

# Islamic & Ethical Finance

## Sukuks: An emerging asset class



*Ibrahim Mardam-Bey, CEO, Siraj Capital Ltd*

Sukuk is emerging as the catalyst that will put Islamic Finance on the global financial-instruments map.

Ibrahim Mardam-Bey began his presentation with a definition of Sukuk: they are certificates of equal value that represent undivided shares, which comply with the Sharia law and its investment principles, which prohibit the charging, or paying of interest. 'This is a broad definition', he said, 'because Sukuks are a new financial instrument still in evolution. They invite out-of-the-box thinking'.

They have many advantages, he said. As marketable securities, Sukuks are 'liquid, easily transferable, and tradable'. They are also 'rateable'. In addition, they are 'easily credit-enhanced', that is, they can be structured to achieve targeted rates of return. Finally, they are versatile, because they can: 1) be issued in different legal and fiscal domains, such as under Cayman Island regime or Delaware in the U.S.; 2) have fixed or variable income rates; 3) be compatible with U.S. regulations; and 4) be competitively priced against bonds.

In contrast to bonds, Mardam-Bey continued, the Sukuk are not debts, but

monetised assets. Thus, 'they are Sharia-compatible because they are not making money on money'. There are certain asset-related expenses associated with them.

Over the last 7 years, he said, the Sukuk market had grown nearly 10 fold. In 2000, the Sukuk market reached \$US 336 million. In 2006, this had risen to \$US 27.4 billion. The leading country in which they were issued is Malaysia (140 issues), followed by Bahrain (20 issues); United Arab Emirates and other Gulf states follow closely behind. Most Sukuk issues are corporate, Mardam-Bey noted, but sovereign issues are growing in importance. In the future, he predicted, short-term issues will be made.

'During the last year', he said, 'a number of challenges have been more or less resolved'. While Sukuk issues are limited in number, their success appears to ensure that there will be many more opportunities to purchase them in the future. With the advent of shorter-term Sukuks as well as international sales, the buy-and-hold strategy of investors is diminishing: 'alternative financial instruments are becoming available', he explained.

Furthermore, Mardam-Bey believes that the lack of harmonization is also a diminishing problem. Currently, he said, 'there are many efforts, to reduce the conflicts between interpretations of Sharia law, regional variations in regulations and their implementation, and legal regimes'. Documentation and legal due diligence have improved and become more uniform, he said.

Finally, with training and scholarships, efforts are underway to increase the

number of qualified personnel in the industry.

### **The East Cameron Experience**

Mardam-Bey related his experience with the first Sukuk issue in the U.S., which he managed. Because it was a new financial instrument for the U.S., there were many challenges, he said. First, they had to gain approval to issue them in that jurisdiction, which created a number of legal hoops to jump through.

Second, to resolve certain fiscal questions, such as the level of debt exposure the issue would entail, he had to get an opinion from the Internal Revenue Service of the U.S. Department of Treasury.

Third, he had to get it rated by Standard & Poor's.

Fourth, there were significant marketing issues. Not only did Hurricane Katrina destroy the off-shore oil platform that was serving as the 'asset' in the transaction, which he assured didn't matter, but there was a lack of understanding about both the Sukuk itself and Sharia law. According to Mardam-Bey, 'lots of people asked us, 'who are you to sell to us'? So we had a lot of explaining to do'.

The most important step to resolve these issues, he said, was the hiring of Merrill Lynch as book runner. 'That opened the doors we wanted open', he explained. 'The majority of investors were New York-based hedge funds. They easily understood that Sukuks were asset-based and that the rates we were offering were good. They also wanted to learn about a novel financial

instrument, and the best way to do that was to buy'.

Mardam-Bey concluded by asking whether Sukuks were global. 'The answer', he said, 'is 'yes''. Already, he said, 'the concept of a Sharia security is understood in Japan, the U.S., and Europe as a fixed-income investment solution'. The spread also reacted to the current sub-prime crisis. 'I saw that

as good', he explained, 'because that meant Sukuks were part of the global family' of financial instruments.

In the future, he predicted, sovereign Sukuks would increase in number, though the majority would remain corporate. 'They will', he said, 'become the catalyst to put Islamic finance on the global markets map'.