SHARED RISK & REWARD

Issue 126 – December 2, 2012

Reading List

ADIB issues world's first hybrid perpetual Tier 1 sukuk (link)

AAOIFI 2008 Resolution on Sukuk(pdf)

Blog Posts This Week

When Dr. Zeti speaks, you should be listening

A Saudi Fannie Mae

Bahrain should focus on developing its financial sector with a focus on quality, not quantity

Sharing Risk is looking for sponsors for the Shared Risk & Reward newsletter. If you or your company would be interested in sponsorship opportunities, please email:

Blake Goud
blake@sharingrisk.org

SHARING RISK
1500 SW FIRST AVE., SUITE 910
PORTLAND, OR 97201

http://www.sharingrisk.org
Sharing Risk Blog

Follow Sharing Risk on Twitter | Like Sharing Risk on Facebook

AAOIFI resolution & the ADIB mudaraba sukuk

When Abu Dhabi Islamic Bank issued its latest sukuk, the demand was large (the $500 million sukuk was upsized to $1 billion after it received orders of $15 billion). However, the structure used–a perpetual, non-cumulative mudaraba with a call after 6 years—demonstrates how a sukuk can be structured as a mudaraba that will be called at its par value, even though an AAOIFI resolution in 2008 said that a purchase undertaking should not specify ex ante the price at which the purchase is completed.

Specifically, AAOIFI prohibited: "the Mudarib (investment manager) […] to undertake {now} to re-purchase the assets from Sukuk holders or from one who holds them, for its nominal value, when the Sukuk are extinguished, at the end of its maturity." In a literal sense, ADIB is not undertaking to purchase the assets from Sukuk holders "at the end of its maturity", since the it carries a perpetual maturity, and will only be redeemed if ADIB chooses to redeem it.

The sukuk documents, however, specify that if the sukuk are called, they will be called at their "outstanding face amount together with any Outstanding Payments". However, from my perspective as neither a lawyer nor a Shari'ah scholar, this looks like it should fall afoul of the AAOIFI resolution unless the argument is made that the mudaraba sukuk does not fall under the AAOIFI resolution because there is no fixed "end of its maturity" when ADIB is committing to repurchase the assets.

There are economic justifications for why the option for ADIB to call the sukuk at par is different than a similar purchase undertaking in a mudaraba sukuk with fixed maturity. For example, if the value of the assets of the mudaraba declined, the bank would likely not be in the position to exercise its call option (or would be prohibited by its regulators from doing so). So, the value of the assets in which the mudaraba capital was invested will be at least equal to the face value of the sukuk.

But, why not provide some sharing of that upside between the bank and its mudaraba sukuk holders. If there were potential upside to the call value of the sukuk, it could lower the cost to the bank in terms of periodic distribution amounts by providing upside if the bank's assets rise in value. This would allow the sukuk to retain its debt characteristics (fixed periodic distribution amounts paid from the profits generated by the mudaraba assets) but also introduce some profit-sharing in the redemption of the sukuk if they are called by the originator.

It's unlikely that this would attract more investors (since the ADIB sukuk was already heavily subscribed) and also because bond investors are primarily concerned with the potential for losses, not gains, but neither would it scare off any potential investors and it would become more fully aligned with my own reading of AAOIFI's intent with their mudaraba sukuk resolution.

Until next week,
Blake Goud