AIFC

SUKUK GUIDELINES

Astana International Financial Centre (AIFC)

CONTENTS

LIST OF KEY ABBREVIATIONS AND ACRONYMS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
AIFC	Astana International Financial Centre
AIX	Astana International Exchange
AT1	Additional Tier 1
EPR	Expected Profit Rate
ESG	Environmental, Social, and Governance
GFC	Green Finance Centre
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IsDB	Islamic Development Bank
PRI	Principles of Responsible Investing
SDGs	Sustainable Development Goals
SPV	Special Purpose Vehicle
SSSB	Sukuk Shariah Supervisory Board

LIST OF FIGURES

1. PREAMBLE

- The Sukuk Guidelines (Guidelines) have been designed to facilitate the development and growth of the Islamic capital market in Kazakhstan.
- Potential Sukuk issuers including government entities, quasi-government bodies, financial institutions, and corporates, among others, can benefit from the Guidelines.
- The Guidelines provide key information on most common types of Sukuk including underlying structures, main conditions and features, issuance process, list of legal agreements, governance, tradability etc.
- The structures listed in the Guidelines have been devised, where applicable, in line with the Shariah Standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).
- Sukuk issuers should ensure that any Sukuk they issue is in line with the relevant laws and regulations and the related Shariah requirements as defined by the designated authority(ies) including their Shariah advisers. Sukuk issuers should not solely rely on the information provided in the Guidelines in structuring and issuing Sukuk.

2. INTRODUCTION TO ISLAMIC FINANCE

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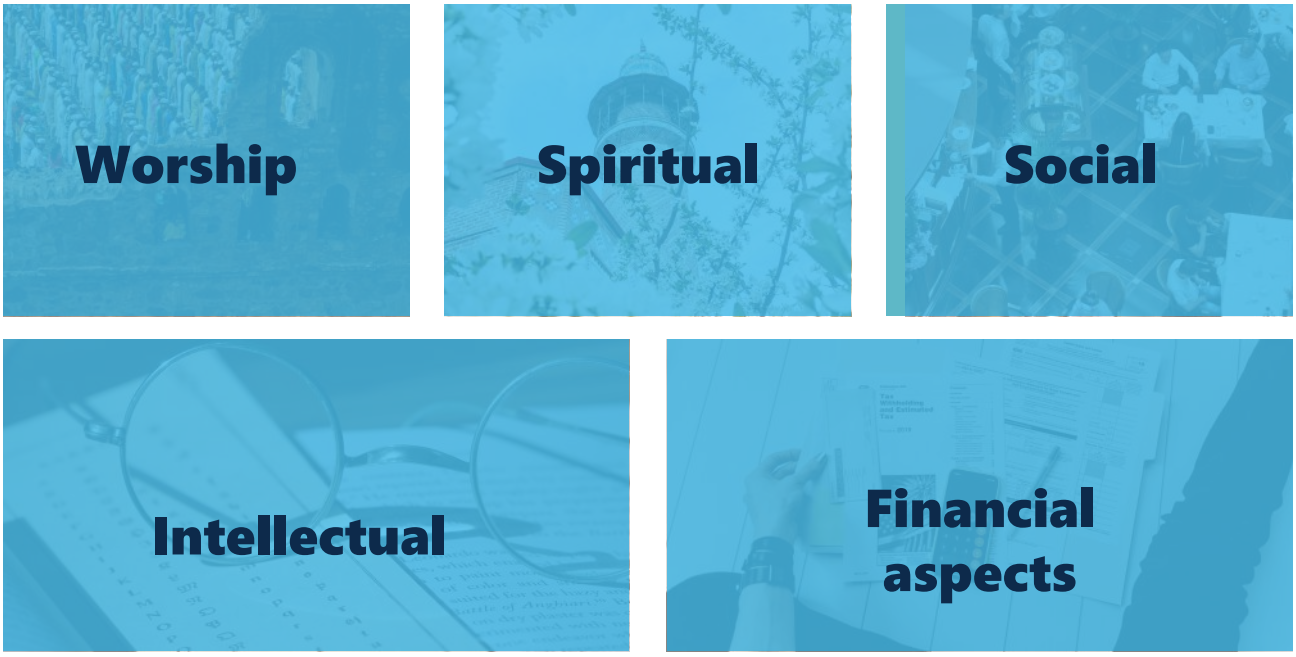
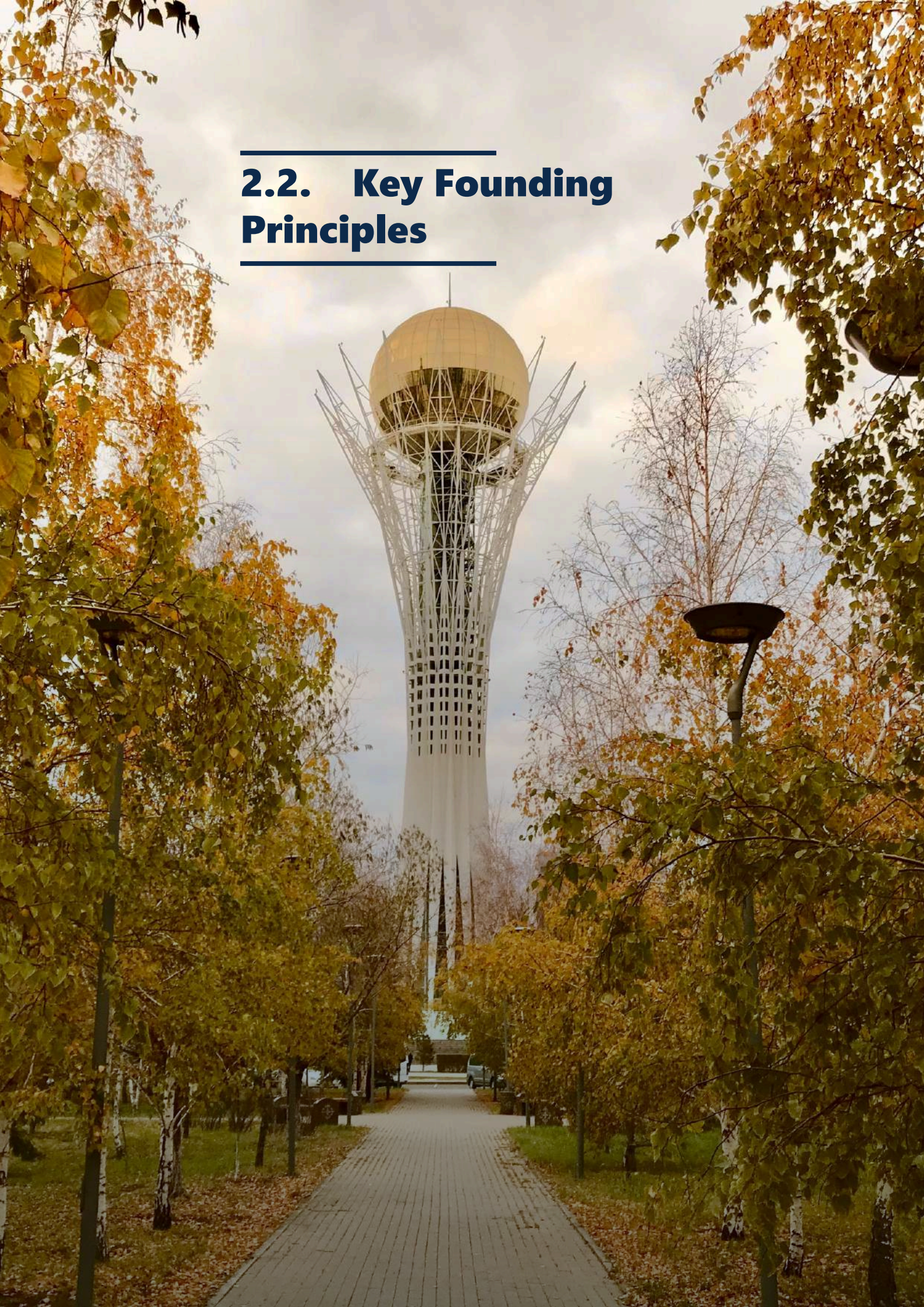
Islamic finance is an alternative financial system that is subject to a distinctive set of rules drawn from Shariah (Islamic law), that apply to Islamic financial products and instruments, in addition to the standard industry rules and regulations. Islamic finance is open for all, Muslims and non-Muslims alike.

2.1. Shariah

- Shariah provides a governing framework that covers all parts of Muslims' lives, including, among others, worship, spiritual, social, intellectual, and financial aspects. Shariah rules and principles are mainly derived from the Holy Quran and the Sunnah (teachings of the Prophet Muhammad, Peace and Blessing Be Upon Him).



- Based on the abovementioned two primary sources, Muslim scholars have developed the tools of Islamic jurisprudence expressed through different processes including interpretation, analogical reasoning, and general consensus to opine on contemporary issues including financial matters.
- It is generally believed by the majority of scholars that Shariah primarily aims to achievement of benefit and prevention of harm or corruption in relation to faith, life, intellect, lineage and wealth.
- Consequently, Islamic financial transactions and instruments have to comply with Shariah requirements, and the outcome of these transactions should contribute positively to achieving the objectives of Shariah by protecting the wealth and promoting the well-being of all creatures and greater justice in human society.



2.2. Key Founding Principles

2.2.1. Prohibition of Interest

Shariah scholars generally consider money as a 'medium of exchange', not a 'commodity'. Money has no intrinsic utility, but rather used to purchase or acquire goods and services. Based on that, money cannot be sold for more or less than its face value[1].

When money is used to generate money, as in the case of extending a loan for a certain period of time in return for an additional amount of money, this increment is considered interest (Riba[2]) which is prohibited in Shariah, regardless of whether this addition is excessive or not.

2.2.2. Prohibition of Excessive Uncertainty and Gambling

Commercial arrangements and contracts that entail excessive uncertainty, ambiguity, or risk (Gharar[3]) are prohibited in Islamic finance. Prohibited levels of Gharar are typically manifested when there are detectable, preventable, and disputable high ambiguities, uncertainties, and risks in the fundamental conditions of a commercial transaction at the time of executing the contract (e.g., subject matter, price, or date of delivery/performance are not clearly specified/defined in a sale contract).

Therefore, Islamic financial transactions and instruments should be clear, and transparent with full disclosures by all the contracting parties on the key terms and conditions of the underlying agreement.

Islamic finance also prohibits commercial transactions that are based on gambling (Maysir[4]), chance or speculation or sometimes referred to as zero-sum transactions where one party's gain in a transaction must lead to the other's loss, rather than creating a mutually beneficial outcome.

[1] Except in currency exchange that is subject to certain Shariah conditions
[2] Riba is an Arabic word which could be loosely translated as interest/usury
[3] Gharar is an Arabic word for ambiguity, uncertainty, or risk
[4] Maysir or Qimar are Arabic words for gambling

2.2.3. Creation of Asset-Backed Financial Transactions

In Islamic finance, money is considered as a lubricant to the engine of the real economy to facilitate the production and exchange of assets, goods, and services.

Therefore, money can only grow and generate a return if deployed into real economic activities such as trading, leasing, investing and other Shariah compliant transactions that are backed, based, or linked to real assets, goods, and services.

Based on the above, Islamic finance is essentially believed to be an asset-backed form of finance that assists in connecting the financial sector with the real economy.

2.2.4. Promotion of Participation and Risk Sharing

The prohibition of interest does not necessarily create a cost-free Islamic financing system, but rather necessitates linking profitability in Islamic finance with involvement in asset-backed commercial transactions that may, as in the case of certain participatory products and instruments, require sharing of the resulting rewards and risks related to such transactions and their underlying assets.

Thus, Islamic economists stress that sharing risks and rewards is one of the key foundations of a fair and functional Islamic financial system. Moreover, Islamic finance encourages having prudent risk management measures in commercial transactions to duly mitigate any underlying risks and accordingly preserve the wealth in accordance with the objectives of Shariah.

2.2.5. Abiding By a Comprehensive Ethical Framework

Islamic finance is said to promote ethical financial transactions that encourage trade, labour, entrepreneurship, transparency, honesty, righteousness, integrity, and fairness. Although Islamic finance is not a charity finance, it encompasses tools for serving deprived populations such as Islamic interest-free loans (Qard Hasan), obligatory annual almsgiving (Zakat), optional donations (Sadaqa), Islamic endowment (Waqf) etc.

Therefore, Islamic financial instruments cannot be interest-based or speculative financial products, have excessive uncertainty in their terms and conditions that may lead to disputes between the contracting parties, omit or avoid necessary disclosures, present wrong declarations, provide misleading information, or engage in other types of unethical practices.

Islamic financial instruments cannot support any activity that is deemed unlawful in Shariah. For example, any transactions that are detrimental to society, environment, animals (e.g. funding businesses that trade in alcoholic beverages, tobacco, gambling, pornography, animal poaching or weaponry etc.)

2.3. Main Contracts

- As it is forbidden in Islamic finance to pay or receive interest, money should be used to create real economic value where it may earn a return by having it invested in permissible commercial transactions and activities.
- Accordingly, there are different types of Shariah compliant contracts that can be used to structure Islamic financial products and instruments to meet various financial needs. The following contracts are the most used ones in Islamic finance:

CATEGORY	NAME	DESCRIPTION
Sales contracts	Murabaha	Profit-disclosed sale of an existing asset.
	Salam	Sale of a commodity with full spot payment for future delivery.
	Istisna	Sale of an asset to be manufactured.
Lease contract	Ijarah	Islamic lease (could be structured as operational or financial lease).
Loan contract	Qard Hasan	Interest-free benevolent loan.
Participatory contracts	Mudaraba	Partnership where one party (or more) provides the funds, and the other party provides expertise in deploying the funds in a Shariah compliant business activity for profit generation that will be shared between both parties in accordance with a pre-agreed ratio. Any financial loss will be borne by the fund provider unless the other party is guilty of negligence, misconduct, or failure in following the contractual conditions, in which case they will bear the loss.
	Musharaka	Partnership where two or more parties co-fund a specific Shariah compliant project/asset and share the profit in accordance with a pre-agreed ratio and loss in accordance with their capital participation ratios.
Services contracts	Wakala	Wakala is an agency contract where one party (principal) appoints another party (agent) to carry out a Shariah compliant activity on their behalf.
	Kafala	Guarantee that is intended to secure fulfilment of contractual and/or financial obligations.

2.4. Standardisation

- Over the years, the Islamic finance industry has developed its offering and products in many legal and taxation systems across diverse societies and communities with different cultural fabrics, and various religious practices.
- As a result of such globalisation and growth, an urgent need for harmonisation and standardisation has emerged in the industry to achieve the following key objectives:

  - Maintain the integrity of the Islamic finance industry and protect its reputation from any controversial practices.
  - Boost stability of the Islamic finance industry.
  - Provide internationally recognised benchmarks, standards, and best practices for the stakeholders of the industry.
  - Create uniformity and consistency in the operations and practices of Islamic finance focusing on structures of products/instruments, processes and procedures, Shariah governance and compliance requirements, accounting and auditing, risk management, liquidity management etc.
  - Boost cross-border investment transactions and international cooperation in the Islamic finance field.
  - Reduce the overall operational costs, streamline the day-to-day business activities, and improve competitiveness of Islamic financial products and instruments.

- Hence, the industry stakeholders have established the following leading standard-setting bodies to take the industry to the next level:

Shariah

Governance

Auditing

Accounting

Ethics

2.4.1. Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

- AAOIFI was established in 1991 in Bahrain as an international, autonomous, and not-for-profit industry standard-setting body. AAOIFI's primary objective is to ensure consistency and uniformity of practices across all sectors of the Islamic finance industry.
- Till the date, AAOIFI has issued more than 100 standards in the following technical areas:

  - Shariah.

  - Governance.

  - Auditing.

  - Accounting.

  - Ethics.

- The standards of AAOIFI are mandatory regulatory requirements in dozens of jurisdictions and are also partially adopted or used for guidance in many others. The Shariah standards of AAOIFI are the unanimous opinion of Shariah scholars representing different schools of Islamic jurisprudence and regions of the world.
- Apart from governments and regulatory bodies, the Shariah standards of AAOIFI are voluntarily implemented and followed by the Islamic Development Bank (IsDB) and numerous well-known Islamic finance consultancies, auditing firms, Islamic banks, Takaful[5] companies, non-banking credit institutions, capital market firms, educational/training institutions, Shariah scholars and professionals around the globe.

[5] Islamic insurance

2.4.2. Islamic Financial Services Board (IFSB)

IFSB was formed in 2002 in Malaysia as an international standard-setting organisation for regulatory and supervisory agencies, multilateral organisations and market players that have a vested interest in developing a sound and stable Islamic financial industry.

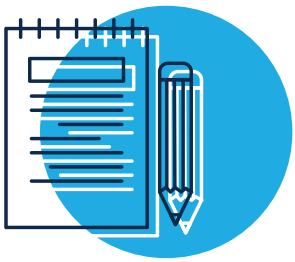
IFSB promotes the development of a stable, prudent, and transparent Islamic finance industry by introducing new bespoke standards or adapting existing international standards consistent with Shariah principles and recommending them for Islamic financial services providers, capital market participants and insurance providers.

To date, IFSB has issued over 37 standards, guidance notes and technical notes primarily focused on prudential and regulatory areas including risk management, capital adequacy, solvency requirements, supervisory review process, liquidity management, corporate governance etc.

2.4.3. International Islamic Financial Market (IIFM)

- IIFM was established in 2002 in Bahrain as non-profit standard setting body for the capital and money markets of the Islamic finance industry.
- The mandate of IIFM is to develop the following for the products and instruments of Islamic capital and money markets:

Standardised Shariah compliant legal documentation.



Operational guidelines.

Shariah pronouncements (Fatwas).

Jurisdiction-specific legal opinions, where applicable.

- Till the date, IIFM has issued more than 14 standards for the following Islamic capital and money markets' products/instruments structured for facilitating hedging, liquidity management, and trade finance:
  - Islamic Treasury Placement.
  - Shariah Compliant Hedging Master Framework.
  - Islamic Profit Rate Swap.
  - Interbank Unrestricted Investment Placement.
  - Shariah Compliant Alternative to Conventional Repo.
  - Islamic Cross-Currency Swap.
  - Islamic Foreign Exchange Forward.
  - Credit Support Product for Cash Collateral.
  - Unfunded/funded Participation Product for Trade Finance.
  - Ijara Sukuk Documentation Templates.
  - Mudaraba Tier1 Sukuk Standard Documentation.
- According to the IIFM, the above-listed products and standards have been used by hundreds of Islamic financial services providers and other institutions across +15 jurisdictions around the globe.

3. SUKUK OVERVIEW

• 3.1. Definition

- Sukuk is the plural of the Arabic word "Sak" which could mean financial instrument, legal deed, or cheque. Sukuk are sometimes referred to as Islamic bonds in the industry.
- "Taskeek" is the Arabic word for Islamic securitisation which essentially generates Sukuk.
- Definition of Sukuk as per AAOIFI is as follows:
  - "Certificates of equal value representing undivided shares in ownership of tangible assets, usufructs, and services or (in the ownership of) the assets of particular projects or special investment activity".
- The Islamic Banking Business Prudential Rules of AIFC provides the following definition for Sukuk:
  - "Certificates that represent a holder's proportionate ownership in an undivided part of an asset or pool of assets where the holder assumes all rights and obligations to the asset or pool. A typical Sukuk transaction would involve the originator of the Sukuk, the issuer of the Sukuk and an investor (Sukuk holder)".
- The Law on Securities Market of the Republic of Kazakhstan defines Sukuk (termed as "Islamic Securities" in the law) as follows:
  - "Issuance securities the terms of issue of that correspond to the principles of Islamic finance, certifying right of ownership of an undivided share to physical assets and (or) right to dispose assets and (or) income from use of them, services or assets of specific projects, for financing of that these securities have been issued".
- Based on the above, it could be concluded that Sukuk are financial instruments issued by sovereign, quasi-sovereign or corporate entities to raise funds against underlying assets of Sukuk structure, which may be tangible assets (e.g., ownership of property or projects like infrastructure etc.) or intangible assets (e.g., usufruct of a property).

3.2. Sukuk vs Bonds

The table below illustrates the similarities and differences between Sukuk and conventional bonds:

SIMILARITIES	DIFFERENCES
• Financial instruments that are usually marketable, transferable, and tradable in the primary and secondary markets.	• Sukuk are issued using contracts and structures compliant with Shariah.
• May be rated by local, regional, and international rating companies and agencies.	• Sukuk would only fund projects/assets/ services/ activities compliant with Shariah.
• Can be secured or the credit rating may be enhanced by using certain collateral.	• Conventional bonds represent pure debt obligation whereas Sukuk represent ownership stakes in the underlying projects/assets/services.
• Can be offered across various legal and fiscal domains to achieve the objective of the issuers.	• The sale of a bond is the sale of debt, but the sale of Sukuk is typically a sale of undivided share in the underlying assets.
• Subject to a defined set of legal and regulatory requirements.	• Sukuk are secured by ownership rights in the underlying assets while conventional bonds are typically unsecured debt.
	• Principal and return in Sukuk are not always guaranteed, but in conventional bonds, they are always guaranteed by the issuer at the outset

3.3. Key Milestones of Issuance Process

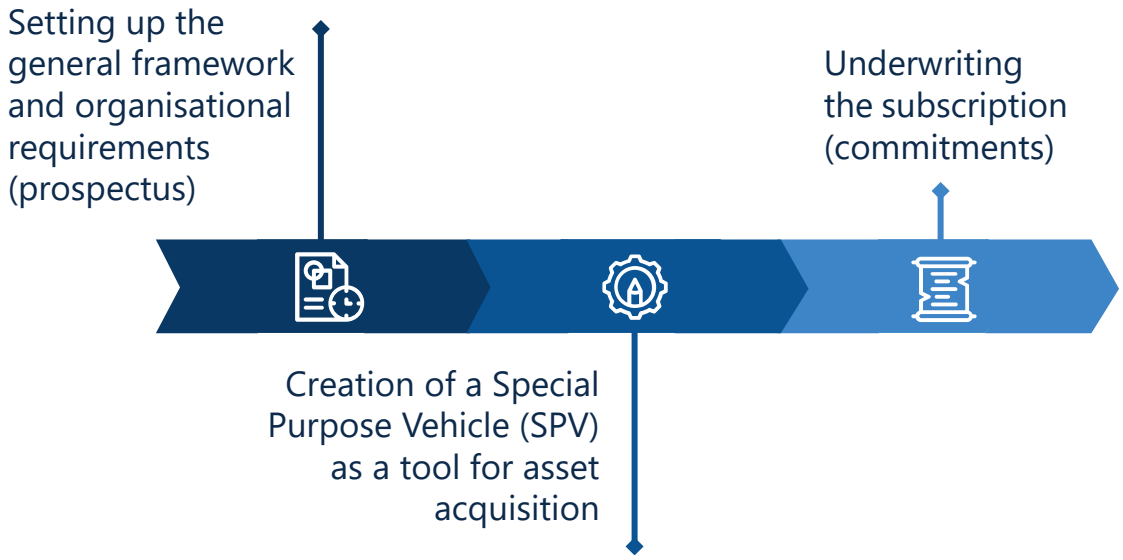
The key milestones of Sukuk issuance process are as follows:

- **Setting up the general framework and organisational requirements**: all legal, procedural, and organisational issues in addition to Shariah compliance requirements need to be defined and incorporated in the subscription prospectus.

- **Creation of a Special Purpose Vehicle (SPV) as a tool for asset acquisition**: an SPV is a bankruptcy-remote[6] and tax-efficient[7] legal entity[8] that technically issues the Sukuk and holds the underlying assets on behalf, and for the benefit of the investors or Sukuk holders.

- **Underwriting the subscription**: commitment(s), typically given by financial institution(s) acting as "arranger(s)" in the Sukuk issuance, to purchase any Sukuk unsold at the close of the subscription process.

Figure 1. Key Milestones of Sukuk Issuance Process



[6] In cases of bankruptcy of the originator, the Sukuk underlying assets will remain ringfenced from the rest of the originator's assets, preventing any creditors making a claim on the Sukuk assets or interfering with rights of the Sukuk holders with respect to the underlying assets (Article 96 of the Law on Rehabilitation and Bankruptcy of the Republic of Kazakhstan)

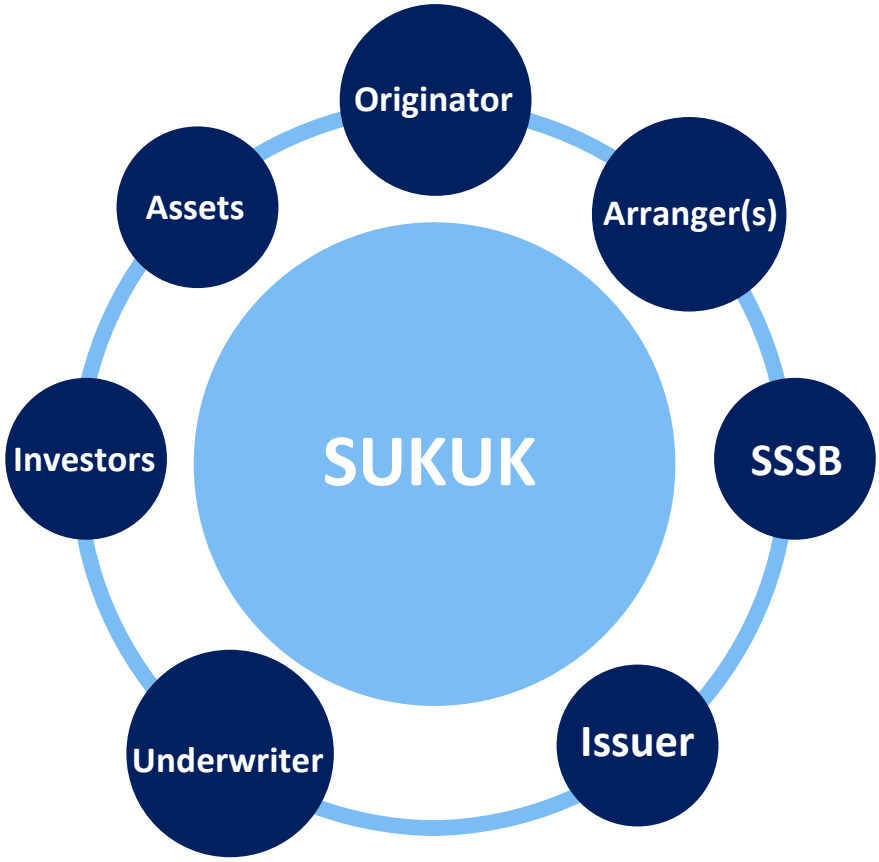
[7] The Tax Code of the Republic of Kazakhstan provides tax exemptions for transactions/income conducted/generated by the SPV, subject to meeting certain conditions

[8] Depending on relevant legal, regulatory, and taxation requirements, among other factors, the SPV could be established in the form of a trust, limited liability partnership, limited liability company, or other legal form to facilitate the Sukuk issuance

3.4. Main Components and Parties

The Figure 2 below shows main components and parties of a Sukuk issuance:

Figure 2. Sukuk Parties and Components



In the Guidelines, the aforementioned components and parties have the following meanings, unless the context otherwise requires:

- **originator**: the legal entity raising funds to undertake a certain activity/project. This could be sovereign, quasi-sovereign, or corporate institution, among others.
- **Arranger(s)**: where applicable, the financial institution(s) that lead(s) the issuance by working closely with the originator to set up the SPV and manage the entire issuance process (prospectus, underwriting, promotion, etc.).
- **Sukuk Shariah Supervisory Board (SSSB)**: Shariah scholars appointed/assigned to approve the prospectus and relevant Sukuk documentation and oversee the Shariah compliance throughout the lifetime of the Sukuk[9].
- **Issuer**: the SPV that issues the Sukuk to the investors (the subscribers).
- **Underwriter(s)**: where applicable, the party(ies) committed to buy all unsubscribed Sukuk (could be the same as the arranger(s)).
- **Investors**: Sukuk holders that receive Sukuk certificates from the SPV in return for their funds subscribed to Sukuk.
- **Assets**: the underlying assets/usufruct to be owned[10] by the investors until maturity.

[9] This could be the Shariah board of the arranger(s)
[10] Full transfer of legal title and ownership of Sukuk assets (asset-backed) and/or transfer of beneficial ownership/rights only (asset-based)

3.5. Tradability of Sukuk

- Trading permissibility, from a Shariah compliance standpoint, for any Sukuk is dependant primarily on the composition of the underlying assets (e.g., properties to be let, commodities to be traded, machinery to be manufactured etc.) which is typically related to the main contract used to structure the Sukuk (e.g., Murabaha, Wakala etc.).
- Trading Sukuk is generally acceptable from a Shariah compliance perspective if the majority of the Sukuk underlying assets do not represent cash, cash equivalents, and/or debts. Otherwise, Sukuk could be transferable at par value to avoid Riba.
- According to AAOIFI Shariah Standards, for Sukuk to be tradable, less than 50% of the underlying assets can be in the forms of cash, cash equivalents, and/or debts (Sukuk trading to be banned when this ratio goes above 67%).
- The aforementioned percentage is a collective Ijtihad (independent reasoning) of AAOIFI's Shariah board. Other Shariah scholars may use differing thresholds for determining permissibility of Sukuk tradability.

3.6. Governance

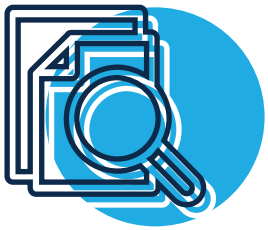
- This section is primarily based on relevant Shariah and Governance Standards of AAOIFI.

3.6.1. Key Pillars of Sukuk Governance

- **Shariah compliance** which requires all governing bodies of Sukuk issuers, including management, to ensure that the Sukuk underlying activities adhere to Shariah principles.

- **Accountability** is that all governance bodies of Sukuk issuers, including management, are responsible for their respective functions.

- **Fairness** encompasses the fair treatment of all stakeholders.



- **Transparency** means that the affairs of the Sukuk issuers shall be transparent, and financial and operational reporting shall be carried out in such a way that no material information is hidden from respective stakeholders.

- **Responsibility** means that the Sukuk issuer and their organs of governance and management, shall all, function in a responsible manner towards the stakeholders and community at large.

3.6.2. Pre-Issuance Considerations

Regulatory and prudential requirements

- Eligibility criteria for Sukuk issuance which include safeguarding the interest of the Sukuk holders and the Sukuk market shall be met and adequate regulatory approvals for the issuance shall be obtained, where applicable. As part of this, a prospectus shall be provided.
- According to AIFC Islamic Finance Rules, the prospectus issued in relation to a Sukuk issuance must include:
  - Shariah compliance opinion of the SSSB in respect of the Sukuk (Fatwa).
  - A detailed description of the Sukuk structure, underlying transactions, and an explanation of the flow of funds.
  - Disclosures required by AAOIFI Standards.

Shariah responsibilities of Sukuk issuers

- The Shariah responsibilities applicable to a Sukuk issuance, shall generally include appointing/assigning the SSSB, the originator's responsibility regarding ensuring Shariah compliance in all relevant aspects and throughout the lifetime of the Sukuk, and appointing/assigning the external Shariah Auditor.
- The originator shall appoint, for every Sukuk issuance, an SSSB. If the originator already has a Shariah board, duly meeting the requirements of the AAOIFI Governance Standard No.12, the same may additionally be assigned as SSSB for one or more of the Sukuk issuances[11].

Initial Shariah approval and Fatwa

- The SSSB shall issue a well-documented and reasonably explained Fatwa duly considering the specific requirements of AAOIFI's Shariah Standard No. 29 "Stipulations and Ethics of Fatwa in the Institutional Framework", in addition to the requirements of the AAOIFI Governance Standard No.12 and any other regulatory requirements.

Sukuk trading and listing

- The originator shall ensure the listing of Sukuk instruments in the relevant markets is done as per Shariah principles and rules.
- The originator shall ensure effective identification and communication of the requirements as per the relevant Shariah principles and rules regarding:
  - The overall tradability of the Sukuk.
  - Any restrictions with regard to the valuation applicable for Sukuk trade or transfer.

[11]This could also be the SB of the arranger(s)

3.6.3. Considerations During Continuity of Sukuk

Originator's responsibility for Shariah compliance

- To ensure Shariah compliance in a Sukuk's entire lifecycle, the originator shall adopt a governance regime which encompasses different elements including but not limited to the following:
  - The purpose for which the Sukuk was issued shall remain Shariah compliant.
  - The SSSB is made aware of any substantive changes in assets, business, documentation, terms and conditions etc. that may have an impact on the Shariah compliance of the Sukuk.
  - In case of changes in the terms and conditions of Sukuk structure and relevant documentation, the Sukuk issuers shall be responsible for the communication of such changes to the SSSB.

SSSB responsibilities

- The SSSB shall have periodic meetings (at least on an annual basis) and general oversight during the entire lifecycle of the Sukuk issuance.

External Shariah audit

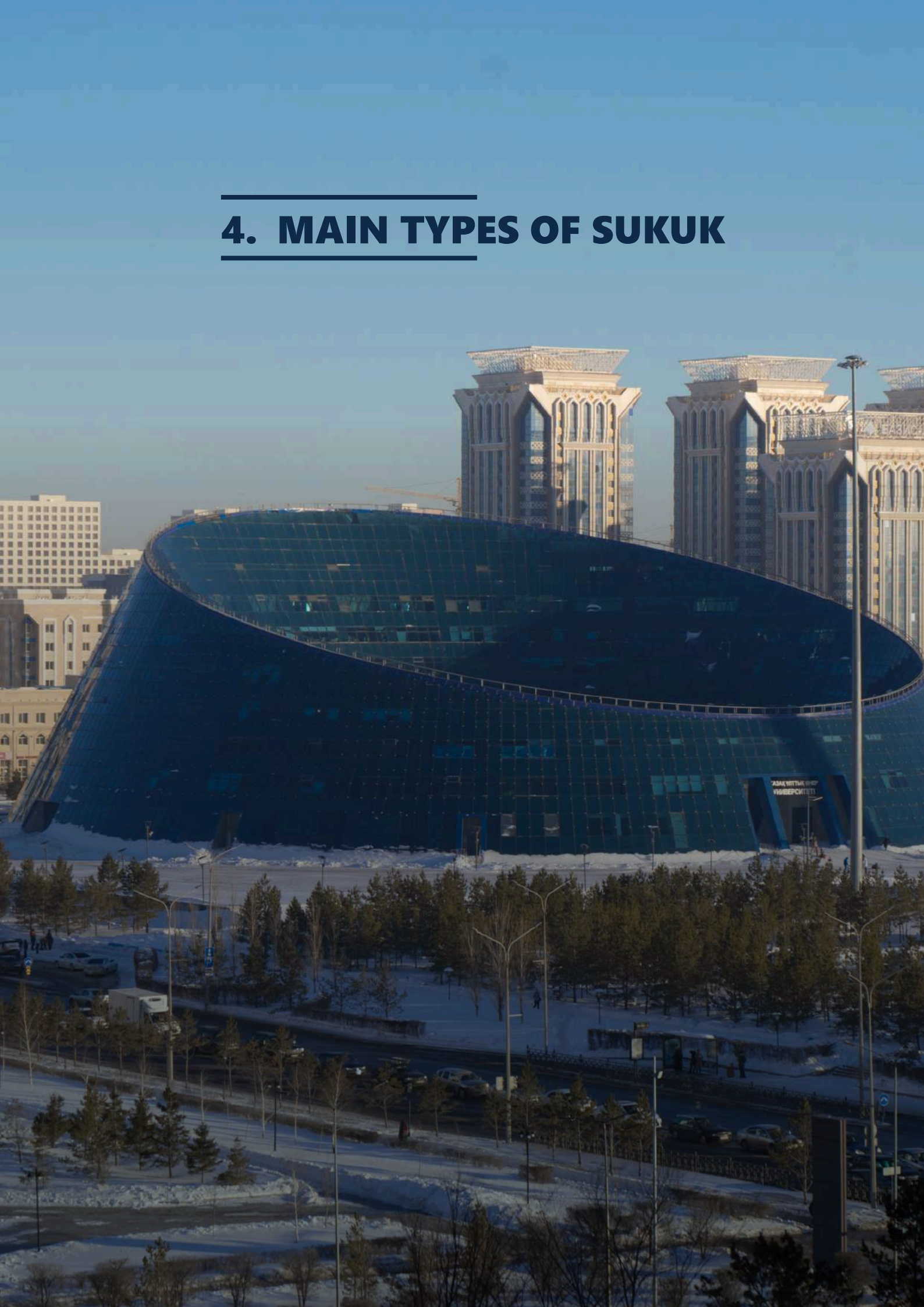
- The originator shall ensure that an external Shariah audit is performed of the Sukuk issuance (at least on an annual basis).
- The external Shariah audit report shall be addressed to those charged with governance of the originator and/or Sukuk issuer and shall be made available to all Sukuk holders, owners of the originator, those charged with governance and other relevant stakeholders including the regulator and the Central Shariah Board of the relevant jurisdiction, as applicable. The draft report shall be first submitted to the SSSB and shall be finalised after due consultation with SSSB, particularly, regarding any corrective measures needed.

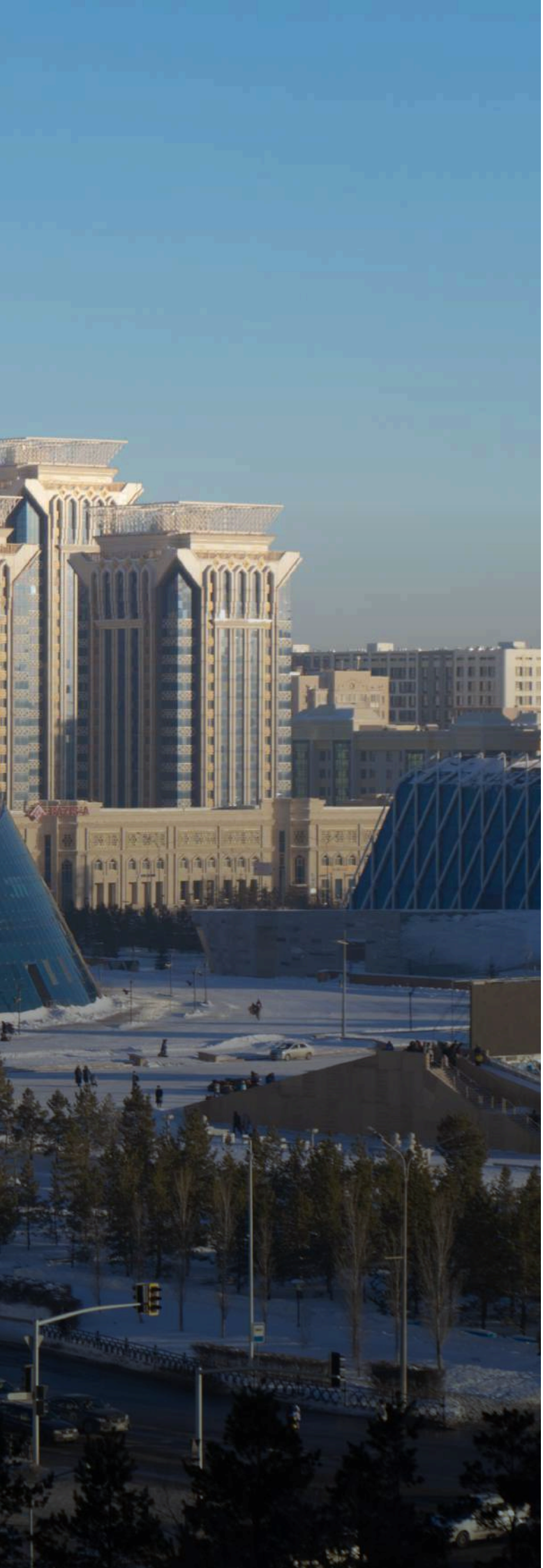
3.6.4. Considerations at Maturity and Liquidation of Sukuk

SSSB responsibilities

- The SSSB shall supervise, from a Shariah perspective, the maturity and liquidation processes of the Sukuk issuance. Based on such supervision duly considering the financial reporting (particularly regarding the final returns distribution) and external auditors' and external Shariah auditors' reports as applicable, the SSSB shall issue a final SSSB report on Sukuk issuance.

4. MAIN TYPES OF SUKUK





- This section explains how Sukuk can be designed using a number of Shariah compliant contracts selected to showcase the structuring of eight different types of Sukuk.
- However, it is important to note that Sukuk structuring is very dynamic in nature and can be completed in various ways using different combinations of the contracts mentioned in this section, among others.

4.1. Murabaha Sukuk

4.1.1. Definition

- Murabaha is a sale contract where the cost of the subject matter (Murabaha assets) and the profit realised by the seller are disclosed to the buyer.
- Murabaha is mostly used in the Islamic finance industry in combination with a deferred payment facility.

4.1.2. Key Conditions and Particulars

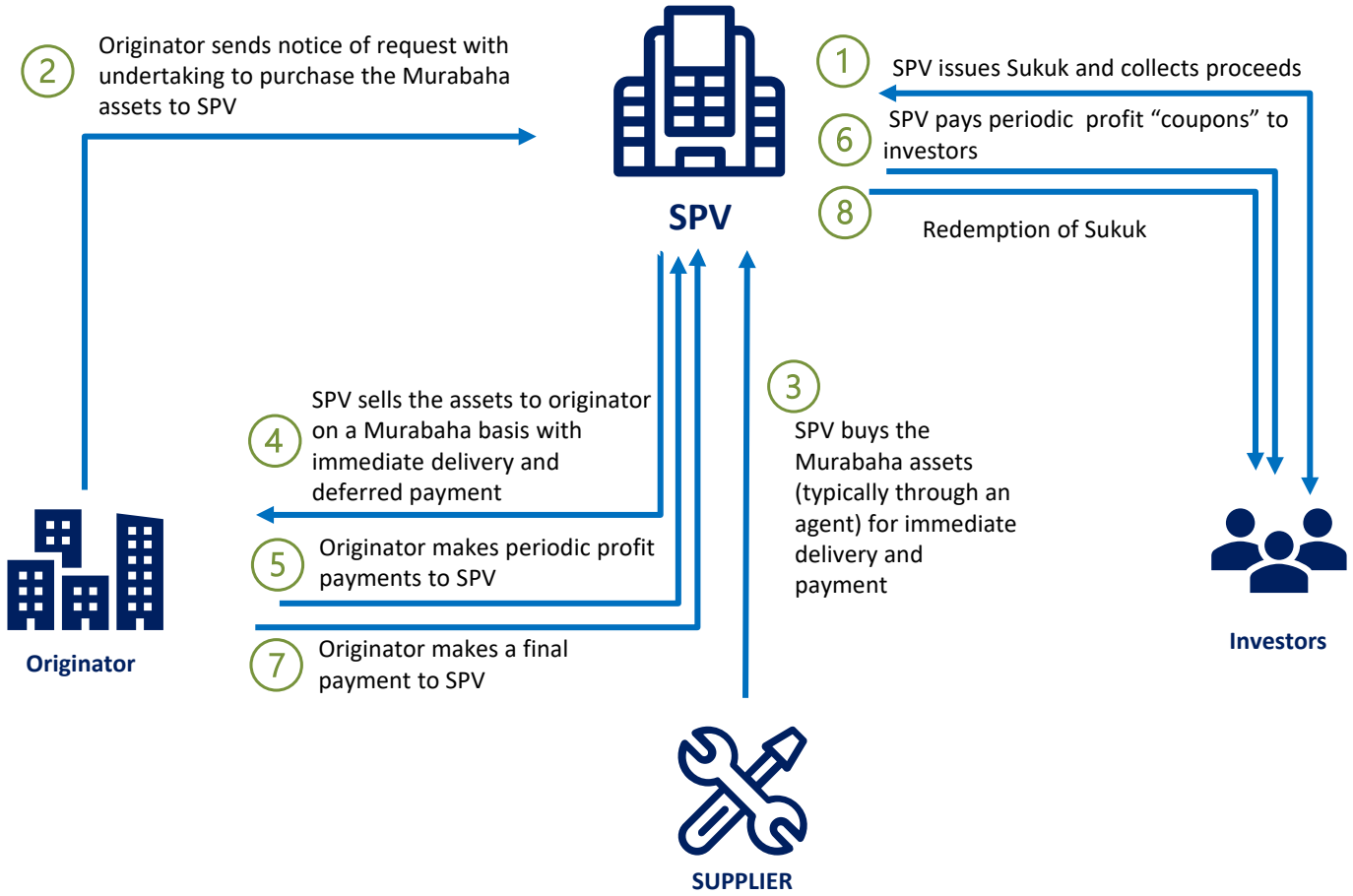
- Murabaha assets should be Shariah compliant, existent, and owned (physical and/or constructive ownership) by the seller at time of sale, valuable, deliverable, described, quantified, and clearly priced.
- Cost price and profit margin should be declared to the buyer and agreed at the outset.
- The buyer becomes the owner of Murabaha assets and assumes full responsibility for them after concluding the Murabaha contract.

4.1.3. Sukuk Indicative Application

- Under Murabaha Sukuk, the funds provided by the investors are used to purchase the Murabaha assets from a supplier upon the request of the originator.
- Subsequently, the originator, acting as buyer, and the investors, acting as sellers, would enter a Murabaha arrangement with immediate delivery of the Murabaha assets and deferred payment for the sale price.
- The Murabaha assets could be a specified quantity and quality of certain goods to be used by the originator in line with their business needs and objectives.
- The profit margin on the sale will be calculated based on the applicable profit rate. The profit rate is a rate of return set by the originator.
- The sale price of the Murabaha assets (principal + profit) is typically paid by the issuer to the investors as follows:
  - Profit is paid as equal periodic Sukuk coupons.
  - Principal is paid upon redemption of the Sukuk on the maturity date.

4.1.4. Process Flow

Figure 3. Murabaha Sukuk Issuance Process



4.1.5. Tradability

Murabaha Sukuk are generally not tradable as they would represent pure debt obligations after completion of the Murabaha sale transaction.

4.1.6. Main Legal Documents

The main legal documents used in Murabaha Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV[12]	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. • Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Purchase Undertaking (if any)	Originator undertakes irrevocably to purchase the Murabaha assets from the SPV when the latter requests at the relevant agreed price on the relevant exercise date.
Agency Agreement (if any)	The SPV, acting as a principal, may assign a buying agent and accordingly enter into an agency agreement to facilitate the purchase of the Sukuk assets.
Purchase Agreement	To conclude the purchase of the underlying assets from the supplier.
Murabaha Agreement	Concluded between the originator (as the purchaser) and SPV as the seller where the sale price will include the aggregate face amount of the Sukuk certificates and the profit amount.
The Guarantee (if any)	The guarantor[13] will unconditionally and irrevocably guarantee to the SPV, the prompt and complete settlement of all payment obligations of the originator under the Murabaha agreement.

[12] This document(s) will vary depending on the legal form of the SPV e.g., trust deed/declaration, articles of association of a limited liability company or partnership etc.
[13] Could be the originator and/or third-party

4.2. Ijara Sukuk

4.2.1. Definition

- Ijara is a lease contract where the usufruct of a certain asset is rented from the owner of the asset (or lessor) to the lessee against payment of rent.
-

4.2.2. Key Conditions and Particulars

- The underlying Ijara assets should be Shariah compliant and used according to Shariah principles.
- The underlying Ijara assets and/or their usufruct must be owned by the lessor and remains the property of the lessor throughout the lease term.
- The rent amount and payment terms/dates must be agreed at the outset by the contracting parties[14].
- Lessor is responsible for major maintenance of the Ijara assets while ordinary maintenance remains the lessee's responsibility.

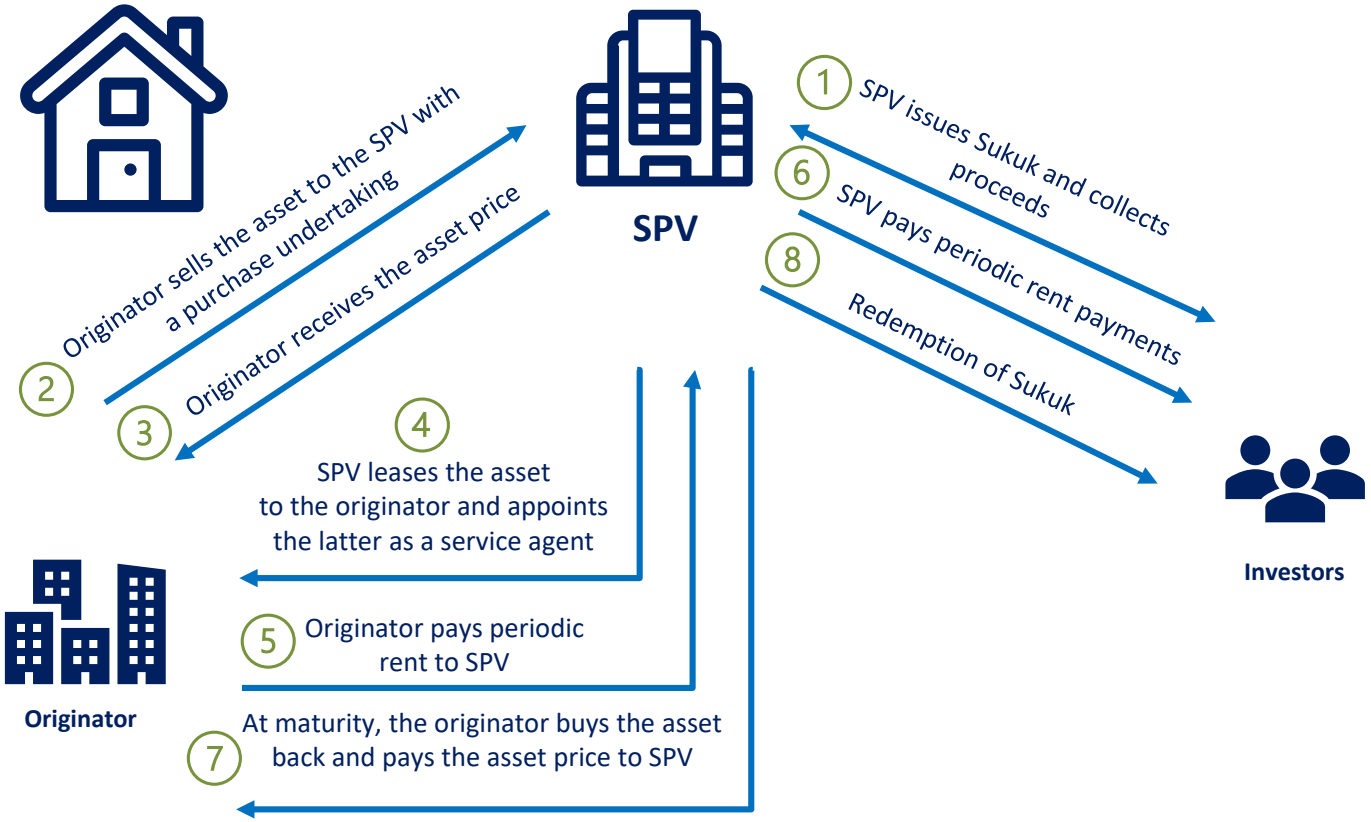
[14] Rent could be fixed during the entire lease term or variable where it can be reviewed periodically and amended according to a set of criteria to meet Shariah requirements

4.2.3. Sukuk Indicative Application

- The originator uses a building (or a pool of buildings) as the Sukuk's underlying asset(s).
- The originator sets up the SPV to act as the 'issuer' for the purpose of Sukuk issuance, as 'representative' of the Sukuk holders, and as 'lessor' of the asset.
- Originator sells the building(s) to the SPV for an agreed price and with an undertaking to buy back the building(s) at the maturity of the Sukuk.
- The SPV issues Sukuk and collects proceeds from the investors to pay the agreed amount of money to the originator as the purchase price of the building(s).
- The SPV (which now owns the building(s)) leases the same to the originator for an agreed amount of rent to be paid periodically (which will be the income for the SPV from the asset(s) that could be distributed to the Sukuk holders as periodic rent payments).
- The building(s) continues to be used as usual but originator, as 'lessee', pays the agreed rent to SPV (originator may have the right to sub-lease it to another lessee, subject to the Sukuk terms and conditions).
- The SPV also appoints the originator as their agent for servicing the building(s) (major maintenance, Islamic insurance, if any, and payment of taxes, if applicable).
- At maturity, the originator buys back the building(s) from the originator and pays the purchase price. This amount is used to pay the Sukuk holders for redemption of Sukuk. The ownership of the building(s) is transferred back to the originator.

4.2.4. Process Flow

Figure 4. Ijara Sukuk Issuance Process



4.2.5. Tradability

Ijara Sukuk are generally tradable as the underlying assets are typically tangible assets to be leased.

4.2.6. Main Legal Documents

The main legal documents used in Ijara Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Sale Agreement	The originator will sell the underlying asset to the SPV.
Purchase Undertaking	The originator undertakes irrevocably to purchase the assets from the SPV on the relevant maturity/exercise date(s).
Ijara Agreement	• SPV will lease to the originator the underlying assets. • Originator will be responsible, at its own cost and expense, for the performance of all ordinary maintenance and repair required for the leased assets.
Service Agency Agreement	Originator is appointed as a servicing agent by the SPV to manage the leased assets (major maintenance, Islamic insurance, if any, and payment of taxes, if applicable).
Purchase Agreement	The originator buys the assets back from the SPV on the relevant maturity/exercise date(s).

4.3. Musharaka Sukuk

4.3.1. Definition

Musharaka is a partnership contract where two or more parties co-fund a specific Shariah compliant project/asset with the goal of generating profit.

4.3.2. Key Conditions and Particulars

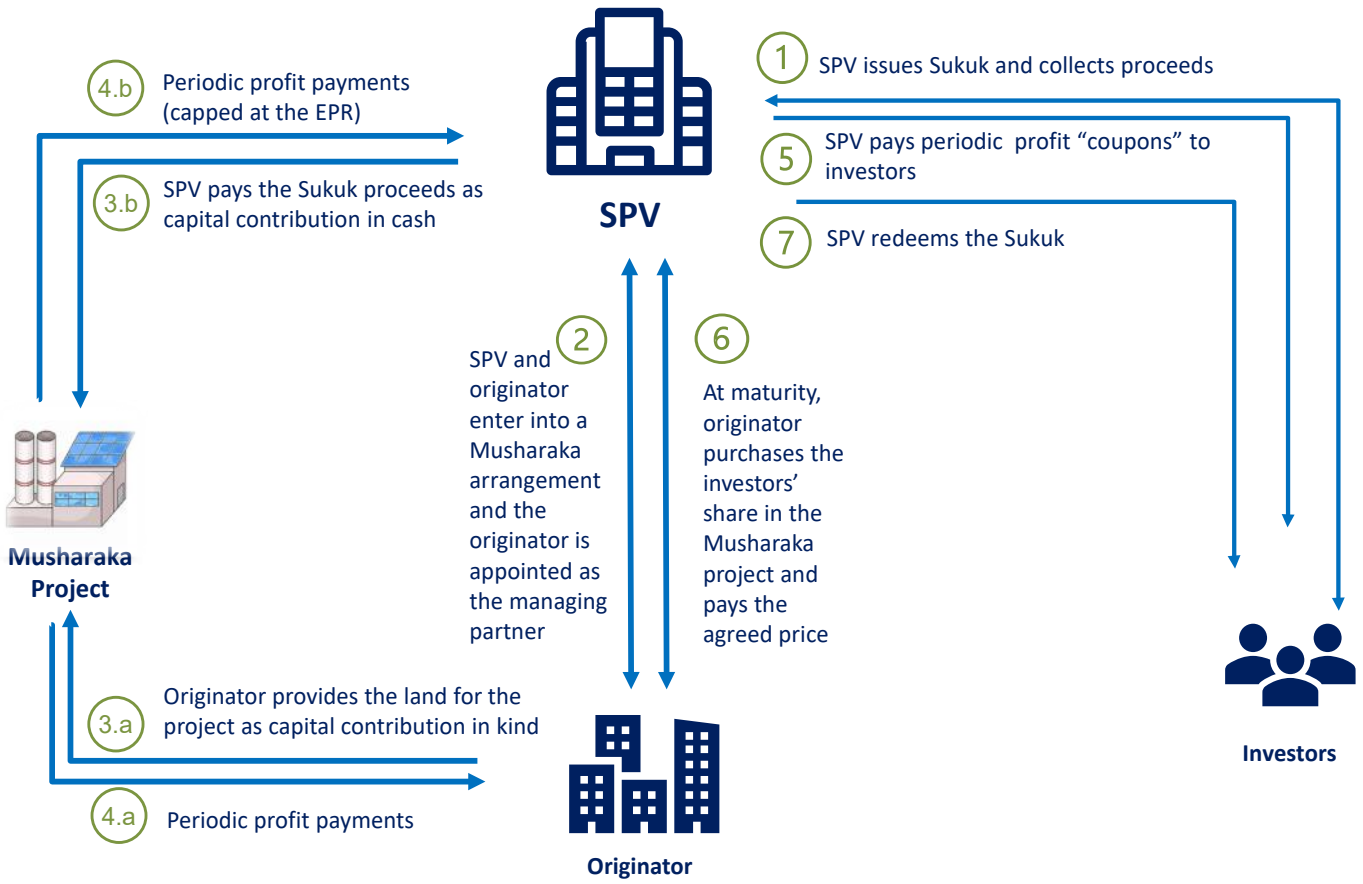
- The underlying Musharaka project/assets should be Shariah compliant.
- Capital contributions of each partner could be provided in cash or in kind (valued at market price and/or other agreed price).
- The partners can run/manage the Musharaka project/asset together, delegate to one partner (managing partner) the full responsibility of the business management, or hire a third party to assume the responsibility of business management.
- The partners will share any generated profit from the Musharaka project/assets according to agreed profit-sharing ratios. Advance profit payments can also be made, assuming that such payments will remain subject to final adjustments based on the actual profit achieved by the Musharaka project/assets.
- Losses, if any, will be borne by all partners according to each partner's capital contribution. However, the managing partner should bear all losses incurred due to their proven negligence, misconduct, fraud, or non-compliance with the agreed Musharaka contractual terms and conditions.

4.3.3. Sukuk Indicative Application

- The originator and the investors would enter a Musharaka arrangement where the originator is appointed as the managing partner. The investors' capital contribution would be provided in cash (Sukuk proceeds) and the originator could provide its capital contribution in kind (e.g., land for building a solar power plant, where the land shall be valued at an agreed market price).
- The originator would then use Sukuk proceeds to create the Musharaka project, and any profit generated will be shared according to the agreed profit-sharing ratios. However, the investors' share of the Musharaka profit is typically capped at an agreed Expected Profit Rate (EPR)[15], and any profit exceeding the expected profit would be retained by the originator as a reward for achieving the EPR.
- The originator in its capacity as the managing partner shall perform its obligations under the Musharaka Sukuk and always look after the interests of the investors by acting dutifully and in good faith. The originator will also have an obligation to closely monitor the performance of the Musharaka project and ensure the EPR is achievable during the Sukuk tenor. This responsibility to actively monitor the performance of the Musharaka project is a Shariah compliant capital-protection arrangement.
- However, under a Musharaka agreement, the managing partner cannot provide an unconditional guarantee to return the invested capital save for instances of negligence, gross misconduct, fraud of the managing partner, and/or non-compliance with the agreed Musharaka terms and conditions.
- On the Sukuk maturity date, the investors will sell their shares in the Musharaka project, and the originator pays the market value, or any other price agreed between the parties.

4.3.4. Process Flow

Figure 5. Musharaka Sukuk Issuance Process



[15] EPR is an annual percentage rate that represents the return rate the Sukuk holders are expected to receive on their investments

4.3.5. Tradability

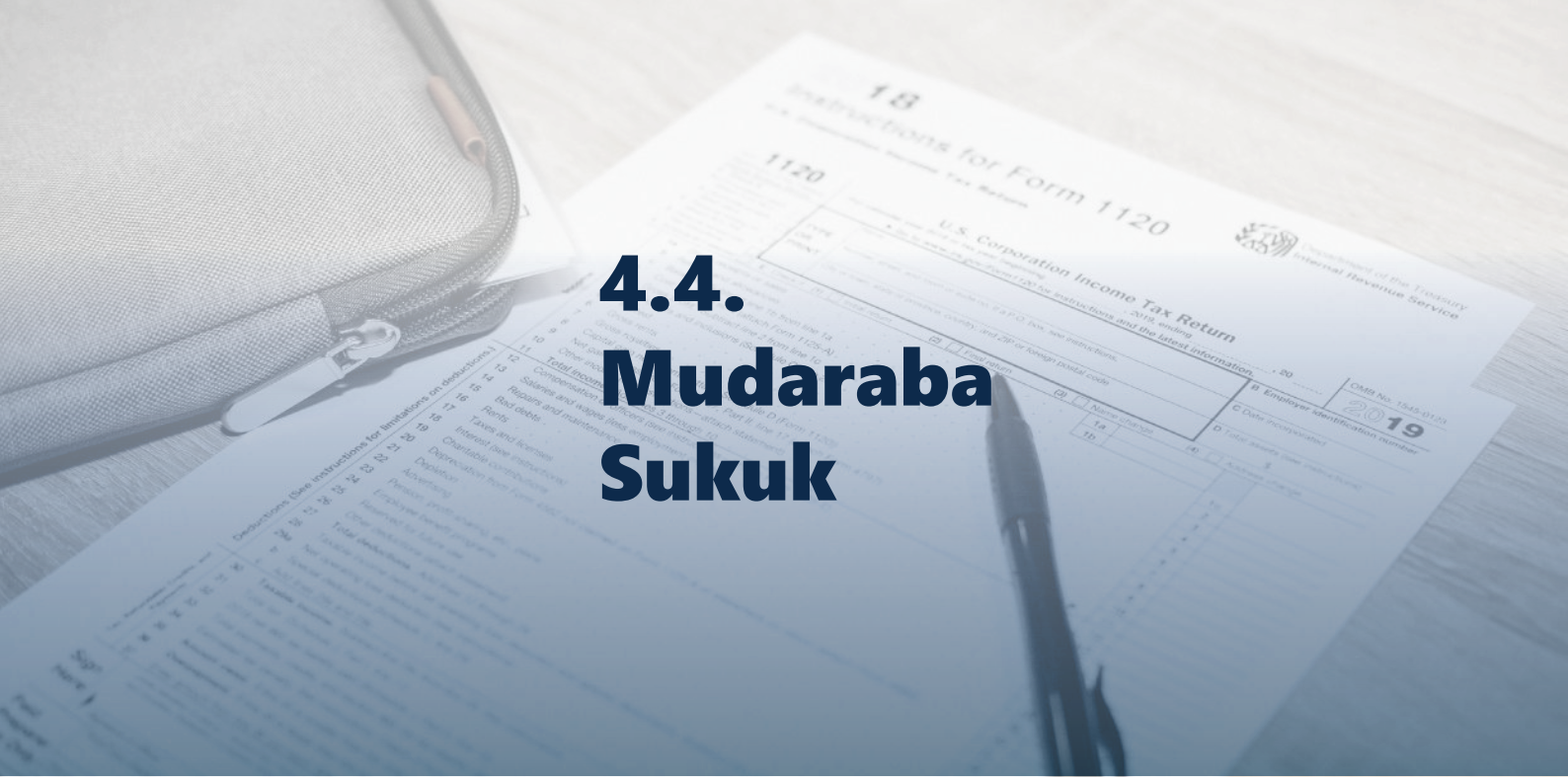
Tradability of Musharaka Sukuk is subject to the composition of the underlying Musharaka project/assets[16].

4.3.6. Main Legal Documents

The main legal documents used in Musharaka Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Musharaka Agreement	The originator and the SPV enter into the Musharaka partnership arrangement.
Purchase Undertaking	Originator undertakes irrevocably to purchase the investors' share in the Musharaka project/assets from the SPV when the latter requests at the agreed price on the relevant exercise/maturity date(s).
Management Agreement	The SPV appointing the originator as the managing partner to carry out all necessary actions on behalf of the partners to achieve the Musharaka's intended objectives.

[16] Please refer to section 3.5 of the Guidelines for more information about the Shariah compliance requirements for Sukuk tradability



4.4. Mudaraba Sukuk

4.4.1. Definition

Mudaraba is a type of partnership arrangement where one party (or more) provides the funds, and the other party (managing partner) provides expertise in deploying the funds in a Shariah compliant project or business activity for profit generation purposes.

4.4.2. Key Conditions and Particulars

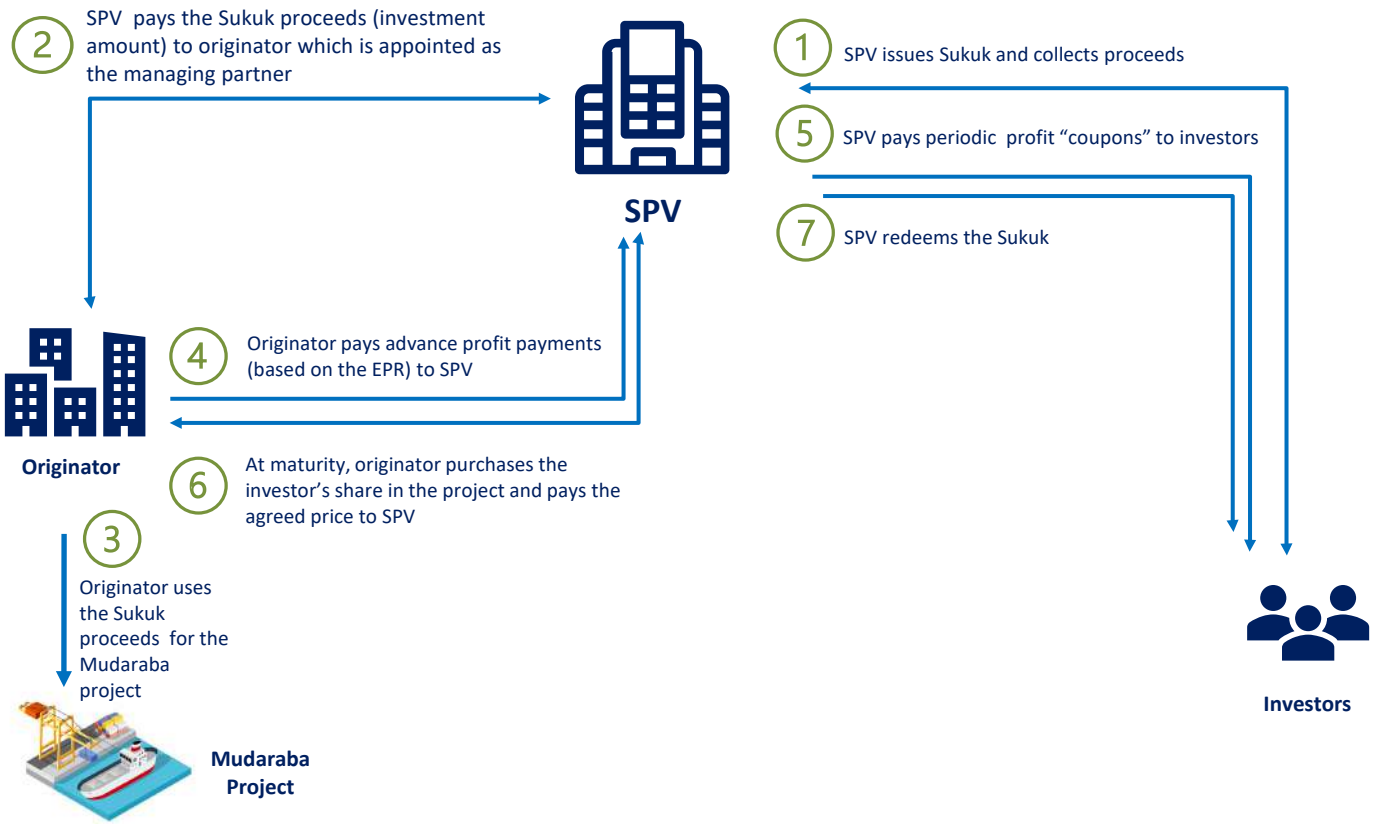
- The underlying Mudaraba project/assets/activities should be Shariah compliant.
- The partners will share any profit generated from the Mudaraba project/assets according to an agreed profit-sharing ratio.
- Losses, if any, will be borne by the capital provider(s), except in cases of the managing partner's negligence, misconduct, wilful default, fraud, or non-compliance with the agreed Mudaraba contractual terms and conditions.
- The managing partner has a fiduciary responsibility and hence acts as trustee in managing the Mudaraba project/assets/activities on behalf of all partners.

4.4.3. Sukuk Indicative Application

- Under Mudaraba Sukuk, the originator would be appointed as the managing partner while the investors will be the capital providers. The originator in its capacity as the managing partner shall invest the funds in the Mudaraba project/assets.
- The originator shall perform their obligations dutifully under the Mudaraba Sukuk and look after the interests of the investors in good faith. The originator will also have an obligation to closely monitor the performance of the Mudaraba project/assets and ensure that the EPR[17] is achievable during the Sukuk tenor.
- However, under a Mudaraba agreement, the managing partner cannot provide an unconditional guarantee to return the invested capital, save for instances of negligence, gross misconduct, fraud of the manging partner, and/or non-compliance with the agreed Mudaraba terms and conditions.
- During the Sukuk tenor, the originator could make advance profit payments[18] to the SPV for distribution to the investors.
- On maturity date, the originator purchases the share of the investors in the Mudaraba project/assets and pays the market value, or any other price agreed[19] between the parties (Sukuk redemption).
- Any profit amount exceeding the expected profit is retained by the originator as a reward for good performance, whilst any shortfall in the principal or between the advance profit payment and the actual profit achieved could be settled in the final pay-out (redemption payment)[20].

4.4.4. Process Flow

Figure 6. Mudaraba Sukuk Issuance Process



[17] The profit share of the Sukuk holders is typically capped at an agreed EPR
[18] Such advance profit payments are typically calculated based on the EPR published by the originator
[19] Typically, this is the principal investment amount of the Sukuk holders
[20] Sometimes Sukuk originators provide a discretionary gift to the Sukuk holders to top up the difference between expected and actual profit to avoid losing the confidence of investors in the market. This is acceptable from Shariah standpoint as long as such gift is not contractually required in the Sukuk documentation

4.4.5. Tradability

Tradability of Mudaraba Sukuk is subject to the composition of the underlying Mudaraba project/assets[21].

4.4.6. Main Legal Documents

The main legal documents used in Mudaraba Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Mudaraba Agreement	The originator and the SPV enter into the Mudaraba partnership arrangement where the originator will act as the managing partner.
Purchase Undertaking	Originator undertakes irrevocably to purchase the investors' share in the Mudaraba project/assets from the SPV when the latter requests at the agreed price on the relevant exercise/maturity date(s).

[21] Please refer to section 3.5 of the Guidelines for more information about the Shariah compliance requirements for Sukuk tradability

4.5. Wakala Sukuk

4.5.1. Definition

- Wakala is an agency contract where one party or more (principal) delegates to another party (agent) the responsibility to undertake a defined action on their behalf (usually for an agreed fee/remuneration).
- Investment Wakala is a form of Wakala where the subject matter of the agency is ''investment of funds''.

4.5.2. Key Conditions and Particulars

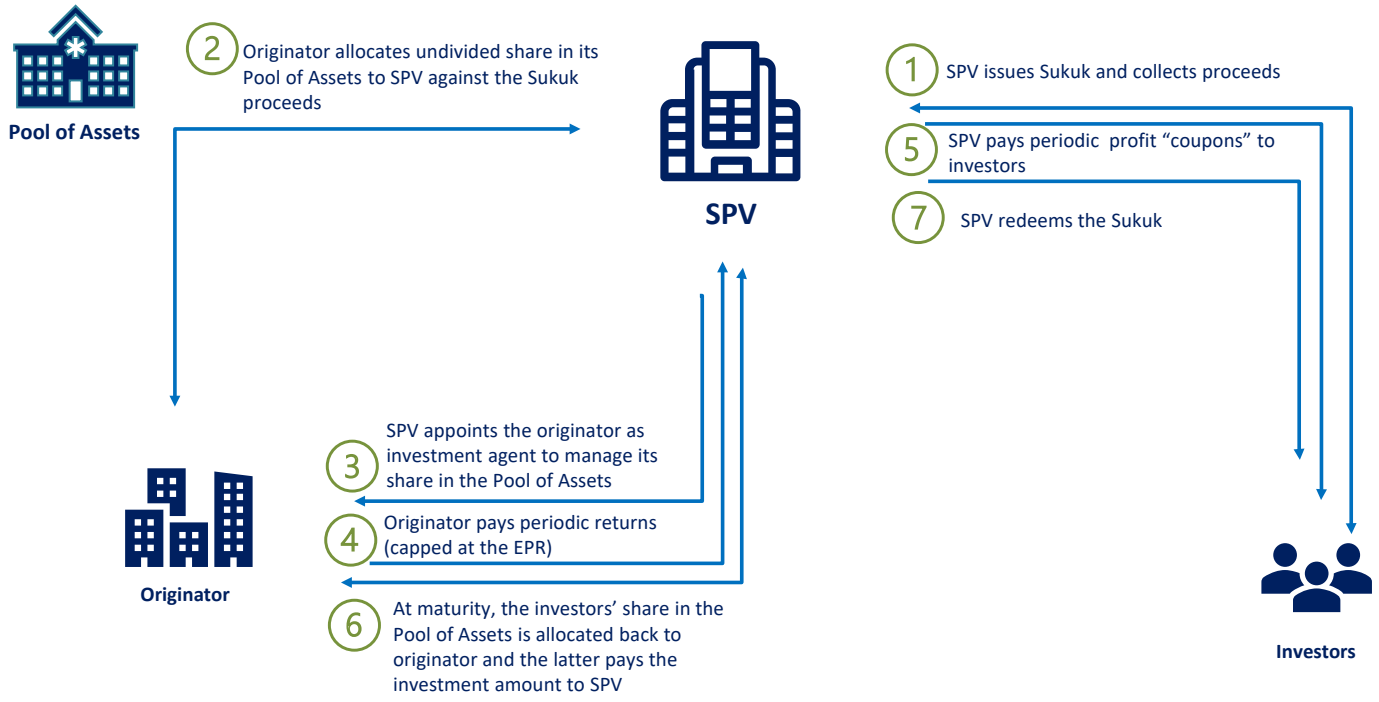
- The principal must be the owner or has the right to make decisions in relation to the subject matter of the agency arrangement.
- The subject matter of the agency arrangement (e.g., actions/services/activities/projects) should be Shariah compliant.
- The agent has a fiduciary responsibility and hence acts as trustee in executing the underlying agency activities.

4.5.3. Sukuk Indicative Application

- Wakala Sukuk is structured as an investment agency arrangement where the investors would appoint the originator as their investment agent.
- The originator may charge a Wakala fee[22] to invest the funds in the Pool of Assets[23] with the aim of generating an EPR for the investors. Any profit generated by the Pool of Assets over the expected profit may be retained by the originator as a reward for their good performance and achieving the EPR.
- The originator in their capacity as investment agent shall perform their obligations under the Wakala Sukuk dutifully and look after the interests of the investors in good faith. The originator shall have an obligation to closely monitor the performance of the Pool of Assets and ensure that the EPR remains achievable during the Sukuk tenor.
- However, under a Wakala agreement, the investment agent cannot provide a guarantee to return the invested capital except in cases of negligence, gross misconduct, fraud of the investment agent, and/or non-compliance with the agreed investment Wakala terms and conditions.
- At maturity, the shares of the investors in the Pool of Assets would be allocated back to the originator and the investment amount, subject to performance, will be paid to the investors (Sukuk redemption).

4.5.4. Process Flow

Figure 7. Wakala Sukuk Issuance Process



[22] In practice, such fee is usually nominal (e.g., US$ 1)
[23] E.g., securitising financing pool of an Islamic financial institution, subject to meeting certain Shariah requirements

4.5.5. Tradability

Tradability of Wakala Sukuk is subject to the composition of the underlying Pool of Assets of Wakala[24].

4.5.6. Main Legal Documents

The main legal documents used in Wakala Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Sale Agreement	Originator sells to the SPV undivided shares in the Pool of Assets against payment of Sukuk proceeds.
Investment Wakala Agreement	The SPV appoints the originator as their investment agent to manage their shares in the Pool of Assets.
Purchase Undertaking	Originator undertakes irrevocably to purchase the SPV's shares in the Pool of Assets upon the occurrence of certain designated events as per the agreed price.
Purchase Agreement	The originator buys the SPV's shares in the Pool of Assets on the relevant maturity/exercise date(s).

[24] Please refer to section 3.5 of the Guidelines for more information about the Shariah compliance requirements for Sukuk tradability

4.6. Istisna' Sukuk

4.6.1. Definition

- Istisna' is a sale contract where the seller, based on the request of the buyer, manufactures, or constructs a specific subject matter (Istisna' assets) to be delivered on an agreed future date.
- Istisna' is typically used in the Islamic finance industry to finance manufacturing/developing assets e.g., properties, airplanes, machines etc.

4.6.2. Key Conditions and Particulars

- Istisna' assets should be Shariah compliant and non-existent[25] but described thoroughly with all the relevant specifications to minimise the uncertainty.
- Sale price and payment terms should be agreed at the outset upon signing the Istisna' contract (payment terms are often structured as progress payments against clearly defined development milestones for the Istisna' assets).

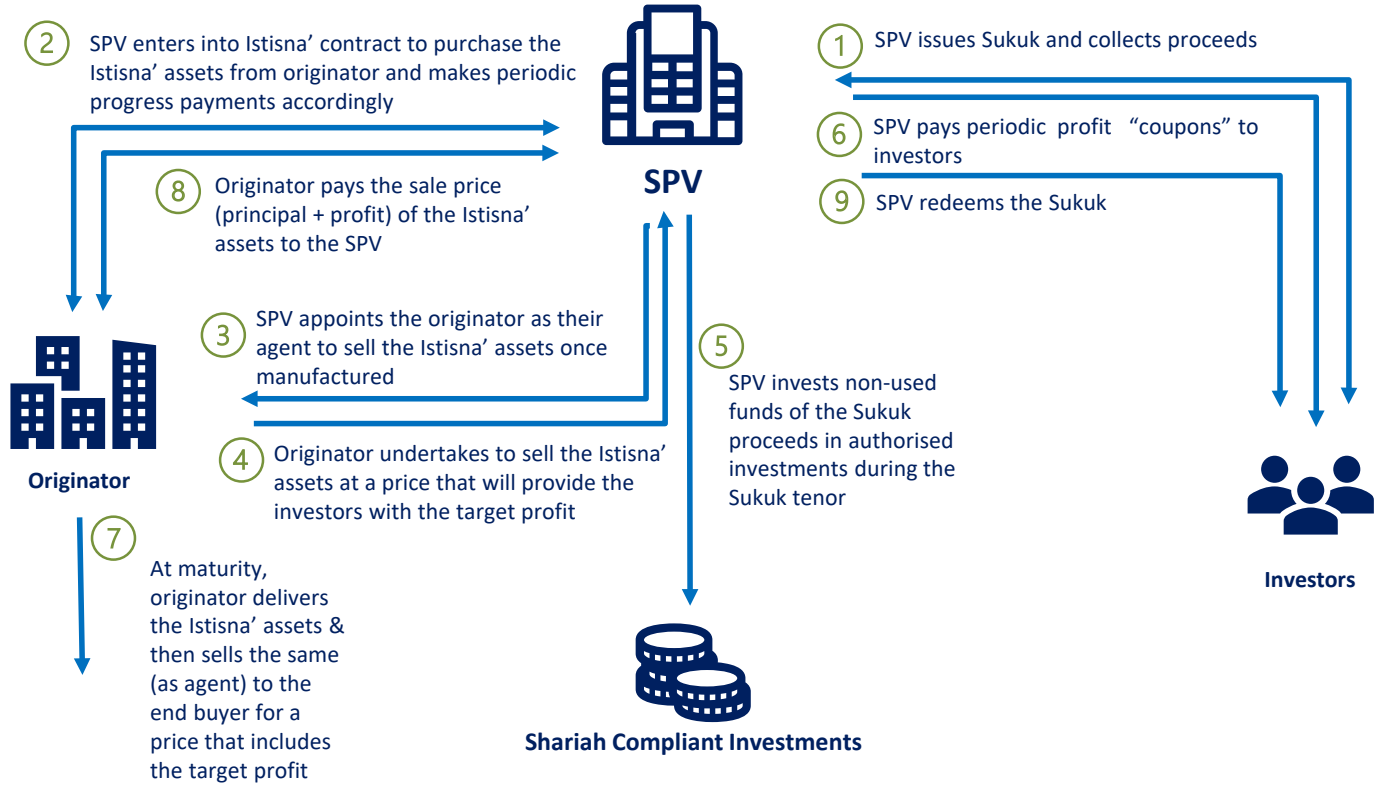
[25] At the time of entering into the Istisna' contract

4.6.3. Sukuk Indicative Application

- The originator, acting as seller, and the investors, acting as buyers, would enter into an Istisna' contract. Istisna' is suitable for long-term development projects so Istisna' assets could be a multi-story building that would be developed according to agreed specifications and completed on a specific date.
- During the Sukuk tenor, the funds raised under Istisna' Sukuk would be used to make periodic progress payments to the originator against specific development milestones for the Istisna' assets. The SPV may invest[26] remaining funds of the Sukuk proceeds in authorised Shariah compliant investments during the Sukuk tenor until all proceeds are paid to the originator[27].
- The investors would appoint the originator as their agent to sell the Istisna' assets, once completed. The originator also undertakes to sell the Istisna' assets at a price that will provide the investors with the target profit.
- Upon maturity of the Sukuk, the originator delivers the developed Istisna' assets and then sells the same (as an agent of the investors) to an end buyer[28] and accordingly generates the agreed target profit for the investors.
- The originator may need the assistance of certain contractors (depending on the nature of the Istisna' assets) to develop, acquire and dispose the Istisna' assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documentation.
- However, the appointment of such contractors should be arranged by the originator independently and shall not relieve the originator from their obligations with the investors as defined in the Sukuk documentation.

4.6.4. Process Flow

Figure 8. Istisna' Sukuk Issuance Process



[26] The funds could be invested in profit-making instant-access Islamic banking accounts or other highly rated and liquid Sukuk
[27] The amount of invested funds will vary during the Sukuk tenor, subject to the progress payments made to the originator
[28] In practice, the end buyer is identified at the outset (prior to initiating the Sukuk issuance process). The originator may also ask the end buyer to sign an undertaking to purchase the Istisna' assets, once completed, as per the agreed price with the Sukuk holders

4.6.5. Tradability

- The Istisna' Sukuk are generally not tradable. However, their tradability status may change during the Sukuk tenor depending on the level of completion for construction/ manufacturing of the Istisna' assets.
- Hence, specific guidance and approval from the SSSB should be required and communicated with the investors in a timely fashion.

4.6.6. Main Legal Documents

The main legal documents used in Istisna' Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Istisna' Agreement	Entered into between the originator as the seller of the Istisna' assets to the SPV (the buyer).
Investment Agreement(s)	The agreement(s) that allow the SPV to invest the Sukuk proceeds in authorised Shariah compliant investments.
Agency Agreement	The SPV appoints the originator as an agent to sell the Istisna' assets, once completed, to an end buyer as per the agreed price.
Undertaking to Purchase	The end buyer undertakes to purchase the Istisna' assets from the originator at a price that will provide the Sukuk holders with the target profit.
Sale Agreement	The originator, as an agent of the SPV, sells the Istisna' assets to the end buyer.

4.7. Salam Sukuk

4.7.1. Definition

- Salam is a sale contract involving spot payment of the full sale price and deferred delivery of the subject matter (Salam assets).
- Salam is typically used in the Islamic finance industry to facilitate financing agricultural produce and extraction/ production of natural resources.

4.7.2. Key Conditions and Particulars

- Salam assets should be Shariah compliant, non-existent[29], measurable, general and replaceable, and described thoroughly to minimise the uncertainty.
- Salam assets to be delivered in the future on an agreed date and place.
- Sale price should be agreed at the outset and paid in full by the buyer upon signing the Salam contract.

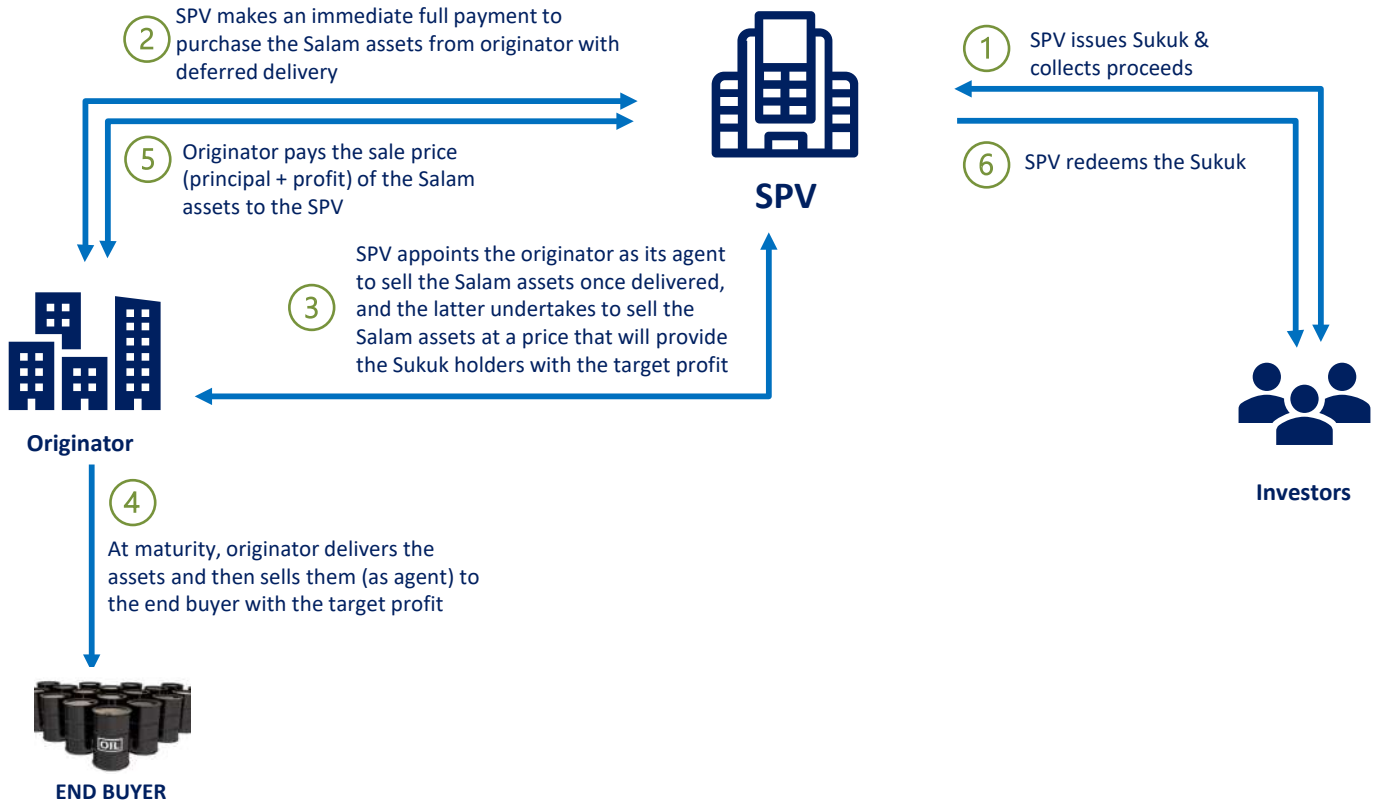
[29] At the time of entering into the Salam contract

4.7.3. Sukuk Indicative Application

- The originator, acting as seller, and the investors, acting as buyers, would enter a Salam arrangement. Accordingly, the investors make an immediate full payment to purchase the Salam assets on a deferred delivery basis from the originator.
- The investors would also appoint the originator as their agent to liquidate the Salam assets where the originator undertakes to sell the same at a price that will provide the investors with the agreed target profit. The Salam assets could be a certain volume, weight, and quality of crude oil to be delivered on a specific date.
- Upon maturity of the Sukuk, the originator delivers the Salam assets and then sells the same (as an agent of the investors) to an end buyer[30] to liquidate the Salam assets and generate the agreed profit for the investors.
- The originator may request the assistance of certain contracts/suppliers (depending on the nature of the Salam assets) to acquire and dispose the Salam assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documentation.
- However, the appointment of such contractors/suppliers should be arranged by the originator independently and shall not relieve the originator from their obligations with the investors as defined in the Sukuk documentation.
- It is important to note that Salam Sukuk are comparable with short-term zero-coupon bonds where the Sukuk are sold to investors with a discount and the full face-value (principal + profit) is paid at maturity.

4.7.4. Process Flow

Figure 9. Salam Sukuk Issuance Process



[30] In practice, the end buyer is identified at the outset (prior to initiating the Sukuk issuance process). The originator may also ask the end buyer to sign an undertaking to purchase the Salam assets, once delivered, as per the agreed price with the investors

4.7.5. Tradability

The Salam Sukuk are generally not tradable.

4.7.6. Main Legal Documents

The main legal documents used in Salam Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Salam Agreement	Entered into between the originator as the seller of the Salam assets to the SPV (the buyer).
Agency Agreement	The SPV appoints the originator as an agent to sell the Salam assets, once delivered, to an end buyer as per the agreed price.
Undertaking to Purchase	The end buyer undertakes to purchase the Salam assets from the originator at a price that will provide the Sukuk holders with the target profit.
Sale Agreement	The originator, as an agent of the SPV, sells the Salam assets to the end buyer.

4.8. Hybrid Sukuk

4.8.1. Definition

- Hybrid Sukuk is a term used in the Islamic finance industry to refer to innovative Sukuk structures that employ multiple Shariah compliant contracts.
- This section showcases a hybrid Sukuk structure that is based on Istisna' and Ijara.
- Istisna' was defined under section 4.6.1 of the Guidelines.
- Ijara was defined under section 4.2.1 of the Guidelines.

4.8.2. Key Conditions and Particulars

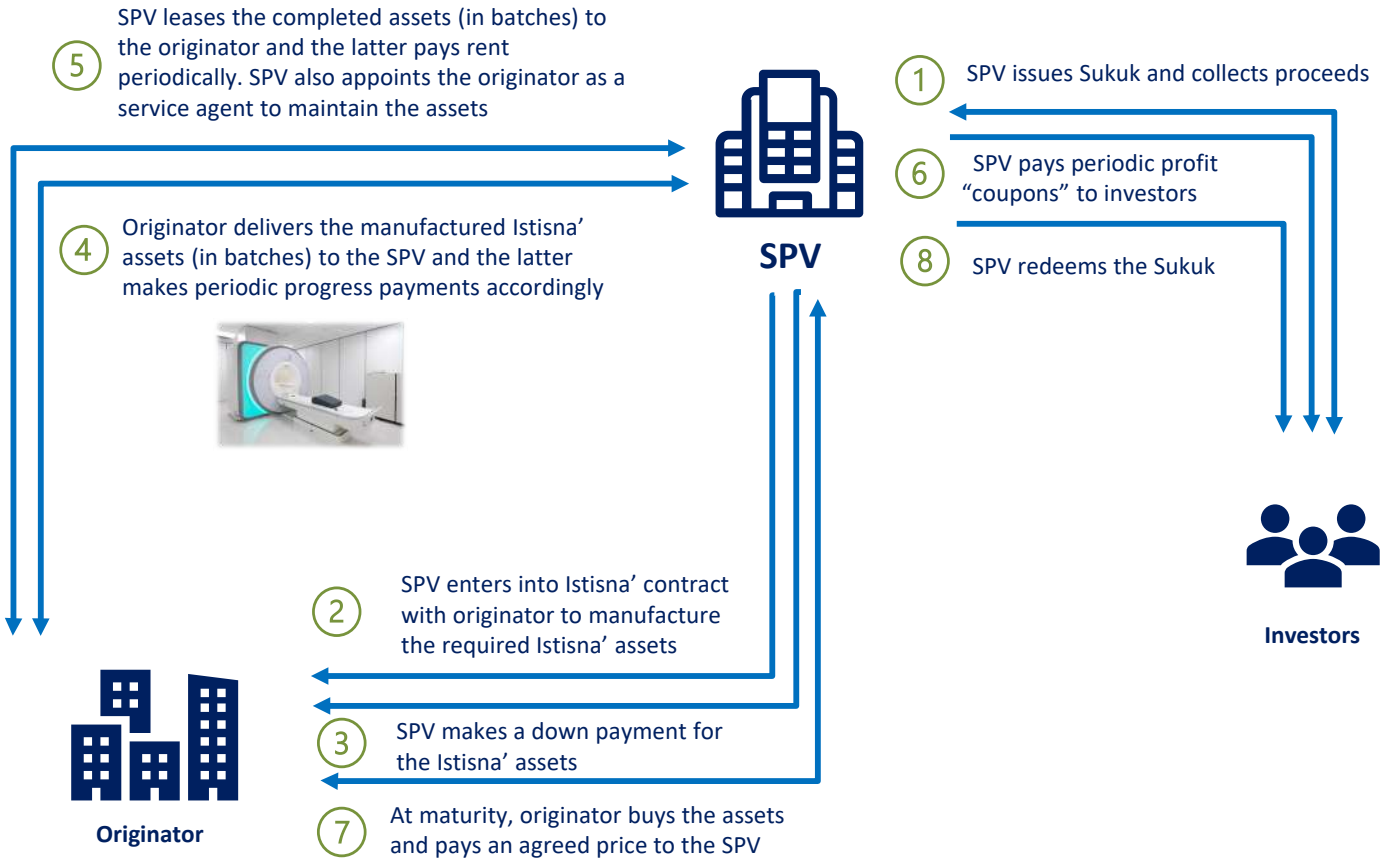
- Key conditions and particulars of Istisna' have been listed under section 4.6.2 of the Guidelines.
- Key conditions and particulars of Ijara have been listed under section 4.2.2 of the Guidelines.

4.8.3. Sukuk Indicative Application

- This hybrid Sukuk is suitable for long-term development projects. Under this structure, the originator and the investors would enter the following arrangements:
  - **Istisna' contract** - the investors would purchase the Istisna' assets from the originator (to be developed and delivered in batches during the Sukuk tenor) and a down payment would be advanced to the originator accordingly. Further progress payments would be made to the originator, subject to meeting the agreed development milestones for the Istisna' assets. The assets could be a set of medical equipment that would be manufactured and delivered in batches according to certain specifications.
  - **Ijara contract**[31] - the originator enters an Ijara contract with the investors to lease the completed assets (in batches) to the originator and the latter pays rent periodically. The investors would also appoint the originator as a service agent to maintain the leased assets during the Sukuk tenor.
- Upon maturity of the Sukuk, the Ijara arrangement would be terminated, and the originator would buy the assets and accordingly pay an agreed price to the investors.
- The originator may request the assistance of certain contractors/suppliers (depending on the nature of the underlying assets) to manufacture, acquire and dispose the assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documentation.
- However, the appointment of such contractors/suppliers should be arranged by the originator independently and shall not relieve the originator from their obligations with the investors as defined in the Sukuk documentation.

4.8.4. Process Flow

Figure 10. Hybrid Sukuk Issuance Process



[31] This contract could also be a forward Ijara (leasing an asset under construction/manufacturing) to provide the investors with returns during the construction period through the payment of advance rent. Such rent can be adjusted against the first rent payment when the construction of the assets is completed. Advance rent is subject to Shariah requirements that shall be defined and approved by the SSSB

4.8.5. Tradability

- Tradability of this hybrid Sukuk is subject to the composition of the underlying assets throughout the Sukuk tenor[32]. However, a Sukuk issuer usually structure hybrid Sukuk in coordination with the SSSB to ensure tradability throughout the Sukuk tenor.
- In all cases, tradability restriction(s), where applicable, should be clearly mentioned in the Sukuk prospectus and/or communicated to the Sukuk holders in a transparent and timely fashion.

4.8.6. Main Legal Documents

The main legal documents used in this hybrid Sukuk may include the following:

Document	Description/Purpose
Constituent Document(s) of the SPV	As per the provisions of the Constituent Document(s), the SPV will: • Hold the relevant assets on trust for the Sukuk holders. • Where applicable, collect the Sukuk proceeds, receive and distribute the profit of the Sukuk holders, and make redemption payments. Exercise all of the rights and take other steps as necessary on behalf of the Sukuk holders in accordance with the Sukuk documentation.
Istisna' Agreement	Entered into between the originator as the seller of the Istisna' assets to the SPV (the buyer).
Ijara Agreement	SPV will lease to the originator the underlying assets. Originator will be responsible, at its own cost and expense, for the performance of all ordinary maintenance and repair required for the leased assets.
Service Agency Agreement	Originator is appointed as a servicing agent by the SPV to manage the leased assets (major maintenance, Islamic insurance, if any, and payment of taxes, if applicable).
Undertaking to Purchase	The originator undertakes to purchase the assets from the SPV at an agreed price.
Sale Agreement	The SPV sells the assets to the originator on the relevant maturity/ exercise date(s).

[32] Please refer to section 3.5 of the Guidelines for more information about the Shariah compliance requirements for Sukuk tradability

5. INNOVATION IN SUKUK

5.1. ESG and Sukuk

- Environmental, Social, and Governance (ESG) refers to a wide range of environmental, social, and corporate governance factors that affect the capacity of a Sukuk issuer/ project/assets to generate shared value in compliance with Shariah and the Principles of Responsible Investing (PRI), among others.
- The PRI is a global initiative introduced by the United Nations to guide investors, asset managers, and bonds/Sukuk issuers, among others, in their way of incorporating ESG in asset allocation and investment strategies and decisions.
- By considering the ESG criteria, the stakeholders including investors can measure the broader impact of business operations related to the Sukuk issuer/project/assets and assess their sustainability.
- The following three ESG components characterise business performance related to Sukuk issuer/project/assets with respect to the environment and society it operates in:

- **Environmental component** considers the effects of business activities on biodiversity, natural resources, and natural environment through measuring certain toxic emissions, waste discharge, energy, and natural resource consumption, e.g., water, land, etc.

- **Social component** covers the links between the business and society. It underlines the ways a business impacts the life and wellbeing of their employees and the surrounding local communities. Public health, education, equality and diversity, personnel health and safety, community support are part and parcel of the social component, amongst others.

- **Governance component** includes such aspects as an internal structure of a business, its control mechanisms, corporate culture, corporate reporting systems, auditing, and regulatory compliance. Businesses should seek fair, ethical, and transparent corporate governance to meet their stakeholder expectations and achieve sustainability.

- The importance of ESG lies in the fact that global challenges like climate change, environmental degradation, biodiversity loss, impacts on human health and social unrest urge investors to analyse how ESG-related risks and opportunities are likely to impact a business future financial position.
- Therefore, for ethical purposes and to avoid certain financial risks, a growing number of investors look for Sukuk issuer/project/assets with strong ESG track records. These investors are value-driven and perceive the absence of relevant ESG practices as a potential lack of capacity to create long-term value.

- Benefits of ESG integration into business include:

Attraction of investments and additional capital.

New market expansion opportunities.

Boosting transparency, good reputation, and trust.

More effective alignment with emerging global frameworks and stakeholder expectations.

Better compliance with tightening regulatory requirements.

Competitive advantage.

ESG reporting

- ESG reporting increases transparency through responsible communication and contributes to timely management of emerging risks and opportunities. Adaptive and stakeholder focused ESG indicators are viewed as powerful tools to deliver resiliency in challenging periods and assure stakeholders that Sukuk issuer/project/assets are creating long-term value while achieving the intended positive impact.
- Sukuk issuers should use consistent and globally recognised methodologies to allow for meaningful comparisons of ESG data over time and across various jurisdictions.

A key example of ESG Sukuk issuance

- In September 2021, Kuveyt Türk Katilim Bankasi A.S., one of the leading Turkish participation banks that is majority-owned by Kuwait Finance House, issued a US$ 350 million sustainability Sukuk due in 2031, listed on the Irish Stock Exchange. This Sukuk issuance was based on Investment Wakala structure.
- The proceeds of the aforementioned Sukuk are being used to finance and/or refinance eligible green and/or social projects in accordance with Kuveyt Türk's Sustainable Finance Framework.
- The appetite for ESG Sukuk has been clearly demonstrated by the fact that this issuance was oversubscribed by 12 times with an order book of **US$4 billion.**

US$4 billion.

5.2. Green Sukuk

- Green Sukuk are a special type of ESG Sukuk in which issuers exclusively use the proceeds in climate and environmental projects and assets.
- Funds raised under Green Sukuk can be used to protect the environment and natural resources, conserve energy, promote renewable technologies, reduce greenhouse gas emissions, and finance climate change mitigation and change adaptation projects.
- Main categories of green finance projects include but are not limited to:

  - Renewable energy.
  - Energy efficiency.
  - Pollution prevention and control.
  - Environmentally sustainable management of living natural resources and land use.
  - Terrestrial and aquatic biodiversity conservation.
  - Clean transportation.
  - Sustainable water and wastewater management.
  - Climate change mitigation and adaptation.
  - Eco-efficient and circular economy adapted products, production technologies and processes.
  - Green buildings that meet regional, national, and/or internationally recognised standards.

Overview on Green Sukuk market

- Green Sukuk issuance is mainly driven by sovereigns and multilateral development institutions in key Islamic finance jurisdictions. This is partly because numerous Muslim-majority countries are signatories to the 2015 Paris Agreement on Climate Change, and have adopted the UN Sustainable Development Goals (SDGs) with published net-zero emission targets.
- As of 2021, around US$ 20 billion worth of Green Sukuk have been issued since the market inception in 2017.

A key example of Green Sukuk issuance

- In November 2019, the IsDB successfully created and finalised an innovative Green Finance Framework to utilise funds exclusively for green projects in IsDB member countries and became the first AAA-rated multilateral institution to issue a Green Sukuk, raising one billion Euro in the same year.
- The funds raised under the aforementioned debut Green Sukuk of IsDB are being used to finance and/or refinance projects across the 57 member countries of IsDB in renewable energy, clean transportation, energy efficiency, pollution prevention and control, wastewater management etc.

AIFC and Green Finance

- It is important to note that AIFC has set up a dedicated Green Finance Centre (GFC) to:
  - Enable the development of green finance in Kazakhstan and Central Asia.
  - Bring investments to sustainable economy through value-based financial instruments such as green and ESG Sukuk.
  - Act as a regional think-tank, providing strategic and business consulting in green finance and sustainable development to governments, quasi-state organisations, and private institutions, among others.
- The Astana International Exchange (AIX) has also published Green Bond Listing Conditions[33] which are expected to be applicable to Green Sukuk as well within the AIFC.

[33] Please refer to AIX Business Rules GRN 4, 5, and 6 for more details on such listing requirements

5.3. Perpetual Sukuk

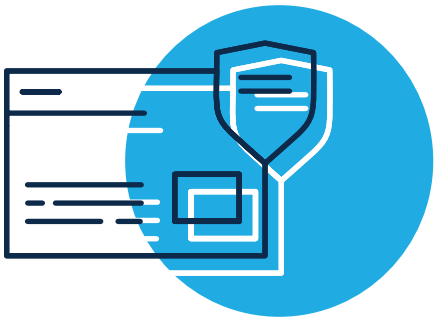
- Perpetual Sukuk are Additional Tier 1 (AT1) capital type of Sukuk that have a high degree of loss absorbency and equity-like features with no set maturity date[34]. However, full redemption of perpetual Sukuk could be included in the structure at the issuer's discretion, subject to defining the trigger event(s) in the Sukuk documentation.
- This type of Sukuk should be capable of being converted into common equity or written off, subject to certain conditions that must be clearly defined in the Sukuk prospectus.
- Perpetual Sukuk pay an expected profit rate that is typically fixed at the issuance time. However, the expected profit rate could be increased later by the Sukuk issuer as an incentive for retaining and/or attracting existing/new investors.
- As per the IFSB standards, Musharaka is the most suitable structure for perpetual Sukuk, but Mudaraba has been also used in the market.
- Key benefits of perpetual Sukuk include:
  - Provide Islamic financial institutions, particularly Islamic banks, with funding alternatives that improve their capital structures and assist them in meeting prudential regulatory requirements.
  - Alternative funding source for corporates that face difficulties in raising capital through equity issuances.
  - Enhance the issuer's credit profile due to increased financial flexibility and efficient capital management.
  - Act as a cost-effective balance sheet management tool.
  - Offer investors an innovative type of asset class that gives exposure to both debt and equity like features.
- The first Perpetual Sukuk in the Islamic finance industry was issued by the Abu Dhabi Islamic Bank in 2012 raising US$ 1 billion using a Mudaraba structure. The issuance was 30 times oversubscribed indicating an impressive level of demand for this type of instruments in the global Islamic capital markets.

[34] Perpetual Sukuk are contractually subordinate to the claims of external creditors. Hence, such Sukuk provide protection to senior and other creditors and act as a capital cushion to absorb any unexpected losses

5.4. Tier 2 Sukuk

- Tier 2 Sukuk are considered part of gone-concern capital which means when an Islamic bank fails, Tier 2 Sukuk must absorb losses after exhausting Tier 1 capital, but before depositors and general creditors.
- Tier 2 Sukuk would have:
  - A set maturity date (at least 5 years).
  - To be capable of being converted into common equity or written off, subject to certain conditions.
- As per IFSB standards, Tier 2 Sukuk are structured on the basis of either Mudaraba or Investment Wakala.
- Similar to perpetual Sukuk, Tier 2 Sukuk provide Islamic financial institutions, particularly Islamic banks, with funding alternatives that improve their capital structures and assist them in meeting prudential regulatory requirements. Moreover, Tier 2 Sukuk offer investors a unique type of hybrid asset class, having both debt and equity like features.
- Clarity and transparency in all the terms and conditions of Tier 2 Sukuk are of high importance from a Shariah compliance standpoint.
- In 2020, Riyad Bank, one of the largest financial institutions in Saudi Arabia, successfully issued a Tier 2 Sukuk raising US$ 1.5 billion. This Sukuk had a 10-year tenor, maturing in 2030, but it is callable after five years from 2025.
- According to Riyad Bank, the aforementioned Sukuk is the first ever Basel III compliant US dollar Tier 2 Sukuk, and also the largest corporate Sukuk issuance in the region. This Sukuk issuance was based on Investment Wakala structure.
- The investor demand for the abovementioned Sukuk issuance was one of the highest seen in the region, with the issuance oversubscribed 5.5 times while the order book reached over US$ 8.3 billion.

6. CUSTODIAN OF THE GUIDELINES



6.1. Ownership and Custody

The Guidelines shall remain in the custody of the AIFC which is the owner, responsible for maintaining, updating, revising, and editing the Guidelines.

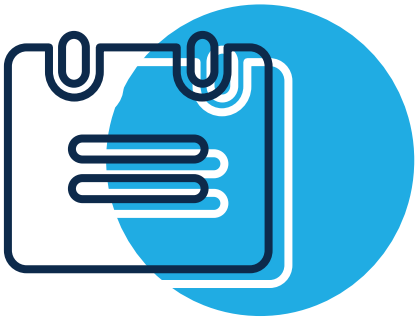
6.2. Revision and Updates

The Guidelines shall stay in effect until replaced by any revised version.

The Guidelines shall be reviewed at least once every 3 years by the AIFC to ensure they remain properly updated.

6.3. Effective Date

The Guidelines shall become effective from DD/MM/YYYY.

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