



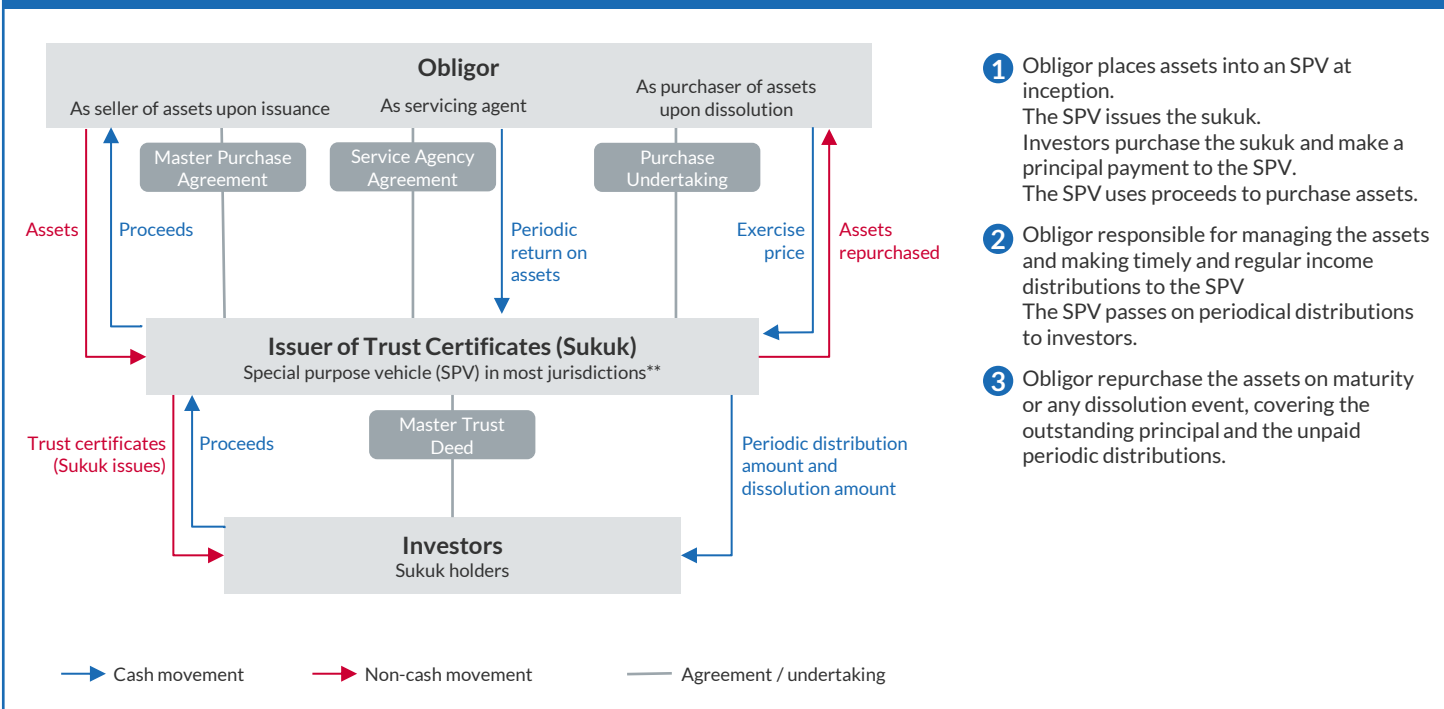
Criteria Essentials – Sukuk Ratings 1/2



Sukuk Rating Criteria Scope

- Apply only to obligor-backed (or asset-based) sukuk
- Apply globally to senior unsecured, secured, subordinated or short-term obligations
- Do not apply to asset-backed sukuk, which rely on underlying collateral
- Sukuk unrateable if principal repayment is subject to market risk
- Applied in conjunction with relevant master criteria
- Sukuk ratings are not a confirmation of sharia compliance

Simplified Example of a Sukuk Transaction



- 1 Obligor places assets into an SPV at inception. The SPV issues the sukuk. Investors purchase the sukuk and make a principal payment to the SPV. The SPV uses proceeds to purchase assets.
- 2 Obligor responsible for managing the assets and making timely and regular income distributions to the SPV. The SPV passes on periodical distributions to investors.
- 3 Obligor repurchase the assets on maturity or any dissolution event, covering the outstanding principal and the unpaid periodical distributions.

Assets and Enforcement

- Nature of assets varies depending on the obligor
- For unsecured sukuk holders:
 - No recourse against the assets
 - Recourse against the obligor only, pursuant to the purchase undertaking
- Sukuk terms authorising the registration of assets title in the trustee's name upon default are insufficient for sukuk to be considered secured. Could be reassessed if warranted

Distribution of Returns

- Benchmark rate of return typically defined in documentation
- Documentation includes full and timely payment of periodical distribution and of principal.
- Investors rely upon contractual commitments and obligor direct support features such as
 - Liquidity facility
 - Advance rental
 - Top-up mechanism
 - Indemnity

* It remains uncertain whether certificate holders will be able to enforce their contractual rights in relevant courts due to lack of legal precedents in many jurisdictions. If Fitch cannot form a view on these aspects or uncertainty is high, the sukuk would be unrateable.
 ** Sukuk structures generally involve a single-purpose SPV. Depending on local legislation, an SPV may not always be required, and the transaction may sometimes be held on the books of the originator rather than an SPV's. This does not have implications for Fitch's Sukuk Rating Criteria. This document is a summary of, and complementary material to, our current Sukuk Rating Criteria report available on Fitch Ratings' public website. It does not replace our criteria and should be used in conjunction with it.



Criteria Essentials – Sukuk Ratings 2/2

Defining Sukuk

- Sukuk developed as the Islamic finance industry’s alternative to conventional bonds
- Commonly referred to as Islamic bonds
- Typically structured around contractual arrangements formulated according to sharia
- Represent undivided shares in the ownership of tangible assets and their usufruct
- Most sukuk resemble debt obligations with fixed returns, but some resemble equity-like investments.

Typical Events of Default and Covenants for Sukuk

- Failure to pay any amount due
- Failure to perform any obligations or undertakings under the transaction documents
- Failure to comply with any notices; unlawful actions; cessation of operations, insolvency or any arrangements/deferment in relation to any indebtedness.
- Sukuk-specific covenants
 - Sharia non-compliance
 - Triggers that could take the form of put options, dissolution event or covenants related to tangibility event and total and partial loss events

Most Commonly-Used Structures in Sukuk Issuance

Sukuk may incorporate one or more structures

Ijara

Resembles a conventional lease agreement

- Asset leased to a third party for rental payments
- Asset ownership retained by the lessor during the lease term, and typically transferred to the lessee at maturity
- Lessor cannot benefit late payment penalties but may impose a late payment charge to be paid to a charity.
- Lessee often appointed as the lessor’s agent to manage/use the asset
- Lessor is responsible for major maintenance under sharia. In practice, it is often delegated to the lessee.

Murabaha

Asset or commodity at cost plus contract

- Sale of an asset or commodity at cost plus a pre-agreed profit margin, which may be financed in instalments
- Used by banks to provide customers liquidity by buying the asset and reselling it to the customer at a mark-up
- The bank and the customer will often arrange for the bank to sell the assets into the market, with proceeds of that on-sale credited to the customer.

Wakala

A form of an agency contract

- An agency contract between an investor, typically a financial institution, and the agent (the entity requiring financing)
- Typically used in interbank arrangements and between group companies
- In a basic sukuk-al-wakala, the obligor bundles its investments and sell them to the issuer in return for a purchase price. The income derived is used to service the coupon payments.

Other Sukuk Structures

Istisna	A form of financing under which a financier commissions the construction or manufacturing of an asset
Mudaraba	Investors entrusts funds to a corporate that utilises them in a pre-agreed investment or business. After the operation is concluded, the corporate returns the principal and the pre-agreed share of the profit.
Musharaka	Similar to mudaraba, except that, under musharaka, investors take an equity stake in the venture