

Islamic bonds or Sukuk issued in the year ending 14th March 2007 was just US\$16.6 billion, despite a 46% growth from the previous year. What is still lacking in this market and how can this be rectified?



The GCC countries and large economies like Egypt and Turkey need to adopt efficient special purpose vehicle (SPV) rules, asset-backed securities (ABS) rules and Sukuk-specific regulation. Currently, too many Arabian and MENA economies are issuing Sukuk under traditional bond rules and splitting jurisdictions for the SPV and the business deal. This creates risks and inefficiencies that may cause issuers and underwriters to shy away from issuance opportunities.

ABDULKADER THOMAS: President, Shape Financial



I don't think anyone can answer this question. It is a great mystery.

Here we have a perfectly tailored security for asset-backed financing. Yet, we still see many Muslim-oriented borrowers going to traditional bank loans and bonds. Why? Maybe it's because there are not enough fees in issuing bonds of any kind to get investment banks excited.

Remember, most investment banks are trying to come up with Islamic structured products, Islamic private equity (mostly venture capital in disguise) and Islamic real estate deals. There are huge fees in those businesses, thus probably the overly attentive focus of the big global and regional banks on them. Fortunately we are seeing more interesting Sukuk being issued, such as the recent Dar Al Arkan deal, Saudi Arabia's first global corporate deal. This kind of offering richens and deepens the availability of Sukuk, but at the same time has a powerful and positive demonstration effect on other potential issuers.

JOHN A. SANDWICK: Managing Director, Encore Management



Moody's Investors Service

The issue is not just specific to Sukuk, but debt/bond markets in general – there is too much focus on equity finance. The region has been heavily biased towards equity for the last few years. Attracted by the very high levels of returns available, investors were not so focused on the risk, and so the comparatively low returns offered by bonds/Sukuk were not as appealing. However, since the recent corrections, investors are recognizing the need for alternative investments, and this will create more demand for bonds and hence Sukuk.

On the borrower side, (previously) successful IPOs and plentiful liquidity has meant less need for debt and Sukuk finance, but as the regional capital markets mature, we will see increased volumes of Sukuk/bonds. Given that equity and debt markets are reasonably balanced in the US and Europe, I would expect the same to happen in the MENA region eventually.

KHALID HOWLADAR: Vice-President, Senior Analyst, Moody's Investors Service



The problem is that Islamic bonds currently fall between two stools: since they are – with few exceptions – an Islamic veneer on an un-Islamic reality.

On the one hand, “western” investors expect “gearing,” returns linked to LIBOR or similar, and the unequal sharing of risk and reward inherent in many so-called “Islamic” products. Many are put off by the “Islamic” label, and the higher costs arising from the complexity and ingenuity of the financial and legal sophistry of such products.

Islamic investors, on the other hand, may be prepared to hold their nose and let greed get the better of them, but a significant proportion of them are aware, deep down, that “gearing” is inconsistent with Islam. Islamic finance currently stands at a crossroads, I believe, and there are two possibilities for its development:

- (a) it becomes part of the mainstream, accommodating the full suite of products – including Islamic hedge funds and Islamic credit derivatives – in which case it will be recognized and rejected by a majority for what it has become; or
- (b) it retrenches to first principles and develops new products truly based upon Islamic, rather than “western” values.

I am optimistic enough to believe that emerging “asset-based” financial products are actually superior to western “deficit-based” products precisely because they share risk and reward equitably, and that it is through such products that a new global market in ethical (aka Islamic) finance will come about.

CHRIS COOK: Principal, Partnerships Consulting