

# Sukuk in Afghanistan

Office of the Economic Advisor March 2017

able of Contents	Sections
Executive Summary	1
Overview of Sukuk Market worldwide	2
International Case Studies	3
Establishment of Sukuk in Afghanistan	4
Sukuk Framework	
Sukuk Legislation	
Economic Impact of Sukuk	
Recommendations	5
Annex	6

## EXECUTIVE SUMMARY

This presentation will summarize the Sukuk market both domestic & globally and its major components. The GoIRA has planning to launch Sukuk (Islamic Bonds) to (a) finance public expenditure, (b) bring idle cash into circulation, and (c) promote economic growth. In particular this memo will cover the following Sukuk issues: (1) a comprehensive study of Sukuk Market (2) establishment of Sukuk law in Afghanistan, (3) The major Sukuk types, and (4) Case studies of Sukuk management in Malaysia, Saudi Arabia, UAE, Jordan and UK Countries. At the end provide a set of recommendations to move forward with finalizing the legal and regulatory frameworks of Sukuk industry in Afghanistan.

Why do we use Sukuk? The fund raised from Sukuk could be utilized for but not limited to: (1) Budget financing, (2) projects financing, (3) Enhancement of Bank capital, and (4) infrastructure development. Both micro &macro-economic impact of introducing the Ijarah, Istisna and Murabaha Sukuk in Afghanistan. First: Microeconomic impact are the following: (1) Above three Sukuk types are amongst the financial instruments, (2) these securities are fixed-income and high liquidity in secondary market, (3) the more various the securities the more efficient they are. Second: Macroeconomic impact of these securities would be on consuming costs, government costs and investment, particularly these factors can attract domestic and international investors, Moreover the securities could be introduced as instrument of monetary policy.

In this section we will have an overview of the global Sukuk markets. According to the standard and poor approximately \$116.4B^ of Sukuks were issued by corporation's sovereign entities and government related entities in 2014. The Thomson study report\*, in 2015 the total global outstanding Sukuk was \$309.88, and the global Sukuk issued was \$65B, moreover the projected size of Sukuk issuance in 2021 is estimated at \$78.5B. Malaysian domestic Sukuk market is the world largest Sukuk market, the Malaysian domestic market is \$68B in size, whopping the 67% of the total global domestic Sukuk market and in excess of 50% of their entire global Sukuk market. The first international sovereign Sukuk were issued by the Government of Bahrain in September 2001, it was a \$100M Ijarah Sukuk with a fixed rate of 5.2% with 5 years maturity. In 2016, The Dow Jones Sukuk Index, which seeks to track U.S. dollar-denominated, investment-grade Sukuk, added 17 new Sukuk with a total par amount of \$13.5B into the index. Please see more detail in Overview of Sukuk market worldwide section of this presentation.

The challenges in the development of Sukuk market in Afghanistan are as following: (1) the investors and common people don't have enough information about this industry, (2) terms of Sukuk certificates (Government or private company should issue), and (3) lack of technical expertise in Sukuk productions in Afghanistan. After studying, the status of the Sukuk in Afghanistan as well as on international context, we provide the following recommendations: (1) Sukuk Law: MoF &DAB should work together to finalize the Sukuk law, (2) Getting financial support from IDB, IMF and world Bank, (3) lack of Public Awareness, MoF/DAB should work together to establish a strategy for public awareness, and (4) hiring Sukuk Expert: MoF/DAB could hire a technical expert through financial support of IDB, IMF, and World Bank, and these expertise should increase the capacity of Afghan professionals.

\* Thamson Reuters state of Global Islamic economy gateway Sukuk perception & forecast study report of 2017, ^ Latham& Watkins , The Sukuk Handbook, A Guide to structuring Sukuk, Page No: 3

Table of Contents	Sections
Executive Summary	1
Overview of Sukuk Market worldwide	2
International Case Studies	3
Establishment of Sukuk in Afghanistan	4
Sukuk Framework	
Sukuk Legislation	
Economic Impact of Sukuk	
Recommendations	5
Annex	6

### OVERVIEW OF SUKUK MARKET WORLDWIDE

In this section we are going to discuss the concept of Sukuk with experiences of different countries. Islamic securities or Sukuk are such certificates with a unique par value which after subscription implies the payment of par value to the issuer by the buyer and the holder of which is the owner of one or a pool of assets and their benefits. In addition, Sukuk is generally divided into two groups: First is Tradable Sukuk, such as Sukuk Al-Jarah, Musharakah and Mudarabah, second is Non-Tradable Sukuk for example Sukuk Salam and Sukuk Murabah. The Ijarah Sukuk concept is the most popular amongst issuers of global Islamic Securities.

In 2016, The Dow Jones Sukuk Index, which seeks to track U.S. dollar-denominated, investment-grade Sukuk, added 17 new Sukuk with a total par amount of \$13.5B into the index. Sovereign Sukuk continued to dominate the issuance, including \$2.5B from Indonesia, \$1.5B from Malaysia, \$1B from Turkey, and \$500M from Oman. The biggest corporate Sukuk issuances were \$1.5B from IDB Trust, \$1.2B from DP World, and \$1B from Emirates Islamic Bank. Among all the new issuances, 33% was from the United Arab Emirates. The detail is next slide Exhibit #2

According to the Thomson Reuters state of Global Islamic economy gateway Sukuk perception & forecast study report of 2017, in 2015 the total global outstanding Sukuk was \$309.8B, and the global Sukuk issued was \$65B, moreover the projected size of Sukuk issuances in 2021 will be \$78.5B. Malaysian domestic Sukuk market is the world largest Sukuk market, the Malaysian domestic market is \$68B in size, a whopping the 67% of the total global domestic Sukuk market and in excess of 50% of their entire global Sukuk market. The first international sovereign Sukuk were issued by the Government of Bahrain in September 2001, it was a \$100M Ijarah Sukuk with a fixed rate of 5.25% and 5 years maturity. According the standard and poor approximately \$116.4B of Sukuk were issues by corporation's sovereign entities and government related entities in 2014.

According to International Islamic Financial Market (IIFM) of 2016, The total volume of Global Sukuk outstanding from a country perspective, 93% is represented by just 5 countries , Malaysia 57% , Saudi Arabia 17% , UAE 10% , Indonesia 6% & Qatar 4%. Right behind them are Turkey 2% , Bahrain Hong Kong with 1% each. (Next Slide, Exhibit 1)

Base on above experience of different countries we are recommended that GoIRA could launch as domestic Murabaha and Ijarah. Moreover the Murabaha Sukuk are issued for short term maturities of three and six months and be used instead of state treasury bounds with short term maturities.

Asia continues to be the dominant player in the global Sukuk market. Looking at the overall country issuance in the Dow Jones Sukuk Index, show that the Indonesia 6% & Qatar 4%. Right behind them are Turkey 2% , Bahrain Turkey, at 10%. Hong Kong with 1% each.

In terms of region, Asia accounts for 74% of global Sukuk issuances since Gulf Cooperation Countries (GCC) remained the largest contributor, at 57%. For the inception of the market. Malaysia 57%, Saudi Arabia 17%, UAE 10%, non-GCC countries, the three biggest are Indonesia, at 15%, Malaysia, at 13%, and



Table of Contents	Sections
Executive Summary	1
Overview of Sukuk Market worldwide	2
International Case Studies	3
Establishment of Sukuk in Afghanistan	4
Sukuk Framework	
Sukuk Legislation	
Economic Impact of Sukuk	
Recommendations	5
	6

## INTERNATIONAL CASE STUDIES

Sukuk Management in across the world, the purposes of discussing Sukuk market experience of other countries for understanding Sukuk management. like in Saudi Arabia, The government issued \$4B Sukuk with 10 year maturity and its managed by ministry of finance. However Jordan issued \$34M Sukuk in local currency with five year maturity and 3.1% profit, The government of UK issued £2B, in order to attract investor, with five year maturity and 2.3% profit annually. Base on below international study, we recommend that MoF should issues the Al-Ijarah Sukuk certificates as experiment. The detail of Sukuk management is summarized in the following table.

Internati	nternational Case Studies	
Country	Sukuk Type	Conclusion
Malaysia	Sukuk Musharakah	In 1990 for the first time the Sukuk were issued by Shell MDS with \$33M, The world's first foreign owned non-Islamic company.
	Issued in Malaysia	Malaysia's existing Sukuk maturing in 2025 yield 3.5%, while securities due in 2045 are paying 3.9%, data compiled by Bloomberg show.
		In 2007 the Binariang GSM issued \$4.8B Sukuk with 20 tenor years. That is the largest ever Sukuk issuer in the world
Saudi Al-Ijarah Sukuk At 15B riyals, or \$4B, it was the largest		At 15B riyals, or \$4B, it was the largest Islamic bond, or Sukuk, ever issued within the kingdom.
Arabia		The 10-year Sukuk was sold in the domestic market, available only to Saudis
		The Sukuk, guaranteed by the Saudi Ministry of Finance
Dubai	Al-Ijarah Sukuk	In April 2014, Latham & Watkins advised the government of Dubai on the update of its \$5B trust certificate issuance program and the subsequent issues of \$750M Sukuk AI-Ijarah due 2029,
		The government first 15 years issuance and the longest tenor for a Sukuk issued by unrated issues to date. Dubai is the man issuer of Sukuk in GCC countries.
Jordan	Ijarah Sukuk	The SPV of Jordan is up to 2021, issue size is 34M, on local currency JOD, with 3.1% profit rate, for five year maturity from Oct-2016 to Oct-2021.
		The Sukuk management is arrange by Islamic Corporation for the development of the private sector
UK	sovereign Sukuk	Britain has become the first western country to issue an Islamic bond, attracting orders of more than £2B from global investors for its sale of sharia- compliant debt.
		The Sukuk is issued with 5 year maturity, and annually the will pay 2.3% profit
		Since the beginning of 2013, there have only been four triple-AAA rated Islamic bonds, three of which were issued by the Islamic development bank in Saudi Arabia, and one of which was issued for public sector finance in Malaysia.

able of Contents	Sections
Executive Summary	1
Overview of Sukuk Market worldwide	2
International Case Studies	3
Establishment of Sukuk in Afghanistan	4
Sukuk Framework	
Sukuk Legislation	
Economic Impact of Sukuk	
Recommendations	5
Annex	6

#### ESTABLISHMENT OF SUKUK MARKET IN AFGHANISTAN

Why do we need to launch a Sukuk Production in Afghanistan? Afghanistan Financial market growth has been driven by the high demand for the Shariah Compliant products. Islamic finance become a global phenomenon, in the recent years significant interest in Islamic finance has emerged in the world leading conventional financial centers including London, New York, Hong Kong, China and western financial institutions are increasingly considering investment and financing through Islamic products. The GoIRA has planning to launch Sukuk (Islamic Bonds) to (a) finance public expenditure, (b) bring idle cash into circulation, and (c) promote economic growth. For launching this production the MoF/DAB should establish the legal and regulatory framework for Sukuk industry in Afghanistan.

## Sukuk Framework

The legal framework for jurisdictions that envisage issuing sovereign Sukuk however should be carefully designed. To be effective, the legal framework will need to be drafted to ensure compliance with relevant Sharl'ah principles, while reflecting the features of Sukuk from a legal, accounting, and public debt management perspective. Moreover, the legal framework for sovereign Sukuk should also clarify their legal status and treatment for purposes of public debt and cash management.

Sukuk markets are seen as a source of long-term financing. To fully utilize the potential of Sukuk markets, policy makers urge to work for the development of domestic markets and access to international markets. In developing a domestic market, policy makers use a framework similar to a bond market. That is to develop: (a). a well-functioning money market (b). Well-functioning primary market (c). Market infrastructure (d) and an efficient legal and regulatory framework.

## Sukuk legislation

The adoption of Sukuk has faced legal and regulatory problems, every countries governed by their own legal independent system of Shariah board such as in Afghanistan Shariah Supervisory Council (ASSC). The first draft of Sukuk law was prepared by MoF in 1392 but since last three years no further action has been taken regarding the Sukuk law. The reason behind this issues is lack of Sukuk expert and unfamiliar of the relent government department with Sukuk industry. We recommended that GoIRA should hire a technical expert in Sukuk, in order to increase the capacity of MoF, DAB and MoJ employees. It is also mentionable that we could get the financial support from World Bank, IMF and Islamic development Bank.

## Current Sukuk Law (Afghanistan)

- · The first draft of law is consist of six chapters, (1) Definition and General provisions, (2) Purpose and governing scope, (3) Issuing Sukuk, (4) Afghanistan Shariah Supervisory Council, (5) The Sukuk instrument, and (6) Special Purpose Vehicle (SPV).
- 14 Articles, one Article on Definition and General provisions, 3 Article on propose and governing scope, 2 Article issuing Sukuk, 1 Afghanistan Shariah Supervisory Council, Sukuk Instrument, SPV

## More information regarding the following items should be added and finalized the law.

Recommendations for Finalizing the Sukuk Law

- Add one article regarding the permissibility of Sukuk out the Financial market, or information about the
- Sukuk trade should added Add one article about the violation of law. Add more articles regarding Special Purpose Vehicle,
- it should be exempted from registration fees, income tax, and sale tax. Add one article regarding specific Fatwa on Sukuk
- Productions in Afghanistan.

## Economic Impact of Sukuk

Introducing the Sukuk production in Afghanistan and its impact on Economic growth, All kinds of Sukuk are from amongst the beneficiary fixed income financial instruments, so they can cover the goals and preferences of a major group of the owners of excess funds willing to make a risk-free investment. All Sukuk but, specifically Ijarah, Murabaha, Musharaka Sukuk has both microeconomic and Macroeconomic impacts, which is going to discuss below.

#### Microeconomic study

In this section we are going summarized the microeconomic impact of major Sukuk productions. Sukuk is financial instrument for financing the public expenditure, bring idle cash into circulation and promote economic growth. The microeconomic studies of major Sukuk productions are the following: (1) All kind of Ijarah, Istisna and Murabaha Sukuk are amongst the financial instruments, (2) all these securities are fixed- income, (3) All these securities are in a high level of liquidity in secondary market and (4) The more the various the securities, the more efficient they are.

#### Macroeconomic study

These securities would have a great impact of macroeconomic variables, including consuming costs, government costs and investment and particularly these factors can attract domestic and international investors. The major impact of macroeconomic study are the following: (1) attract domestic and international investors, (2) these securities are as instruments of financial policy against budget deficit and would have inflation of less than borrowing from the central bank, (3) the rate of return of these securities would be close to the real rate of return, (4) Murabaha Sukuk could be designed for very short term maturities of three and six months and be used instead of state treasury bounds with short term maturities and (5) the central bank could make a great impact on the volume of liquidity by trading such securities. Moreover the securities could be introduced as instrument of monetary policy

### Economic Impact of Sukuk

Sukuk Model Microeconomic Macroeconomi Positive Impact of these securities on fiscal and monetary policies. Ijarah, Istisna, These securities are the financial instruments for individuals and firms Rate of return of these securities would be closer to real rate of return. Murabaha and Supply of capital for commercial and leasing companies. Musharaka Sukuk's High liquidity in secondary market Murabaha Sukuk is designed for short term maturities These securities are fixed-income For central bank it is as instrument of monetary policy.

Table of Contents	Sections
Executive Summary	1
Overview of Sukuk Market worldwide	2
International Case Studies	3
Establishment of Sukuk in Afghanistan	4
Sukuk Framework	
Sukuk Legislation	
Economic Impact of Sukuk	
Recommendations	5
	6

## RECOMMENDATIONS

After considering the findings and conclusions of this presentation, we are going to provided some recommendations for effort to successfully launch the Sukuk production in Afghanistan, where recommendations are the following: (1) The Sukuk law should be finalized and approved, (2) Haring a Sukuk Expert, (3) Increase the human capacity of MoF, DAB and MoJ, (4) Public awareness, (5) Issuing domestic Sukuk as experiment, and (6) Getting financial support from IDB, IMF, and WB. The below table will provide the detail of recommendations. Please see Annex regarding the current Sukuk law.

Management Finalize the Sukuk Law: MoF & DAB should work together to finalize the Sukuk law. Then, the law should be sent to MoJ for further legal actions, and MoJ shall share their comments on the Sukuk law if they have, finally it will be forward to the parliament for discussion and approval.

## Increase the human capacity: GoIRA should organize the trainings to employees of MoF, MoJ and DAB to develop the technical skills to analyze and comments on the Sukuk law.

Operation

Public awareness : One of the biggest challenges regarding Sukuk market in Afghanistan is public awareness. MoF/DAB

Financial Support from IDB, IMF and WB: The GolRA could access to these institutions for providing training to senior staff of MoJ, MoF and DAB, to develop the technical skills in order to analyze and comments on the Sukuk law. Moreover The Islamic Development bank has grant for launching Sukuk production in Islamic countries. In order to obtain this grant from IDB

Financial

Hiring Sukuk expert: For better management & development of Sukuk market in Afghanistan, the MoF/DAB could hire a technical expert in this matter, and these expertise should increase the capacity of Afghan professionals.	Issuing domestic Sukuk as Experiment: Domestic Sukuk are issue in local currencies such as in Bahrain Al-Salam Sukuk, so we recommended that GolRA should issue a domestic Sukuk as experiences.	Headquarter for supporting this production.	

Table of Contents Section	
Executive Summary	1
Overview of Sukuk Market worldwide	2
International Case Studies	3
Establishment of Sukuk in Afghanistan	4
Sukuk Framework	
Sukuk Legislation	
Economic Impact of Sukuk	
Recommendations	5
Annex	6

## Annex

The major Sukuk types such as, (Murabaha), business ( Musharaka), investment ( Istithmar), projects ( Istisna) and asset ( Al-Ijarah). The common Sukuk shown below

## Al-Ijarah Sukuk (Lease-Based Sukuk)

The Ijarah contract is essentially a rental or lease contract: It establishes the right to use an asset for a fee. The basic idea of Ijara Sukuk is that the Sukuk holders (investors) are the owners of the asset and are entitled to receive a return when that asset is leased.

In this scenario, the SPV receives the Sukuk proceeds from the investors; in return, each investor gets a portion of ownership in the asset to be leased. The SPV buys the title of the asset from the same company that is going to lease the asset. In turn, the company pays a rental fee to the SPV.

The Ijarah contract process begins when a company that needs an asset, but can't afford to purchase it outright contracts with an SPV, which agrees to purchase the asset and rent it to the company for a fixed period of time. The below diagram explain the Ijara Sukuk process



## MUDARABA SUKUK

MUDARABA SUKUK (Sukuk based on equity partnership) In simple mudaraba contracts, investors are considered to be silent partners (rab-al-mal), and the party who utilizes the funds is the working partner (mudarib).

The profit from the investment activity is shared between both parties based on an initial agreement. In a mudaraba Sukuk, the Sukuk holders are the silent partners, who don't participate in the management of the underlying asset, business, or project.

The mudarab Sukuk enable their holder to obtain his capital, as and when the Sukuk are submitted, and also to collect a fixed proportion of profits declared in the issuance publication. The prime Purpose of issuing Sukuk is to provide monetary support to a finance Generating project or any activity distinct from the general business activities

The working partner is the Sukuk obligator. The Sukuk obligator, as the working partner, is generally entitled to a fee and/or share of the profit, which is spelled out in the initial contract with investors.

The Mudarabah sukuk are a significant method of investment, aimed at raising funds. They refer to a document that is given to the holder against the amount of funds paid to the owner of the project. However, Sukuk do not entitle their owner to make claims with respect to any annual interest. So it is good source of financing for the GoIRA, finally it is Recommended that we should launching this production in Afghanistan.



## MURBAHA SUKUK (Cost Plus or Deferred Payment Sukuk)

MURBAHAH SUKUK (Cost Plus or Deferred Payment Sukuk) A Murabahah contract is an agreement between a buyer and seller for the delivery of an asset; the price includes the cost of the asset plus an agreed-upon profit margin for the seller. The buyer can pay the price on the spot or establish deferred payment terms (paying either in installments or in one future lump sum payment)

With Sukuk that are based on the Murabahah contract, the Special Purpose Vehicle (SPV) can use the investors' capital to purchase an asset and sell it to the obligator on a cost-plus-profit-margin basis. The obligator (the buyer) makes deferred payments to the investors (the sellers).

Although the Sukuk Murabahah structure is less commonly used in comparison to some of the other Sukuk structures, such as Ijarah and Mudarabah Sukuk structure. it could be considered as a possible alternative where it is not possible to identify a tangible asset for the purposes of the underlying investment

Murabahah Sukuk could not be traded in the Secondary Market, according to the general Islamic rules and regulations. This is because the contracts in the Sukuk structure involve the sale of debt which is prohibited in the Islamic law.

