that commentators usually give to explain the current dominance of OTC trading.

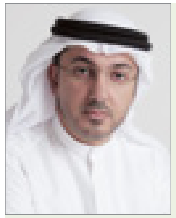
The static nature of the sector is one explanation; buy and hold institutional investors dominate in the primary market, just as with conventional bonds, and the appetite for either selling or buying in the secondary market is limited. But this argument is at least partly circular. In the absence of a satisfactory framework for trading, of course investors' appetite for doing so will be limited. But if the framework is improved, the desire to trade will increase.

Another reason that is sometimes put forward is that whereas comparing equities is an apples-to-apples type of exercise, comparing fixed income issuances is more like apples-to-pears, given the different structures and terms of each issuance. This makes it harder to attract investors into the market, as it is harder to understand, runs the argument. But as research tools improve and investors become more sophisticated, this reason, too, is becoming less persuasive.

THE ON-EXCHANGE OPPORTUNITY

A shift towards trading on-exchange will involve much more than an adjustment of procedures and technical behaviour. It will amount to a shift in culture and mindset. This is always required when new markets are set up and it explains why they can take time to succeed. But the benefits of trading on-exchange are so clear-cut that I believe it is only a matter of time before it becomes widespread. Prominent among these advantages are:

1. **Transparency**
   Moving trading on-exchange will lift it out of the silos in which it currently resides in the fragmented OTC market, which is operated by a large number of broker-dealers and financial institutions. Instead prices, volumes and market depth will be freely available on a single screen, visible to everyone who wants to trade, or who wants to understand the market in order to decide if they want to take part in it. This will raise awareness of the opportunities that exist.



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2. **Price discovery**
   In the opaque OTC market, investors are often uncertain about the true value of particular sukuk securities. This can limit their participation in the sector. On-exchange trading will immediately remove this doubt, just as it does for equities, by shining a light on market sentiment and instantly tracking its fluctuations.

3. **Liquidity**
   There is enormous potential for volumes to soar when on-exchange trading gains critical mass. A virtuous circle of activity will be created, driven by a unified marketplace where everyone is engaging openly with everyone else.

4. **Risk mitigation**
   On-exchange trading can mitigate risk by also providing a central counterparty, as this eliminates the danger of an individual party failing to honour a transaction. This framework is especially important for Shariah-compliant products such as sukuk, given the emphasis placed by Islamic finance on promoting financial responsibility and providing a safe environment for investing.

A number of exchanges in the Middle East, East Asia and Europe have already created on-exchange trading platforms for sukuk. Some are likely to grow, others will not. The usual criteria that apply to the success of any trading platform, such as trading fees, trading hours and robustness of trading technology will also apply to sukuk. So too will the efficiency and reliability of clearing and settlement mechanisms. Particularly critical will be the number and quality of sukuk available to be traded on a particular exchange. Exchanges that are most successful in attracting new sukuk listings will have a clear advantage.

An international consensus in favour of expanding on-exchange trading for multiple asset classes has been growing since the global financial crisis struck more than five years ago. There is broad recognition that it is safer for the financial system as a whole, as well as for individual investors. It was OTC trading, after all, that lay at the centre of the crisis. This mood gives a fair wind to a movement towards on-exchange trading of sukuk that I believe will soon gather pace. I do not expect that it will entirely replace OTC trading. But it will give investors a choice about how they wish to participate in the market, to the benefit of the entire sukuk sector.


STOCK EXCHANGE

Hedging Risk

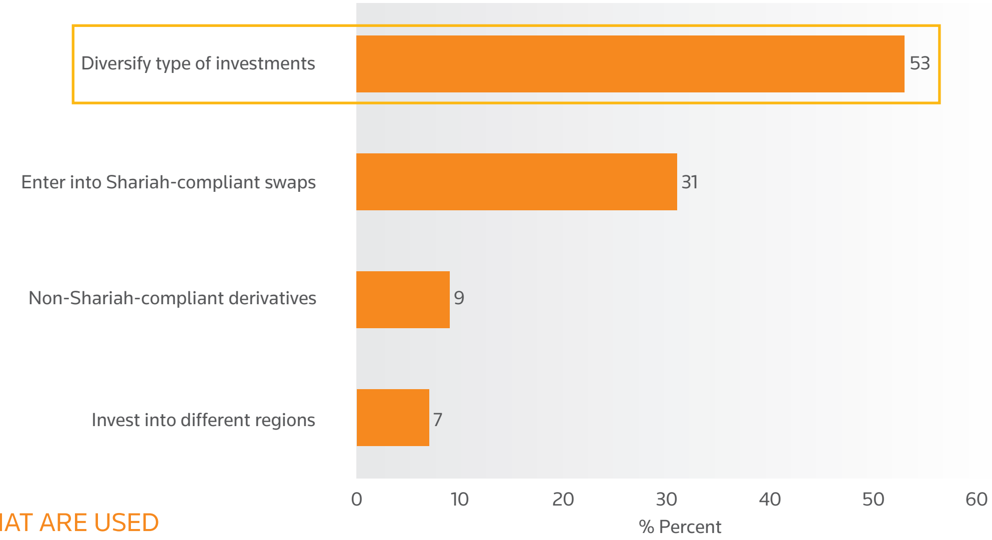
Strategies to protect against market movements?

Given a limited suite of Shariah hedging options, 53% of investors believe that diversifying types of investments would be the most common strategy to hedge against credit risk, FX and interest rate risk. 31% of investors would enter into Shariah-compliant swaps, while 9% would consider using non-Shariah-compliant derivatives.

Profit rate swaps, currency swaps and currency hedges have become more popular lately but there are still many scholars who approach them cautiously, if at all. Hence the preference for diversifying investments over swaps.

Survey	Respondents	Skipped
Buy side	97	9

SURVEY FINDINGS – AS AN INVESTOR, WHAT ARE THE MOST COMMON STRATEGIES THAT ARE USED TO MITIGATE CREDIT RISK AND HEDGE AGAINST FX AND INTEREST RATE RISK?



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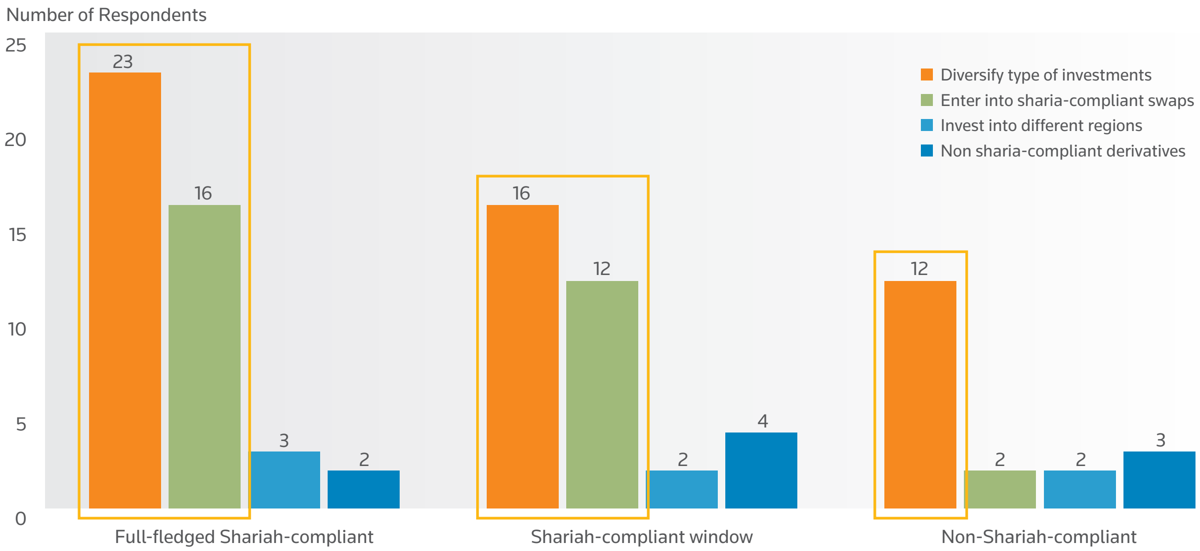


> *"31% of investors would enter into Shariah-compliant swaps"*

Chapter Five

The Year of the Sovereigns

Emerging Sukuk Markets

Who's in it for the long run?

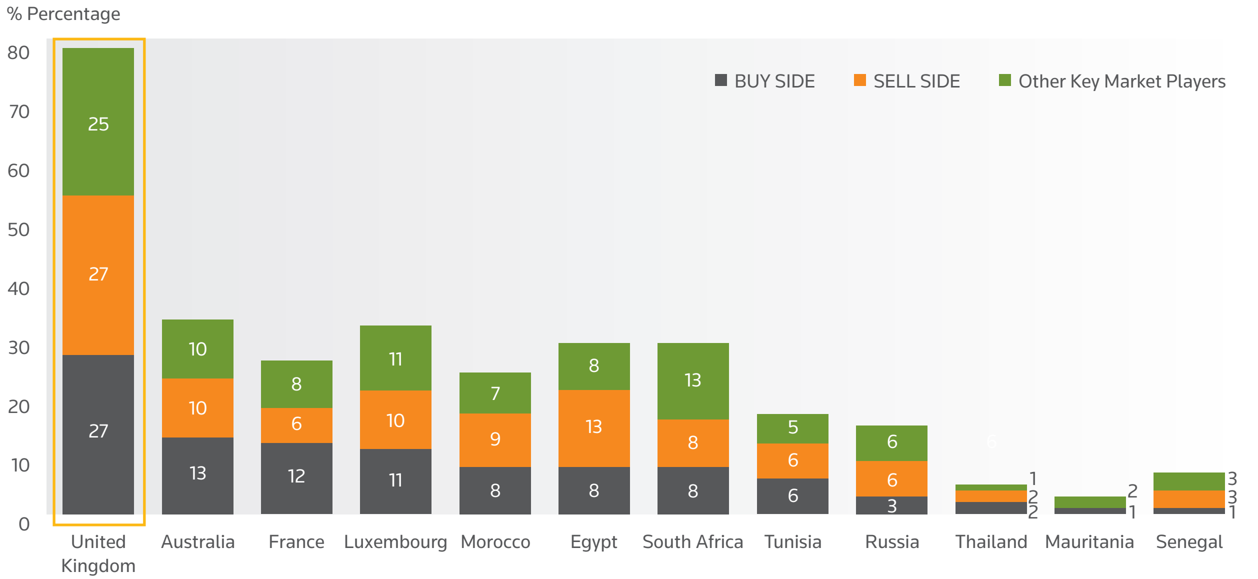
19 countries have issued sukuk in the first 9 months of 2014, with new names led by three big emerging sukuk markets -- UK, Luxembourg and Hong Kong.

The United Kingdom's and Luxembourg's debut sukuk issuances are expected to open the door for corporate sukuk and for other non-OIC countries to tap the sukuk market.

From our survey, investors have their eye on three markets, all of which are non-OIC countries -- Australia (13%), France (12%) and Luxembourg (11%) -- while issuers see Egypt as the second preferred destination after the UK.

Survey	Respondents	Skipped
Buy Side	93	13
Sell Side	39	5
Others	46	8

SURVEY FINDINGS – OUT OF THE FOLLOWING EMERGING ISLAMIC FINANCE MARKETS, WHICH ARE THE 5 MOST ATTRACTIVE FOR SUKUK INVESTMENT?



"From our survey, investors have their eye on three markets, all of which are non-OIC countries..."

Market Opinion

Which sovereign will issue next?

By Blake Goud
Community Leader – Thomson Reuters Islamic Finance Gateway

During the year-to-date, most of the new sovereign issuance came from non-traditional markets for sukuk including Hong Kong, Luxembourg, South Africa and the United Kingdom. The pipeline for the remainder of 2014 and 2015 is much more focused in markets where there is a large Muslim population. In these countries, particularly those like Tunisia which is still managing some instability, these issuance plans are subject to delays and are much less certain than issuers like Saudi Arabia or Oman where there is more financial market stability and where the issuance is more likely to occur.

Most of the announced or rumoured pipeline is made up of debut issuers, including all of the Maghreb countries except for Algeria. In the Middle East, the list of issuers includes new countries like Egypt, Jordan, and Oman as well as those like Yemen and Saudi Arabia which have issued sukuk in the past. The rest of the possible issuers are from Asia including repeat issuers Pakistan as well as new issuer Philippines.

NORTH AFRICA: TUNISIA MOST LIKELY TO ISSUE

Of these pipeline issuances, three were included in the Sukuk Survey's question on emerging markets in Islamic finance – Morocco, Egypt and Tunisia – which came in 5th, 6th and 8th in being most attractive for sukuk investment, likely as a result of their lower credit ratings. All but Tunisia were ranked higher than South Africa which was four times oversubscribed. If these countries issue sukuk, both investors and lead arrangers believe they would be attractive suggesting they would receive high demand.

Of these three issuers, the most likely would be Tunisia, which has indicated interest in both US dollar and local currency issuance with the USD issuance the most likely as the government has stated its intention to complete by the end of 2014 and, on October 17, Reuters reported it had selected Citigroup, Natixis and Standard Chartered and an unnamed regional bank as arrangers. It has issued conventional bonds as well with a USAID-backed $500 million 7-year bond which was followed with a 50 billion yen ($462 million) Samurai bond.

MOROCCO'S CONSIDERATIONS

Morocco is also in the process of building its Islamic banking sector, with an Islamic banking law being approved by parliament and expected by the end of the year. This provides a natural domestic constituency for issuing a sovereign (local currency) sukuk, since Islamic banks will need to have safe assets including sovereign debt. In the preparation for the passage of the law, Morocco's BCME Bank said it would launch an Islamic subsidiary as a joint venture with a major Islamic financial institution from the Middle East which should allow for rapid growth in Islamic banking assets.

In addition, Morocco's fixed exchange rate regime depends upon maintaining foreign exchange reserves, which it could expand through an international sukuk issuance in either Euro or USD (the exchange rate peg is linked 80% EUR / 20% USD). In its efforts to expand its options to maintain the peg, Morocco extended its precautionary and liquidity line with the International Monetary Fund in August 2014. In its request, it highlighted the risks from i) continued economic stagnation in Europe; ii) volatility from the end of quantitative easing; and, iii) high oil prices.

The sukuk market that Morocco could look to would be primarily the USD market as very few Euro-denominated sukuk have been issued, and the latest issuance from Luxembourg received relatively weak demand compared to other debut sovereign issuances issuing around the same time. The weak demand in that sukuk could be due to the low yield (0.436%), or the use of Euro which introduces currency risk to GCC issuers whose currencies are linked to USD. The intention of BCME Bank to grow through a joint venture with a Middle Eastern Islamic bank may also increase its preference towards USD issuance since that bank may try to build its presence in Morocco by arranging a sovereign sukuk, if one is issued.

EGYPT AND LIBYA

The remaining two countries in North Africa with sukuk plans – Egypt and Libya – are less likely than either Morocco or Tunisia to issue sukuk, but for different reasons. Libya has seen significant instability and civil war with the country currently having two rival governments and making an international bond or sukuk unlikely.

Egypt, in contrast, has become more stable following the overthrow of President Mursi in 2013 which has led to a shift in support from Qatar to Saudi Arabia and the UAE. One consequence of the political shift in Egypt has been the perception that a sovereign sukuk is nearly out of the question. However, despite this perception, the Egyptian Financial Services Authority (EFSA) chairman Sherif Samy is focusing on developing a bond trading market to repair the capital markets.

EFSA chairman Samy told Reuters in late October that the EFSA was sending 20 amendments to the financial markets law covering sukuk to replace the law passed under Mursi's government. The law would not refer to sukuk as 'Islamic' but would allow their sale and require a Shariah board's approval prior to their sale.

Samy's comments did not specify whether the law would cover corporate or sovereign issuance, but the development of corporate sukuk market would be helped greatly by a sovereign benchmark. The sovereign issuance could be supported by both official and non-official investors from Saudi Arabia and the UAE and could be issued as a tranche within the planned $1.5 billion international issuance under consideration now.

The last six months have been big in terms of new debut sukuk issuance and the issuance has come from countries without large Muslim populations, showing that sukuk can be used as a part of a country's overall debt management programme. Based on this realisation, it would seem intuitive that other countries, even those like Egypt that may be hostile to the idea of 'Islamic' bonds would benefit from incorporating sukuk in their issuance plans. However, it is countries with more focus on developing their Islamic banking markets like Morocco and Tunisia where a more imminent issuance is likely.

	Issuer Name	Sukuk Name	Country	Currency	Issue Size (MM)	Tenor
Multilateral	International Finance Facility for Immunization	IFFIm Sukuk	United States	USD	500	na
Announced Sovereign Announced	Central Bank of Oman	Oman Sukuk	Oman	OMR	200	na
	Ministry of Finance - Egypt	Egypt Sovereign Sukuk	Egypt	USD	2,000	3 to 5 Years
	Central Bank of Yemen	Yemen Salam Sukuk II	Yemen	YER	50,000	3 to 5 Years
	Government of Pakistan	Pakistan International Sukuk II	Pakistan	USD	na	na
	Bank Indonesia	Indonesia Short Term Sukuk	Indonesia	IDR	na	na
	Jordanian Government	Jordan Sovereign Sukuk	Jordan	JOD	na	na
	Government of Philippines	Philippine Government Sukuk	Philippines	PHP	na	na
	Banque Centrale de Tunisie	Tunisia Sovereign Sukuk	Tunisia	USD	na	na
Rumoured	Central Bank of Libya	Libya Sovereign Sukuk	Libya	USD	na	na
	Government of Morocco	Morocco Sovereign Sukuk	Morocco	na	na	na
	Ministry of Finance - Saudi Arabia	Saudi Taif Airport Sukuk	Saudi Arabia	SAR	na	na
	Ras Al Khaimah	RAK Capital Sukuk	UAE	UAE	na	na
Quasi-Sovereign Announced	Gulf Sukuk I Company	GIB IMTN Sukuk	Bahrain	MYR	na	na
	Industrial Bank of Korea (IBK)	Industrial Bank of Korea Sukuk	South Korea	MYR	na	na
	Dana Infra Nasional Bhd	Dana Infra Retail Sukuk(Tranche 3)	Malaysia	MYR	100	na
	DIFC Investments LLC	DIFC Investment Sukuk	UAE	USD	700	na
	Bank Muamalat Malaysia Berhad	Bank Muamalat Senior Sukuk	Malaysia	MYR	2,000	na
	Islamic Bank of Thailand	Islamic Bank of Thailand Sukuk	Thailand	THB	5,000	5 Years
Rumoured	Japan Bank for International Cooperation	Japan Bank for International Cooperation Sukuk	Japan	MYR	na	na
	Kuwait Airways Corporation K.S.C.	Kuwait Airways Sukuk	Kuwait	KWD	na	na

na = not available Source: Zawya Islamic Sukuk Monitor and Thomson Reuters IFG analysis

REUTERS/Olivia Harris

Chapter Six

Sukuk Survey Methodology

Survey Methodology

POPULATION AND SAMPLING

Sukuk Forecast and Perceptions Survey 2015 consists of three separate samples: lead arrangers/issuers, investors/traders, and other key market players such as central banks, regulators, legal advisors, and credit rating agencies.

LEAD ARRANGERS

In collating the population of lead arrangers, level of activity in the sukuk market was the major consideration. A total population of 70 lead arrangers was targeted based on the sukuk league table by Zawya Sukuk Monitor, in addition to Thomson Reuters data.

The 70 arrangers were chosen as a target population to represent not only the regular arrangers who usually arrange five to seven international sukuk per year, but also to represent a wider range of arrangers that are continuously involved in arranging local currency issuances. This ensures a more representative sample. With a minimum sample size of 35 the margin of error of (±12) would be achieved. The final number of respondents exceeded this required minimum representative sample.

INVESTORS

In determining the target population of investors their level of activity was considered. We chose investors across the full spectrum of sectors, with activity in sukuk investment within the last two years.

A target population of 300 investment firms and investor representatives was extracted from Zawya Sukuk Monitor. With a minimum sample size of 100 the margin of error of (±8) would be achieved. The final number of respondents exceeded this required minimum representative sample.

OTHER KEY MARKET PLAYERS

In collecting the population of other key market players, level of involvement in the sukuk market was considered whether as regulators, legal and Shariah advisors or credit rating agencies.

A target population of 120 other key market players was extracted from Zawya Sukuk Monitor. With a minimum sample size of 50 the margin of error of (±10) would be achieved. The final number of respondents exceeded this required minimum representative sample.

Returned responses for arrangers, investors and other key market players include data that some would consider to be proprietary information related to the objectives of the institutions represented by respondents. The survey has also elicited responses that reveal methods of analysis and perceptions of sukuk characteristics that are expected to influence demand and supply in the market.

The response rates for both lead arrangers/issuers, investors/traders and other key market players are sufficiently significant for this exercise. We believe that the respondents' perceptions and forecasts about sukuk have provided an indicative and representative cross sample of the sukuk industry as a whole.

DATA COLLECTION AND SURVEY PERIOD

The participants were first contacted via telephone to request their participation in the survey prior to sending invitations via email. Email invitations for the survey were sent on Jun 12, 2014 and reminders were sent to non-respondents on Jul 10, 2014. The survey was closed at 1600 GMT on Aug 18, 2014.

SURVEY QUESTIONS

Three types of questions were presented to the target population – multiple choice questions, ranking questions, and open-ended questions.

For ranking questions, the data was analysed such that eight points were awarded to the first choice, seven points to the second, six points to the third and so on. The weighted average results are represented in the charts.

Ex-post analysis

RESPONSE STATISTICS

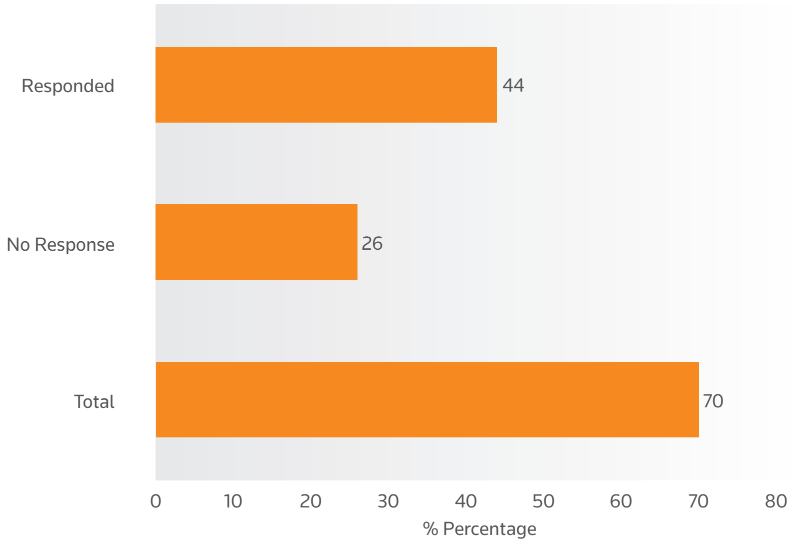
SELL SIDE

The arranger population of 70 was comprised of international banks, local banks, and asset management firms. A total of 44 responses were received, with 26 non-respondents. This results in a total participation rate of 63%.

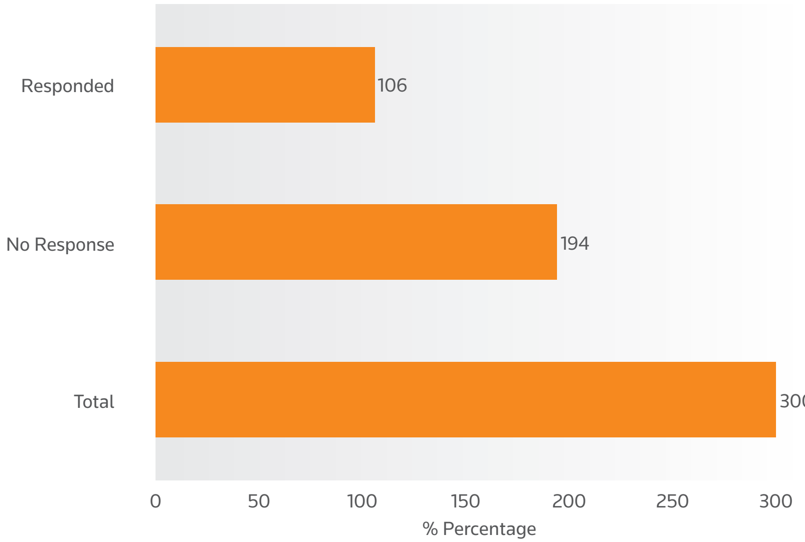
BUY SIDE

The investor population of 300 comprised international and local investors/investor representatives. A total of 106 responses were received, with 194 non-respondents. This results in a total participation of 35.3%.

SELL SIDE: LEAD ARRANGERS ALLOCATION AND RESPONSE



BUY SIDE: INVESTORS ALLOCATION AND RESPONSE

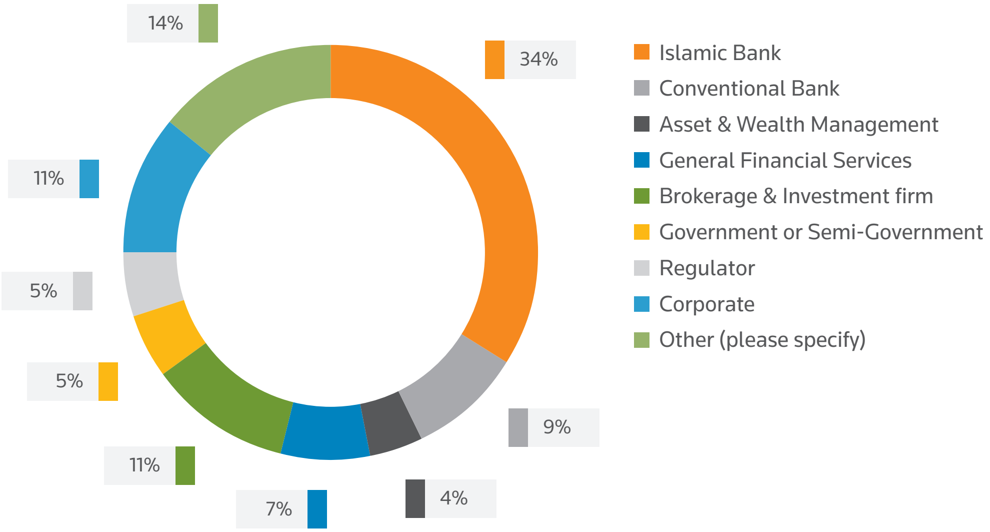


Sector Distribution

SELL SIDE

By sector distribution, Islamic banks take the lead on 34%, followed by brokerage and investment firms and corporates, each on 11%.

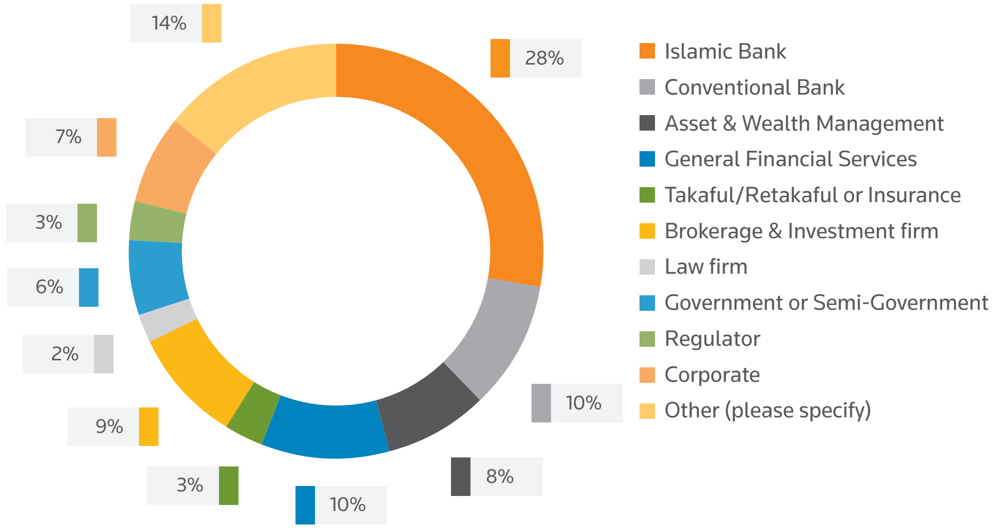
SELL SIDE: BY SECTOR



BUY SIDE

On the buy side, demand for sukuk is represented by a broad range of sectors and segments, with banking ranking highest at 28%, followed by conventional banks and general financial services at 10% each.

BUY SIDE: BY SECTOR

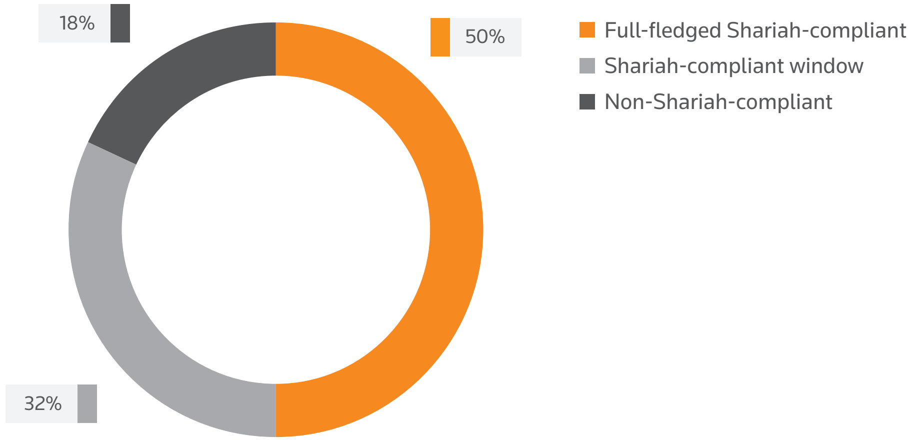


Type of Institutions

SELL SIDE

50% of the lead arrangers are from full-fledged Shariah-compliant financial institutions, followed by 32% from Shariah-compliant windows and 18% from non-Shariah-compliant institutions.

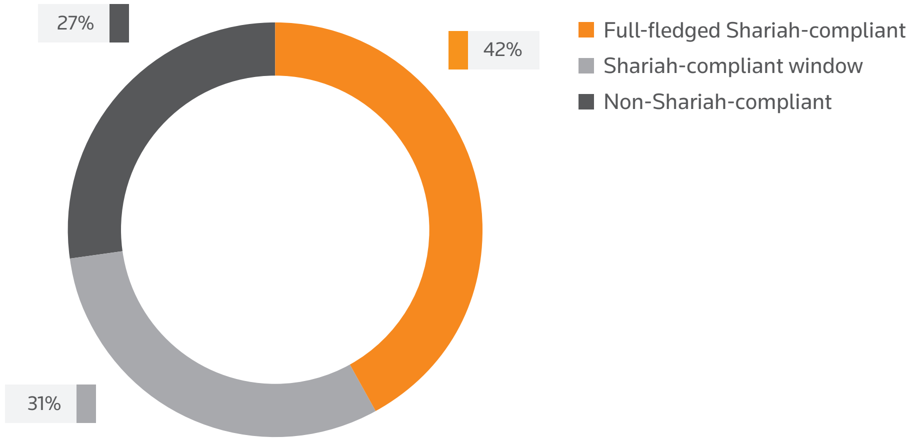
SELL SIDE: TYPE OF INSTITUTION



BUY SIDE

Similarly, the majority of responses of investors came from full-fledged Shariah-compliant institutions at 42% followed by 31% from Shariah-compliant windows and 27% from non-Shariah-compliant institutions.

BUY SIDE: TYPE OF INSTITUTION




REUTERS

Chapter Seven

Appendices

Top Sukuk Pipeline 2014-2015

Sukuk Name	Country	Structure	Amount (MM)	Status	Leads
Saudi Arabian Airlines Sukuk	Saudi Arabia	Unknown	-	Rumoured	-
Etisalat International Sukuk	UAE	Unknown	-	Announced	-
Oman Sukuk	Oman	Unknown	519.494	Announced	-
Egypt Sovereign Sukuk	Egypt	Musharaka	2000	Announced	National Bank of Egypt
Kingdom Holding Company Sukuk	Saudi Arabia	Unknown	-	Announced	-
SABIC Sukuk IV	Saudi Arabia	Unknown	-	Announced	-
Industrial Bank of Korea Sukuk	South Korea	Unknown	-	Announced	-
GIB IMTN Sukuk	Bahrain	Wakala	-	Announced	CIMB Investment Bank Berhad - Standard Chartered Bank
					Standard Chartered Bank
Asian Development Bank MTN Sukuk	Philippines	Unknown	-	Rumoured	-
Acwa Power Sukuk	Saudi Arabia	Unknown	800	Announced	-
Putrajaya Management Sukuk	Malaysia	Wakala	-	Announced	-
Flydubai Sukuk	UAE	Unknown	-	Announced	Crédit Agricole Corporate and Investment Bank - Dubai Islamic Bank PJSC - Emirates NBD Capital Limited - HSBC Bank Middle East Limited - National Bank of Abu Dhabi PJSC - Noor Bank - Standard Chartered Bank
Dana Infra Retail Sukuk(Tranche 3)	Malaysia	Unknown	30.567	Announced	"Aminvestment Bank Group - CIMB Investment Bank Berhad - Maybank Investment Bank Berhad - RHB Islamic Bank
DIFC Investment Sukuk	UAE	Unknown	700	Announced	"
Advanced Petrochemical Sukuk	Saudi Arabia	Unknown	-	Announced	-
Turkiye Finans Varlik MYR Sukuk(IMTN 2)	Turkey	Murabaha	-	Announced	HSBC Bank Middle East Limited - Riyad Capital

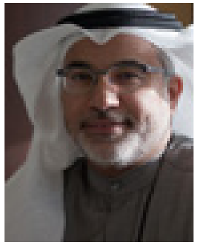
Source: Zawya Islamic Sukuk Monitor and Thomson Reuters IFG analysis http://zawya.com/sukuk/

International Lead Arranger League Table
(Ytd Q3, 2014) – Intl Islamic Finance Debt

Book Runner – Equal to Each Book Runner (Ex. Related to ECM Issuer) Sector: Issue/Announcement Date 1/1/2014 - 6/10/2014	Proceeds Amount + Overallotment Sold This Market (US$ Mil)	Rank	Market Share	Number of Issues
HSBC Holdings PLC	2,925.3	1	18.6	15
Standard Chartered PLC	2,005.9	2	12.8	13
Emirates NBD PJSC	1,220.4	3	7.8	10
National Bank of Abu Dhabi	1,194.1	4	7.6	9
CIMB Group Sdn Bhd	1,122.1	5	7.1	6
Banque Saudi Fransi	600.0	6	3.8	1
Citi	599.5	7	3.8	6
Natl Comml Bank Saudi Arabia	594.4	8	3.8	3
JP Morgan	511.1	9	3.3	2
GIB Capital	500.0	10	3.2	2
First Gulf Bank	429.2	11	2.7	3
BNP Paribas SA	368.0	12	2.3	3
Natixis	354.2	13	2.3	2
Deutsche Bank	334.5	14	2.1	3
Dubai Islamic Bank PJSC	307.9	15	2.0	3
QInvest LLC	295.8	16	1.9	3
Abu Dhabi Islamic Bank (ADIB)	251.2	17	1.6	3
Kuwait Finance House	250.0	18	1.6	2
Malayan Banking Bhd	241.7	19	1.5	2
Al Hilal Islamic Bank	233.3	20	1.5	3
National Bank of Sharjah	187.5	21*	1.2	1
RHB	187.5	21*	1.2	1
Commerzbank AG	187.5	21*	1.2	1
Standard Bank Group Ltd	166.7	24	1.1	1
Barclays	92.9	25	.6	1
Subtotal with Book Runner	15,707.5	-	100.0	22
Subtotal without Book Runner	.0	-	.0	0
Industry Total	15,707.5	0	100.0	22

Source: Thomson Reuters Date: 06/10/2014

Sukuk Debate Participants



ISSAM Z. AL TAWARI

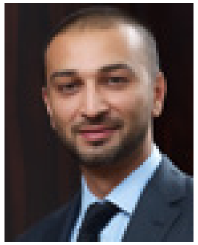
Chairman & Managing Director – Rasameel Structured Finance Company

Issam Al Tawari is currently the Chairman and Managing Director of Rasameel Structured Finance company a Capital Markets focused investment company supervised by the Central Bank of Kuwait, and Chairman of Rasameel Investment Bank, a Dubai-based, DIFC regulated bank. He started his career with Arab Banking Corporation (ABC), Bahrain, working in the area of loans, syndication and Corporate Finance issues with ABC Islamic Bank to become Associate Director with main responsibility over syndication and marketing. He joined The International Investor, Kuwait, in 1998 at the Structured Finance area working on Project Finance, asset-backed leases and broad range of Islamic investment products. His last position with TII was the Chief Operating Officer ("COO") and a Partner with the structured Finance Group. He served on the board of directors of a number of companies and funds. He was also the ex- Chairman of Ain Takaful Insurance company , Kuwait and ex-chairman of Binaá & Namaá (Sorooh) Investment company, Kuwait, specialised in financing B.O.T. projects and co founder of Ritaj Investment Company . He is a member of Young Arab Leaders ("YAL") and the Kuwaiti Economics Societies. In addition he is both a Harvard University and Henley Management College Alumi and received his MBA from University of Hull (Dist.), England in 1998 and his B.A. in Economics and Business Administration from Kuwait University in 1987.

MOHIEDDINE KRONFOL

Chief Investment Officer – Global Sukuk and MENA Fixed Income – Franklin Templeton Investments (ME) – Dubai, United Arab Emirates

Mohieddine (Dino) Kronfol is a chief investment officer of Global Sukuk and MENA fixed income at Franklin Templeton Investments. He is one of the founding partners and board member of Franklin Templeton Investments (ME), formerly Algebra Capital, and has been with the firm since its inception in 2006. Mr. Kronfol is responsible for the investment process, research and performance of the Global Sukuk and MENA Fixed Income teams. In addition, he manages two funds: the Franklin Templeton GCC Bond Fund and the Franklin Templeton Global Sukuk Fund. He is also a member of Franklin Templeton's Fixed Income Policy Committee Research and Local Asset Management teams. Mr. Kronfol was previously the Head of SHUAA Capital's Debt Asset Management where he launched and managed the first funds to focus exclusively on MENA debt. Prior to that, Mr. Kronfol was the Head of Capital Markets at SHUAA where he managed investments in global FX, commodity, interest rate and equity markets. Earlier, Mr. Kronfol was a senior associate responsible for fixed income at MECG, one of the MENA region's first pan-Arab investment banks. Mr. Kronfol holds a bachelor's degree in business administration and an M.B.A. from the American University of Beirut.



USMAN ALI AHMED

Head of Fixed Income – Emirates NBD Asset Management

Usman Ahmed is the Head of Fixed Income at Emirates NBD Asset Management, responsible for the management of the fixed income funds and portfolios, together with overseeing the research activities of the investment team. He is responsible for running multiple strategies including absolute return global emerging market, MENA and global sukuk. The funds under his management cover both the conventional and Shariah-compliant space, and under his guidance, the flagship funds have been awarded an S&P Silver grading. Prior to joining Emirates NBD Asset Management in May 2010, Ahmed was a Director at Mashreq Capital in the UAE, where his team managed $3 billion of fixed income portfolios. In that role he was responsible for the bank's liquidity book and Fixed Income Proprietary trading book, which included a $200 million long/short credit book. He also co-managed three public funds, which delivered strong returns under his management. Prior to joining Mashreq Capital, Ahmed spent seven years at TCH Asset Management (USA) where he oversaw over $7 billion under management. He started his career as a Credit Analyst, and has since served in the capacity of both Senior Portfolio Manager and Director of Research. Ahmed received his MBA from the University of Miami in 1999 and is a CFA Charter holder.

AHSAN ALI

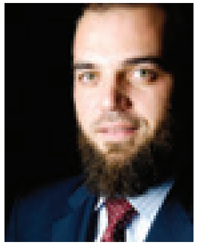
Managing Director & Head of Islamic Origination – Standard Chartered Bank (SCB) Saadiq

Ahsan Ali is responsible for the global Islamic origination business at Standard Chartered Bank (SCB) Saadiq, which comprises all the Islamic structured transactions (including sukuk, syndications, project and export finance, shipping and aviation, structured trade finance, corporate advisory and financial markets). Since joining SCB in March 2004, Ahsan has built this business from inception and has led several award-winning and industry-defining deals. Ahsan has over 21 years of experience in corporate and investment banking. Prior to joining SCB, he worked with Citigroup in Dubai. Ahsan holds an MBA from the Indian Institute of Management, Calcutta and a degree in mechanical engineering from Indian Institute of Technology, Delhi, in addition to a CFA designation.

ALI MARSHAD

Portfolio Manager – SICO Investment Bank

Ali Marshad is a Portfolio Manager and has 9 years of industry experience. In his current role, Ali is responsible for covering the regional fixed income market. He joined SICO in 2008 and previously worked as an Analyst in the United Kingdom for Mercer Investment Consulting. Prior to that he worked as a performance Analyst for UBS Global Asset Management London.



LILIAN LE FALHER

Executive Manager – Head of Treasury, Financial Institutions and Capital Markets – Kuwait Finance House, Bahrain

Lilian has more than 17 years' experience of Investment Banking. He is an Executive Manager of Kuwait Finance House, Bahrain, heading Treasury, Financial Institutions and Capital Markets. He also served on the Board of LMH, a 100% subsidiary of Kuwait Finance House, that focuses on the primary and secondary sukuk market for KFH Group. As representative of KFH, he is a board member of the International Islamic Financial Market and the vice-chairman of its Executive Committee. Prior to joining KFH in 2005, Lilian spent 8 years with BNP Paribas in Europe and the Middle East. He left BNPP as Head of Investment Products for the Middle East region, dealing extensively in Equity, Bonds and Structured Products. Lilian holds a Master in Management (Banking and Finance) from Toulouse Business School (France) and he is a CFA Charter holder.

HUSSAIN ABDULHAQ

CFA – Head of Treasury & Financial Markets – Al Salam Bank (Bahrain)

Hussain has been an Islamic Banking practitioner for more than 12 years with a dedicated experience in Treasury and Capital market products. He started his career in Kuwait Finance House (Bahrain) as a supervisor of the dealing room where he was involved in establishing the full treasury set of products and services while establishing the external lines networks with most of the GCC FIs. He Joined Al Salam Bank (Bahrain) as head of The trading team in 2007 and was promoted to the Head of the Treasury and Capital market team in 2010 supervise the ALM, Trading, Sukuk, and FI activities. Hussain is accredited Instructor of Islamic Finance courses where he conducted courses and workshops in the same field in the MEAN and North Africa. He is a CFA holder and MBA graduate with distinction.

Sukuk Glossary

(Bay') al 'ajil bil ajil – Sale with delayed delivery or payment
A type of sale in which the sale price is paid immediately and delivery of the sale item is delayed, or one in which the sale price is deferred and the sale item is delivered immediately. Synonym: bay' al salam, murabaha.

Ijarah – Lease, rent or wage
The sale of a defined usufruct of any asset in exchange for defined compensation. In the context of Islamic finance, it refers to an arrangement under which one party leases equipment, buildings or other facilities to a client for an agreed rent. Synonym: isti'jar.

Istisna – Manufacturing contract
A type of sale, similar to salam, in which the price is paid to the manufacturer by the purchaser for specified goods that are subsequently manufactured and delivered on a stipulated date.

Mudarabah – Investment management partnership
A form of partnership where one party provides the funds while the other provides expertise and management. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne by the provider(s) of the capital. Synonym: qirad. Murabahah – Full disclosure trust sale; also, Mark-up/Cost plus sale

Originally a term describing a sale in which the seller sells his merchandise for more than the price at which he acquired it. The term is used in contemporary Islamic finance to describe a financing scheme in which a financial institution, usually a bank, agrees to purchase merchandise for a client provided that the client promises to purchase it from the financial institution at an agreed mark-up.

Musharakah – Investment partnership
A standard Islamic transaction in which two or more parties enter into any one of several related types of partnerships (see mudaraba, musaqa, muzara'a). In a typical musharaka agreement, two or more parties agree to provide capital (ra's mal) towards the financing of a commercial venture, share profits according to a stipulated ratio and share losses on the basis of equity participation.

Bay' as Salam – Deferred delivery sale
The sale of fungible goods to be delivered in the future for a price to be paid in the present. Synonym: salaf, bay' 'ajil bil ajil.

Shariah law
Islamic law, originating from the Qu'ran, as defined by practices and explanations rendered by the Prophet Muhammad (pbuh) and ijtihad of 'ulama (personal efforts by qualified sharia scholars to determine the true ruling of the divine law in a subject matter).

Sukuk – Islamic Bond
A term used in contemporary Islamic finance to describe financial certificate equivalents to conventional debt issuances such as bonds. However, unlike debt issuances, sukuk holders are the legal and/or beneficial owners of the underlying assets, and as such, receive the equivalent of a coupon from the performance of the yielding asset.

Wakalah – Agency
A standard Islamic practice, often used in financial transactions, wherein one party acts as an agent (wakil) for another party.

Sukuk Study Authors

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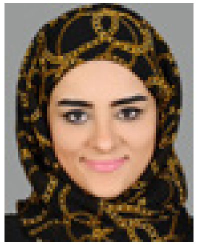

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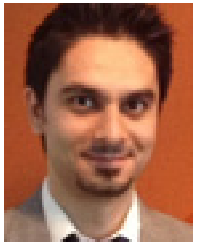

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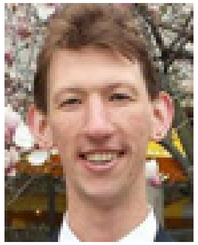

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IFG Community Leader
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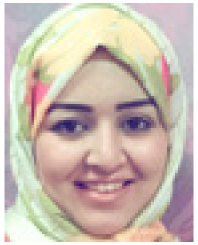

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Notes

Notes

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