

EMERGING ROLE FOR SUKUK IN THE CAPITAL MARKET

Dr. Ahamed Lebbe Abdul Rauf
Assistant Professor
College of Business Administration
The Kingdom University, Bahrain
Email: raufhhz@yahoo.co.uk ; a.abdulrauf@ku.edu.bh

ABSTRACT

This study focuses on a broader view and understanding with regards to the development of Sukuk worldwide and also provides useful feedback on the subject to those who have interest in the Sukuk market. For this purpose, the study covers the growing demand for Shari'ah compliant instruments in the Islamic countries as well as rest of the world as an alternative to conventional instruments. In the conventional financial system, the fixed income securities play a major role in raising capital and have a significant role in the world economy. These aspects are identified in an empirical investigation for used descriptive methodology. Issues emerged in the post crisis fund raising activities through bond offerings have again proven the important role played by Sukuk. In Islamic capital and money market, Sukuk is anticipated to play a similar role as the bond as it gives the industry the option to issue an instrument with a fixed rate of return profile; while Sukuk structuring also takes into account the removal of non- Shari'ah compliant features such as Gharar (uncertainty), Riba (interest) and Maisir (Gambling). This study could be used as a framework for further research and assessment in the area of Sukuk.

Keywords: Shari'ah, Sukuk, Gharar (uncertainty), Riba (interest) and Maisir (Gambling)

INTRODUCTION

Sukuk instrument in Islamic finance is very similar to bond market in the conventional finance. Both are issued to raise capital for long term investment. The bond market has been there for centuries in the conventional financial system. It is a well-established, and is globally applicable because of its predictable nature of return. It is very comfortable for investors to deal with the conventional bond. On the other hand, Islamic bond- the Sukuk is Shari'ah compliant, which means there is no uncertainty (Garar), interest (Riba) and gambling (Maisir). It is also new to the financial market. Very few countries are promoting, and most part of the Islamic finance is still un-institutionalized, so does the Sukuk market.

Despite its inherent weaknesses, Sukuk market has become not only the backbone of the Islamic finance but also the faster of growing aspect in the global financial market in general. In the aftermath of the global financial crisis, the conventional financial system was exposed of the loophole in its so called strengths. The conventional finance is known for its guaranteed rate of return for investment. However, not only conventional financial institutions but even countries with conventional financial system slide into deep crisis.

The aim of this research paper is to understand the broader view of the development in the Sukuk market worldwide, and to provide useful information to those who have aspired for alternative to conventional bond market. For this purpose, an empirical investigation for used descriptive methodology has been applied in this research paper. Data and information were gathered from various authentic publications, interviews and discussions with professionals and experts in the subject.

EMPIRICAL EVIDENCE

The International Financial Service London (IFSL 2009) in recent report pointed out the UK offering of Islamic financial services that includes 22 banks, which is more than any other western countries. An accumulative total of 18 Sukuk issuance, raising US\$ 10 Billion have been listed on the London Stock Exchange, second only to Dubai.

Yves Mersch (2009) says that Luxembourg is another western country that has a positive approach towards Islamic finance. In the late 70s Islamic Banking System Holding Limited Luxembourg was established. In 1982 a life insurance company Takafol SA was established. According to recent statistics, there are 15 Sukuk issuances listed in Luxembourg for a combine value of Euro 5 billion. There are 40 funds managed and promoted by leading global investment companies.

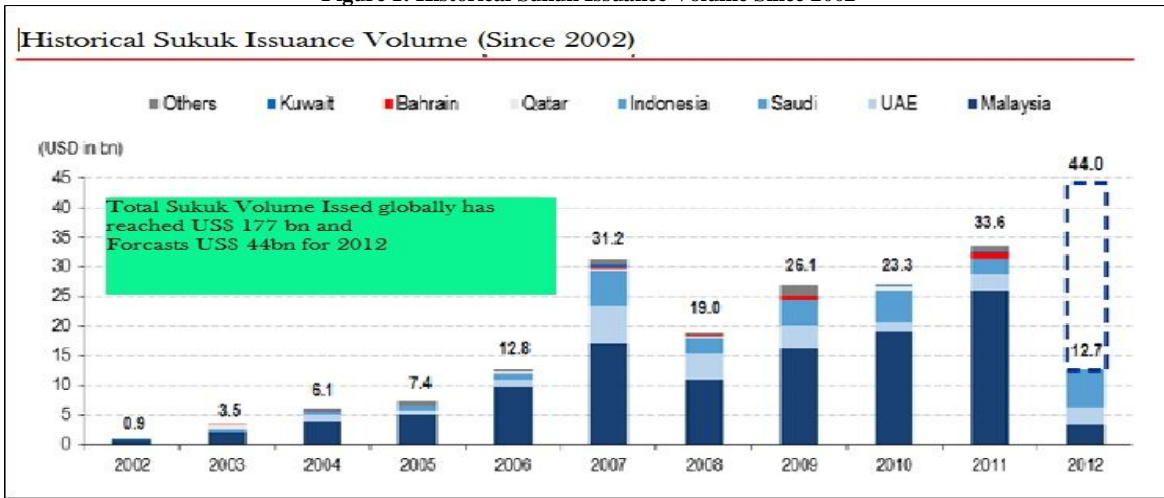
Other western countries France, Irish Republic, United States of America have also opened up their financial market for Sukuk issuance. In the Middle East, Sukuk issuance is nearly 60% while its 30% in Asian countries such as Malaysia, Indonesia, Hong Kong, Singapore and China. The rest 10% is issued in the rest of the world.

Nasir Saidi (2009) reports that an important milestone in the growing globalization of Islamic finance and particularly in the Sukuk market is the International Financial Corporation (IFC) Sukuk. The IFC Hilal Sukuk was AAA rated Dollar denominated five year US\$ 100 million issue. The issuance of IFC Sukuk confirms the recognition of Shari'ah compliant finance and securities by the World Bank.

DATA PRESENTATION AND ANALYSIS

This part of the research is dedicated for examining in depth the historical and diverse growth of Sukuk market with reference to geographical region, jurisdiction and different types of Sukuk issuances.

Figure 1: Historical Sukuk Issuance Volume Since 2002

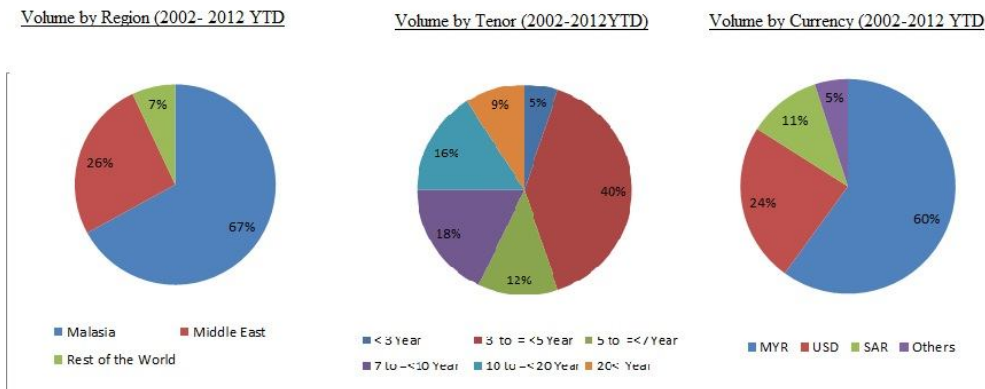


Source: HSBC Dealogic 29 April 2012

According to HSBC Amanah forecast (figure 1) the global Sukuk issuance for 2012 will be US\$ 44 billions, while the accumulated total of Sukuk issued globally since its introduction in 2001 has reached US\$ 177 billions. The largest issuance by early 2012 of around US\$ 6.6 billion was recorded in Malaysia and Saudi Arabia. In 2011, the Malaysian government issued Sukuk worth US\$ 9.6 billions, while the General Authority of Civil Aviation of Saudi Arabia issued US\$ 4 billions in 2012. There is a steady growth of Sukuk market from 2002-2007. Despite a fall in 2008, the growth continues up to date, reaching US \$ 30.6 billions in 2011.

The figures 2 and 3 below show the statistics on Sukuk issuance by region tenor and currency from 2009-2012.

Figure 2: Statistics on Sukuk issuance from 2009-2012.

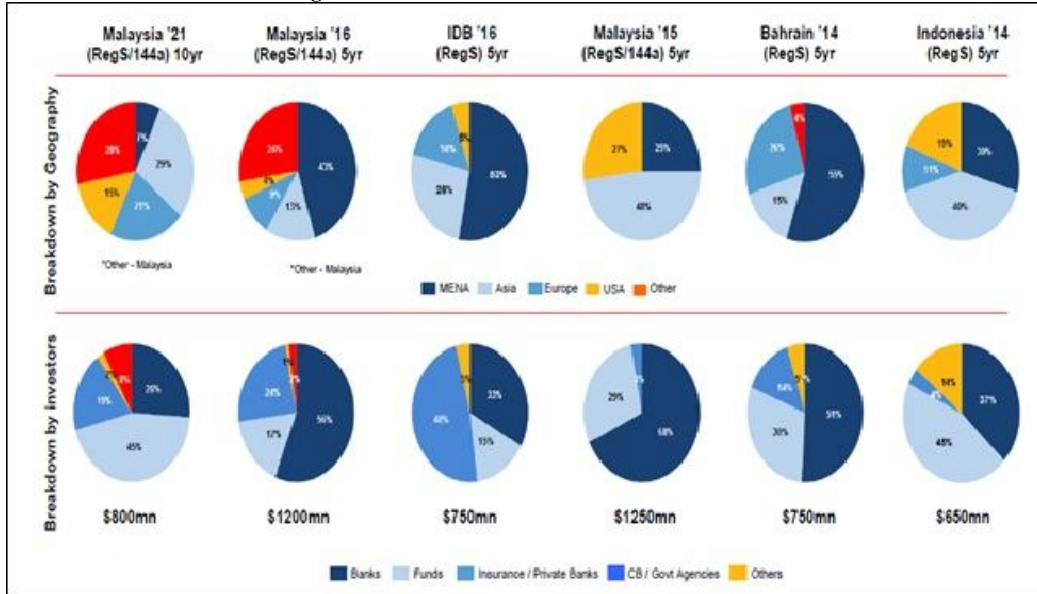


Source: HSBC Dealogic 29 April 2012

By region Malaysia recorded 67% of Sukuk issuance while 26% was issued in the Middle East and 7% in the rest of the world between 2009-2012. In terms of tenor 40% of issuance was for 3-5 year period. In terms of volume by currency of Sukuk issuance is dominated by Malaysian Ringgit the recorded 60%. Secondly 24% issuance was in US Dollars.

The Sukuk issue has witnessed diverse international participation, even though it is skewed towards the Middle East, Malaysia and Indonesia have attracted wider investor diversification. It is also worth mentioning the Islamic investor base is dominated by commercial banks. Moreover, commercial banks and government agencies are large players in SSA issuances.

Figure 3: Statistical information Sukuk Issuances



Source: HSBC Dealogic 29 April 2012

As mentioned earlier, the global Sukuk market for year ended December 2011 yielded strong results for investors and issuance alike. This achievement was despite the impact of the global financial crisis that affected the Islamic finance as well in 2008. The growth in the Sukuk issues over seven year period from 2005-2011 showed a similar trend between Malaysian market share and the global market performance.

Another reason for the fall of Sukuk issuance in 2008 was the results of Sheikh Thaqi Usmani's (2008) pronouncement that questioned the Shari'ah compliance of 85% of Sukuk issued in the Gulf along with the AAOIFI announcement issued in 2008 which forbidden some issuance that violate the principle of risk-reward sharing in the Sukuk structures, did not support also. After 2008 Malaysia continued to lead the market supported by its sufficient liquidity for domestic currency Sukuk, and its complete and clear regulatory framework. Meanwhile in the GCC countries there was a property bubble and incidents of defaults that contributed falling issues of Sukuk.

Figure 4: Malaysian Issuance Vs Global Issuance



Source: Bloomberg

Malaysia continued to control and plays a crucial role in Sukuk issuance. It has seen the biggest Sukuk issuance by a country. Malaysia has formed the National Economic Transformation Plan (NETP) that looks well ahead into the next decade.

In Malaysia, Am investment Bank contributed 40.9% of market share through its 7 issues worth RM 13,250 million while the second biggest contributor was the RHB Investment Bank with 23.4% of the market share followed by CIMB Investment Bank as at 31st December 2007 (see Table 1).

Table 1: Lead Manager's League Table for Sukuk Issues

(As at the 31 st December 2011)	Market Share (%)	Value (RM million)	No. of issues
AmInvestment Bank	40.9	13,250	7
RHB Investment Bank	23.4	7,575	2
CIMB Investment Bank	13.3	4,300	6
Bank Islam	7.7	2,500	2
Maybank Investment Bank	7.2	2,325	5
Royal Bank of Scotland	5.4	1,750	1
Affin Investment Bank	1.5	500	1
Bank Muamalat	0.6	200	1
TOTAL	100.0	32,400	25

Source :RAM

The list of new countries that shows interest in Islamic finance has been getting longer. Egypt had declared to open up Sukuk market by 2011. Jordan cabinet accepted the issuance of Sukuk already. On the other hand, Australia is working on its tax law to facilitate Islamic finance in order to attract more Sukuk. Philippine and Sri Lanka have also showed their intentions to enter the Sukuk. Nigeria announced its willingness to issue its first Sukuk within 2011. Similarly, Senegal, Russia, France, South Korea, Japan and Brazil have also shown interest in expansion of Sukuk market.

CONCLUSION

The Sukuk market is much younger to the conventional market yet, it has shown steady growth since 2001. It is not a product that is not completely free of any defect. It was subject to the performance of the international capital market as well as the weaknesses of the Islamic finance system itself. This was witnessed in 2008. What seemed to be the second phase of Sukuk market is from 2009-2011, period in which the role of the Sukuk market spread globally, especially to the financial centers of the west.

The major contributor to the growth of Sukuk market in terms of volume and values, and in terms of developing the financial framework come from Malaysia, while gulf countries have shown increasing interest in the Sukuk market. In terms of region South East Asia, GCC and rest of the world have been identified.

Based on the experience in the last ten years, it is evident that Sukuk will not only strengthen the Islamic finance but will also complement the conventional bond in a great way in the global capital market.

It emanates from the study that further researches have to be carried out on how to form a unified Shari'ah framework for the Sukuk market; find out the mechanism to prevent defaults; to explore the mechanism to convert the Sukuk market from being asset backed instrument to asset based one.

BIBLIOGRAPHY

- Ayub, M. (2007) Understanding Islamic Finance. Pondicherry, India: John Wiley & Sons Ltd.
- Blake Goud,(2009) a Brief Summary of the GE Capital Sukuk, *Sharing Risk dot Org*, December 10, 2009.
- David Oakley (2009) "Dubai Debacles Overshadows Growth" The Future of Islamic Finance *Financial Times Special Report*.
- Eddie Yue(2008), "Islamic finance - its potential to bring new economic growth to Hong Kong" Keynote address by Mr Eddie Yue, Deputy Chief Executive

- of the Hong Kong Monetary Authority, for the Hong Kong Islamic Finance Forum, Hong Kong SAR, pp. 1-4.
- Ernst & Young (2009) Islamic Funds & Investment Report, p. 72.
- Global Sukuk Market:(2012) Current Status & Growth Potential, Prepared for:
- Conference on the role of Sukuk in development, 18 May(2012), Islamic Financial Solutions.
 - IFIS Global Sukuk Market (H2-2010) Report, Islamic Finance Information Services.
 - Islamic Finance News (2012) Guide, February 2012.
- Islamic Wealth Management Report(2011), Sarasin.
- Iqbal, Z., & Mirakhor, A. (2007). An Introduction to Islamic Finance . Singapore:
- John Wiley & Sons Ltd.
- International Financial Services London, Islamic Finance(2009), IFSL
- RESEARCH, WWW.IFSL.ORG.UK, February 2009, p. 1 & CPI
 - Financial, "Islamic finance grows in London, rides out worst of crunch"
 - [www. CPI Financial.net](http://www.CPIFinancial.net).
- Muhammed, M. A.-B. (2012). Global Sukuk and Islamic Securitization Market.
- Boston: BRILL.
- Mushtak Parker,(2009) "France Introduces Tax Neutrality laws", *Arab News*,
- April 6, 2009.
- Mohammed Damak and Emanuel Volland,(2009) "Islamic finance in France: Paris Tries to Reduce the Gap with London" in *Islamic Finance Outlook 2009*,
- Standard & Poors, p. 55.
- Nasir Saidi "Islamic Finance is coming of Age: IFC lists Sukuk in the DIFC"
- *Zawya*, November 7, 2009.
- Sukuk Report 2nd Edition, A Comprehensive Study of the Global Sukuk Market,
- by International Islamic Financial Market.
- Thomas Molloy,(2009) "Islamic Banking System provides a unique opportunity in tough time", *Irish Independent*, www.independent.ie/business/irish,
- November 5, 2,009.
- Yves Mersch:(2009) "Islamic finance - partnerships opportunities between Luxembourg and the Arab countries" Speech by Mr Yves Mersch, Governor of the Central Bank of Luxembourg, at the 5th Economic Forum Belgium-Luxembourg-Arab Countries, Brussels, 17 November 2009, *BIS Review* 149/2009, pp. 1-4.
- <http://www.bond.my/Islamic%20Bonds/Istisna%20Sukuk.htm>
- <http://plc.practicallaw.com/2-501-9989>
- http://www.investorwords.com/1110/convertible_bond.html
- <http://www.investopedia.com/terms/c/convertiblebond.asp>
- <http://www.aaoifi.com/aaofii/TheOrganization/Overview/tabid/62/language/ar-BH/Default.aspx>
- <http://ifresource.com/2010/01/25/aaofii-standards-2010-edition-published/>
- <http://www.iifm.net/default.asp?action=article&id=126>
- <http://www.scribd.com/doc/19237054/Resolutions-of-the-Council-of-the-Islamic-Fiqh-Academy>
- Source: Bloomberg, IFIS, Zawya, KFHR.
- Source: In-house IIFM Sukuk issuance database