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Luxembourg
A prime location for Sukuk issuance



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Islamic finance in Luxembourg

There has been a recent surge in demand for Sharia'a-compliant instruments from both Islamic and other investors.

This has accelerated the growth of Sharia'a-compliant entities investing in a wide range of sectors such as equities, real estate, private equity, infrastructure, etc.

Worldwide, there are more than 800 Sharia'a-compliant investment funds and their number is growing. These Sharia'a-compliant investment vehicles manage assets of US\$1.5 trillion (regulated and non-regulated funds). It is clear that Luxembourg is a key player in this sector.

Islamic financial products differ from conventional financial products due to prohibitions on interest, gambling, uncertainty, short selling and trading in products deemed incompatible with Sharia'a law

(e.g. alcoholic drinks, weapons, adult entertainment). Under Sharia'a principles, an investor is a business partner seeking to obtain profits from underlying assets or businesses (but is generally exposed to the losses as well) and can never be a creditor expecting a fixed interest return on loans.

Luxembourg has become a domicile of choice for Islamic finance in Europe, with a history of innovation in this field. For example, Europe's first Islamic financial institution was licensed in Luxembourg, and carried out operations from 1978 to the 1990s. In 1983, Luxembourg was the first European country to host a Sharia'a-compliant insurance company (Takaful).

Luxembourg's stock market was the first in Europe to list a Sukuk in 2002, and since that date, 16 Sukuk have been listed on the Luxembourg Stock Exchange.

In 2009, Luxembourg's central bank was the first European entity to become a member of the Malaysia-based Islamic Financial Services Board (IFSB), the prudential/supervisory standard-setting body for Islamic financial institutions. More recently, in May 2011, the Central Bank of Luxembourg hosted the annual IFSB board meeting in Luxembourg.

On 25 October 2010, the Central Bank of Luxembourg was one of the 14 founding members of the International Islamic Liquidity Management Company (IILM Co), which is headquartered in Kuala Lumpur, Malaysia. The idea behind this institution is to create and issue short-term Sharia'a-compliant financial instruments that will facilitate effective cross-border Islamic liquidity management. The founding members are the central banks or monetary authorities of Indonesia, Iran, Kuwait, Luxembourg, Malaysia, Mauritius, Nigeria, Qatar, Saudi Arabia, Sudan, Turkey and the United Arab Emirates, along with two multilateral institutions, the Islamic Development Bank and the Islamic Corporation for the Development of the Private Sector.

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of innovation in this field

Sukuk listed in Luxembourg

Originator	Issue amount	Maturity
Malaysia Global Sukuk	US\$600,000,000	2002-2007
Solidarity Trust Services	US\$400,000,000	2003-2008
Dubai Global Sukuk FZCO	US\$1,000,000,000	2004-2009
Tabreed Financing Corp	US\$100,000,000	2004-2009
Sarawak Corporate Sukuk	US\$350,000,000	2004-2009
Stichting Sachsen-Anhalt	€100,000,000	2004-2009
Pakistan International Sukuk	US\$600,000,000	2005-2010
Wings FZCO	US\$550,000,000	2005-2012
IDB trust services	US\$500,000,000	2005-2010
Gold Sukuk DMCC	US\$200,000,000	2005-2010
QREIC Sukuk LLC	US\$270,000,000	2006-2016
Salam Bounian Development Company Sukuk Ltd	US\$137,500,000	2008-2018
Petronas Global Sukuk Ltd	US\$1,500,000,000	2009-2014
Al my'iar Capital S.A.	TRY 50,000,000	2010 (6 months)



Structuring Sukuk transactions

Sukuk (the plural of SAKK) is an Arabic word that means ‘certificates’.

The Sukuk have similar characteristics to a conventional bond, except that Sukuk are asset-backed (although some might argue that Sukuks are actually asset-based). Often considered as Islamic bonds, Sukuk are in reality investment certificates evidencing an undivided prorata ownership of an underlying tangible asset. Sukuk are structured in such a way that their holders run a credit risk and receive part of the profit and not an interest payment fixed in advance. The products underlying Sukuk may be represented by agreements called ijarah, musharakah or mudarabah.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines Sukuk as being: *“Certificates of equal value representing after closing subscription, receipt of the value of the certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs and services, or equity of a given project or equity of a special investment activity”.*

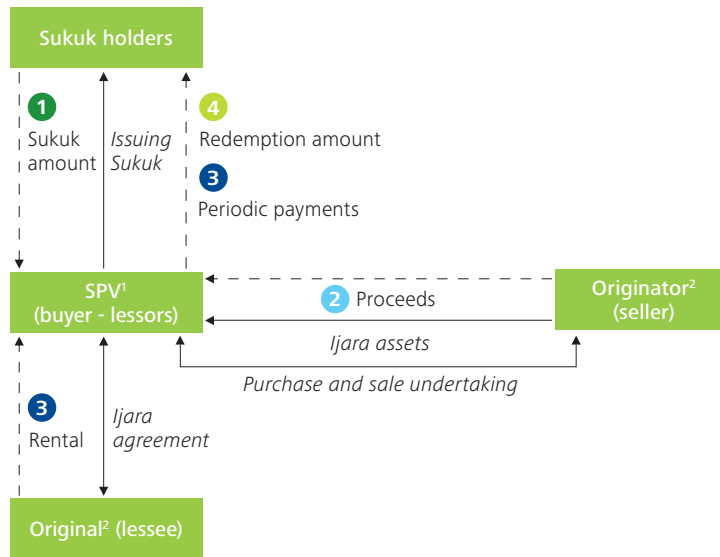
Sukuk are Islamic ‘debt’ instruments, which can be issued by governments, local authorities or public companies. They can be listed on the stock markets. They are a tradable Sharia’a-compliant capital market product providing medium-to-long-term fixed or variable rates of return. Sukuk are rated by international rating agencies, which investors use as a guideline to assess the risk/return parameters of a Sukuk issue. They are similar to conventional bonds in the sense that they generate regular periodic income streams over the investment period, with easy and efficient settlement and the possibility of capital appreciation. They are also liquid instruments that can be traded on the secondary market, with the exception of the Sukuk al-Murabaha, as Sharia’a prohibits trading of debt if not at par value.

Types of Sukuk in Luxembourg

Type of Sukuk	Underlying assets	Target	Tradability	Maturity
Sukuk al-Ijara	Real estate, boats, aircraft, etc.	<ul style="list-style-type: none"> • Sovereign • Corporates 	Tradable	5 to 20 years
Mixed-asset Sukuk	Portfolio of Sharia'a- compliant assets	<ul style="list-style-type: none"> • Corporates • Financial institutions 	Tradable except for loans	5 to 10 years
Sukuk al-Musharaka	Real estate, infrastructure, etc.	<ul style="list-style-type: none"> • Sovereign • Corporates 	Tradable	5 to 20 years
Sukuk al-Murabaha	Commodities, equipment, machinery, tools, vehicles, etc.	<ul style="list-style-type: none"> • Sovereign • Corporates 	No	5 to 20 years
Sukuk al-Istisna	Airports, roads, factory equipment built to a specification, etc.	<ul style="list-style-type: none"> • Sovereign • Corporates 	Tradable	5 to 20 years
Sukuk al-Salam	Agricultural products, commodities, base metals, etc.	<ul style="list-style-type: none"> • Sovereign • Corporates 	No	6 months to 2 years

Sukuk al-Ijara

Sukuk al-Ijara are securities representing the ownership of a specific asset under a lease agreement. They offer a fixed return and can be transferred to other parties in the secondary market.



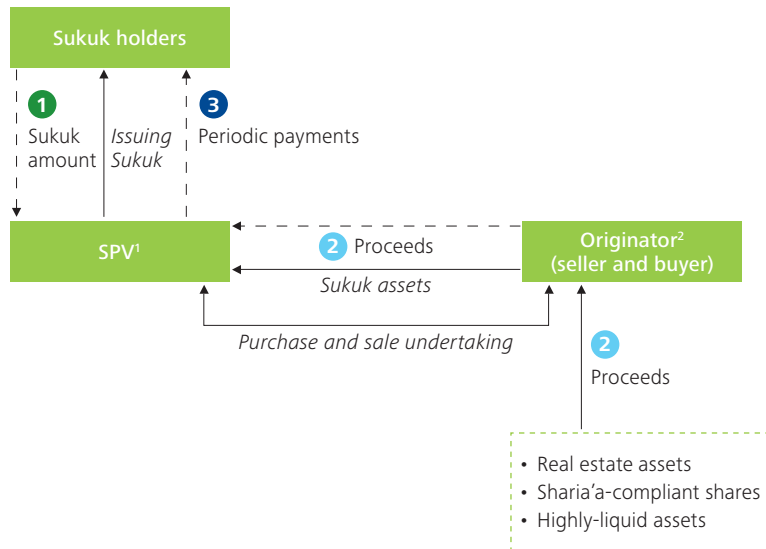
Structuring overview

- 1 The Sukuk holders pay the Sukuk subscription amount to the SPV/issuer
 - 2 The seller sells the beneficial title of the assets (Ijara assets) to the SPV in return for the purchase price, which is paid upfront by the SPV
 - 3 The SPV leases the Sukuk assets (Ijara agreement) to the originator (lessee) for the duration of the facility. Rental income (Ijara instalments) generated by the Sharia'a-compliant assets is distributed to Sukuk holders through the SPV
 - 4 At maturity a redemption amount is paid against the transfer of the Sukuk certificates, which are then cancelled
- Fund flows

1 The SPV will act as trustee in respect of the Sukuk assets for the benefit of the Sukuk holders
 2 In most transactions, the originator is the seller and lessee of the assets

Mixed-asset Sukuk

A mixed-asset Sukuk is backed by a portfolio of Sharia'a-compliant investments. It offers the advantage of a diversified pool of assets, its tradability is assured and the maturing or defaulting assets can be repurchased.



Structuring overview

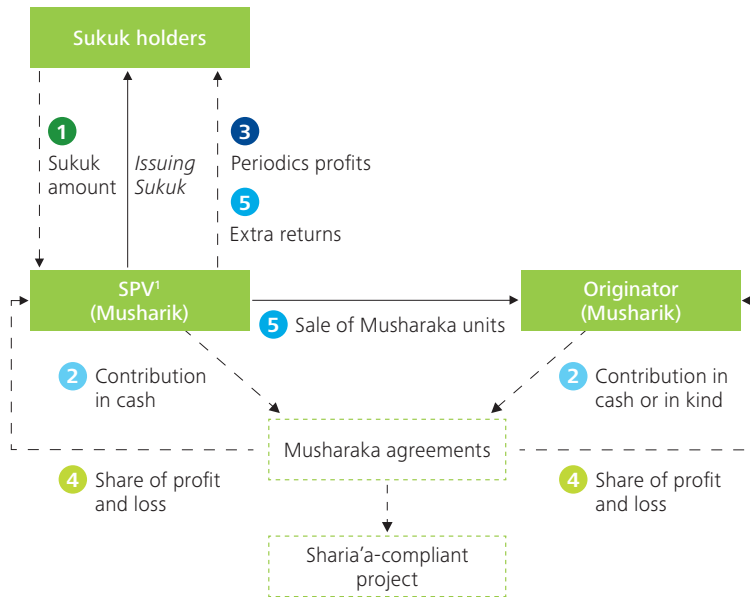
- 1 The Sukuk holders pay the Sukuk subscription amount to the SPV/issuer
- 2 The originator allocates a portfolio of Sharia'a-compliant assets and sells the beneficial title of these 'mixed assets' to the SPV in return for the purchase price, which is paid upfront
- 3 Returns are paid to Sukuk holders on a periodic basis from the income generated by the Sharia'a-compliant assets

--- Fund flows

¹ The SPV will act as trustee in respect of the Sukuk assets for the benefit of the Sukuk holders

Sukuk al-Musharaka

Sukuk Al-Musharaka are designed for the development of specific projects/activities involving the contribution of capital by all parties to the Musharaka agreement.



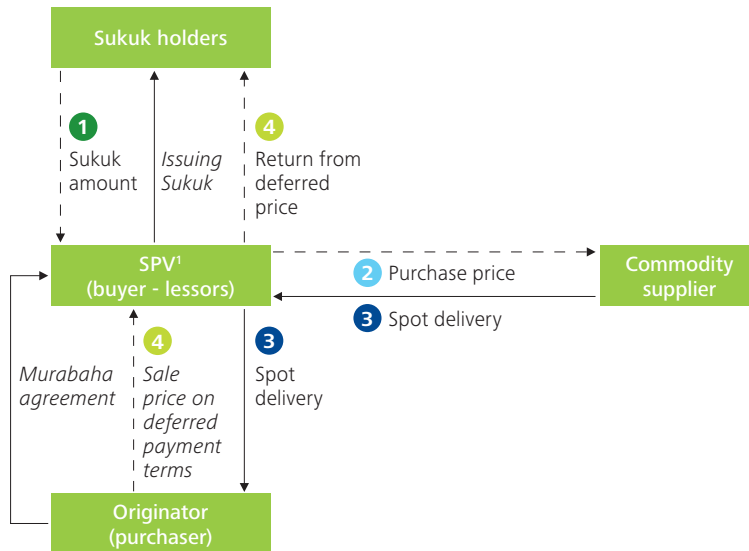
Structuring overview

- 1 The SPV issues Sukuks under a Musharaka agreement (partnership) with the originator
- 2 Each partner (Musharik) provides the Musharaka with a contribution (Sukuk proceeds from the SPV, land or cash from the originator)
- 3 Profits are distributed according to a pre-determined ratio (e.g. 90:10). The originator, in its capacity of management agent, is in charge of distributing the fund flows received through the Musharaka to both Musharik and receives the potential surplus as performance fees
- 4 Under the Musharaka agreement, profits are shared in the pre-agreed ratio between the SPV and the originator. Any losses are distributed in accordance with the proportion of capital provided by the originator and the SPV
- 5 Profits/losses are passed on to the investors in the form of periodic returns

¹ The SPV will act as trustee in respect of the Sukuk assets for the benefit of the Sukuk holders

Sukuk al-Murabaha

Sukuk al-Murabaha are certificates of equal value issued for the purpose of financing the purchase of goods through a Murabaha agreement, so that the Sukuk holders become owners of the Murabaha commodity.



Structuring overview

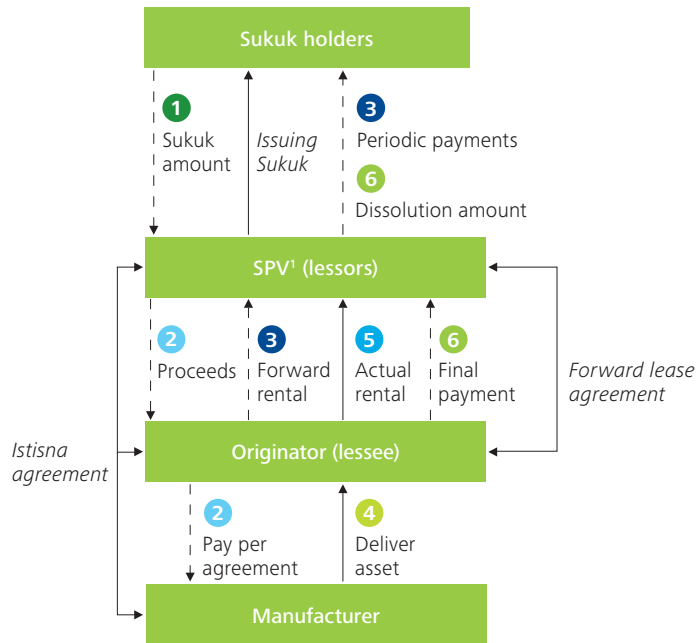
- 1 The Sukuk holders pay the Sukuk subscription amount to the SPV/issuer
- 2 The SPV enters into a Murabaha agreement under which it agrees to sell, and the originator agrees to purchase, certain commodities from the SPV on spot delivery and deferred payment terms
- 3 The commodity supplier makes spot deliveries of the commodities to the SPV in exchange for the purchase price. The SPV then sells these commodities to the originator
- 4 The originator pays the deferred price in instalments to the SPV at regular intervals, which are passed on to Sukuk holders

--- Fund flows

1 The SPV will act as trustee in respect of the Sukuk assets for the benefit of the Sukuk holders

Sukuk al-Istisna

The Sukuk al-Istisna is similar to project finance contracts in conventional finance. This type of Sukuk is often used to provide capital to originators seeking to fund construction of a capital asset that do not have all the funds available at the outset.



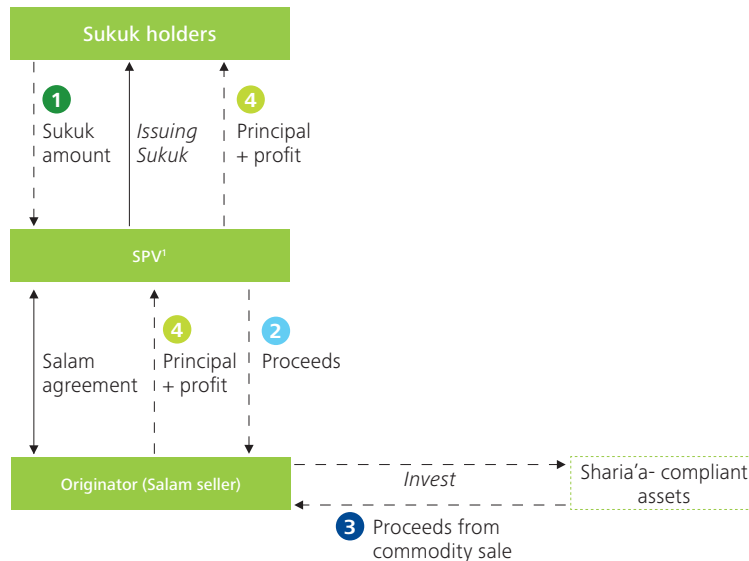
Structuring overview

- 1** The SPV and the originator enter into an Istisna agreement with the manufacturer to manufacture the assets. The Sukuk holders then pay the Sukuk subscription amount to the SPV/issuer
- 2** The Sukuk proceeds from the investors are transferred by the SPV to the originator and subsequently to the manufacturer in line with the agreed payment schedule
- 3** During the construction phase, the originator enters into a forward lease agreement with the SPV. The originator makes forward rental payments to the SPV, which are then distributed to the Sukuk holders as periodic payments
- 4** The manufacturer delivers the assets when completed. Title to the assets passes to the SPV (lessor) and the physical assets are delivered to the originator (lessee)
- 5** Once construction of the asset is complete, the forward lease agreement will be replaced by a lease agreement and the originator will pay rentals to the SPV until the Sukuk al-Istisna matures
- 6** At maturity, the SPV sells the asset to the originator and passes on the proceeds from the sale of the asset to the Sukuk holders

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Sukuk al-Salam

Sukuk al-Salam can be compared with zero coupon bonds and are not tradable in a secondary market. This type of sukuk is short term and held until maturity.



Structuring overview

- 1** The Sukuk holders pay the Sukuk subscription amount to the SPV/issuer
- 2** The SPV enters into a Salam agreement with the originator whereby it will contract to deliver, in the future, specific goods or assets (the asset underlying the Salam agreement) at a predetermined price
- 3** The underwriter, usually an entity, agrees (through an underwriting agreement) to buy the delivered good or asset at a predetermined price at maturity. The price will consist of the initial cash amount received by the originator plus a margin
- 4** At maturity, the proceeds are distributed to the Sukuk holders, in addition to the margin paid by the underwriting entity

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