

Sukuk Al Ijarah (Iran's experience)

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Introduction

- Sukuk in general is understood as a sharia compliant 'Bond' that represents ownership of an asset or its usufruct. The claim embodied in Sukuk is not simply a claim to cash flow but an ownership claim. This also differentiates Sukuk from conventional bonds as the latter proceed over interest bearing securities, whereas Sukuk are basically investment certificates consisting of ownership claims in a pool of assets.

Benefits and Features

- Tradable & sharia-compliant
- Provides medium to long-term fixed or variable rates of return.
- Assessed and rated by international rating agencies, which helps the investors to assess risk/return parameters of a Sukuk issue.
- Regular periodic income streams during the investment period with easy and efficient settlement.
- Liquid instruments, tradable in secondary market.

Types of Sukuk

Sukuk can be of many types depending upon the type of Islamic modes of financing and trades used in its structure. However, the most important and common among those are:

- Mudarabah
- Murabahah
- Musharaka
- Istishna
- Salam
- Ijarah

Steps (involved in the structure):

- The obligator sells certain assets to the SPV at an agreed pre-determined purchase price.
- The SPV raises financing by issuing Sukuk certificates in an amount equal to the purchase price.
- This is passed on to the obligator (as seller).
- A lease agreement is signed between SPV and the obligator for a fixed period of time.

Steps (involved in the structure):

- SPV receives periodic rentals from the obligator;
- These are distributed among the investors i.e. the Sukuk holders.
- At maturity the SPV sells the assets back to the seller at a predetermined value. That value should be equal to any amounts still owed under the terms of the Ijara Sukuk.

Laws and Regulations (In Iran)

- Sukuk Al Ijarah was mentioned for the first time in a law called “The law of Eliminating Production Barriers” in 2015 to improve the financial capability of the private sector by facilitating the process of repaying government debt to the private sector and similar entities.
- This law gave the permission to the ministry of finance to issue Sukuk Al Ijarah using the assets of the indebted public organizations as underlying assets to repay their debt to the private sector.

The process(1)

- The process initiates with the public organizations submitting their requests regarding the issuance of Sukuk including the documents of the potential underlying assets.
- In the second phase the Ministry of Finance (Debt Management Center) invites all the members of the Sukuk issuance committee, which according to the previously mentioned law consists of: representatives of ministry of finance, MPO, central bank, SEO & the representative of the applicant.

The process(2)

The committee's duties:

- To prioritize the debts of the public organization (The applicant).
- Determining the amount of the Sukuk to be issued.
- Decision making about the appropriate coupon rate, term to maturity etc.
- Monitoring the process of issuance, selling and settlement of Sukuk.
- Determining the market makers. (according to the viewpoint of SEO)
- Confirmation of the underlying asset.

The process(3)

The underlying asset(s) must have these characteristics:

1. It actively creates benefits for the owner. (valuable use for the organization that holds the asset)
2. There is no legal limitations regarding the transfer of the asset(s).
3. Insurance coverage according to the type of the asset(s). (i.e. lands do not need an insurance coverage)
4. The asset(s) must belong 100% to the public organization. (no partnership is accepted)

The process(4)

After confirmation of the issuance of Sukuk by the committee:

- Specific contracts (called registry & underwriting contracts) prepared by the SEO will be checked thoroughly and signed by the authorities in Ministry of Finance and MPO. The MPO confirmation at this point assures the investors that the necessary budget for repaying the principal and the coupons will be considered in the annual budget.
- After all the contracts have been signed, they will be returned to the SEO to implement the other required paper work for issuance and make the preparations for trading the issued Sukuk with coordination of OTC . 11

Ijara Sukuk in Practice (1)

- In 2015 for the first time the Iranian government was allowed to issue Ijara Sukuk as a part of settlement plan of the government debt to the private sector.
- In this regard the government announced the conditions regarding the use of the Ijara Sukuk to all the beneficiaries.
- In that Iranian Fiscal year the government issued (5000) Million Rials of Sukuk to repay the government debt to a pension Fund and an Airline. Moreover, the total amount needed for the principal and interest was provided in the annual budget by the MPO.

Ijara Sukuk in practice (2)

- Issued Sukuk can be traded by the investors in the secondary market (over the counter).
- Ijara Sukuk issued in that year with the coupon rate of 18% which is paid every six months to the Sukuk holders; and the maturity date will be in 4 years.
- Also, In the last Iranian fiscal year the government issued 40000 Billion Rials of Sukuk for repayment of the ministry of education debt. In the same year, 4000 Billion Sukuk also was issued to pay back the debt of the ministry of Science, Research and Technology.

Thank you!