

SPECIAL REPORT

Global Sukuk Issuance Poised for Boost from New Legislative and Regulatory Initiatives

Anticipated developments should help create a stable and consistent issuance market in the longer term

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Summary

The sukuk market is poised to face a new set of legislative and regulatory developments and various market challenges that are likely to influence issuance trends globally in the years to come. Moody's is closely monitoring the following developments:

- » A number of jurisdictions are developing legislative and regulatory initiatives that should enhance their ability to explore the sukuk market for the first time; this could also prompt other new jurisdictions (with similar regulatory frameworks) to follow suit in a similar fashion. The more established sukuk markets, including those in the GCC, are also expected to witness new legislative and regulatory developments.
- » The sukuk market is – gradually – acquiring characteristics of maturity, including diversity of the investor base, in terms of both institutional investors and fund industry managers. Moreover, the diversity of sukuk issuances across different jurisdictions and ratings spectrum is creating an environment conducive to active fund issuance and asset management.
- » Continued government and government-related issuer (GRI) supervision of mega energy and infrastructure projects in the GCC markets is fostering a wider investor base, including institutional and cross-border investors that are prepared to commit long-term funding.¹
- » Diversification of type of issuance (secured versus unsecured) and investors' appetite or risk aversion to investing in local and international issuances will be key determining factors going forward. Dar Al Arkan (Ba2, Stable) was the first issuer to tap the unsecured issuance market in 2010 with a US\$450 million sukuk.
- » The emergence of sukuk issuances from new jurisdictions, including new markets in Asia (Japan and Korea) and Europe (the UK), will also be a key driver.
- » The sukuk structures seen in 2009, including *ijarah* and *murabaha*, will continue to dominate the market in 2010.
- » We also expect greater understanding of disputes and defaults in Islamic capital markets in light of the recent ruling in the case of Blom Bank versus The Investment Dar (TID).²

Sukuk market issuance volumes experienced a clear turnaround in 2009 compared to the low volumes reported in 2008 when the impact of the global credit crisis started to be felt in many regions, including the Gulf Cooperation Council (GCC) and Asia Pacific.

Issuances by sovereigns and GRIs issuances surged in particular, helping global sukuk issuances increase by over 50% compared to the previous year. Given the weak economic conditions, corporate entities proved to be less able and willing to be major issuers of new sukuk. A key factor behind the dominance by sovereigns and GRIs was their need to launch a variety of funding programmes to combat declining economic activity, fiscal deficits and lower energy and commodity prices.

In addition, many corporate issuers were focused on restructuring strategies and corporate consolidation, which proved detrimental for the issuance of any new sukuk, coupled with the increased cost of new issuances. Nevertheless, a number of highly rated corporate issuers, including GE Capital (Aa2, Stable), Saudi Electricity Company (A1, Stable) and Petronas (A1, stable) did tap the sukuk market, for issuances worth multiple billions of dollars each.

Looking ahead, in the remaining three quarters of 2010, we expect sovereigns and GRIs to maintain the issuance pattern they exhibited in 2009. This is because several market participants have highlighted the importance of persisting with their stimulus and spending programmes to prevent regional economics suffering setbacks at a time of gradual recovery, in which the effects of a full global economic recovery are yet to be tested. When fully introduced, this would also enable several issuers from different spectrums, including privately owned and listed companies, to tap the sukuk market.

In addition, given the ongoing rise in the cost of debt on unsecured issuance globally and the gradual albeit slow progress of legislative and regulatory developments, certain issuers may bring to the market new asset-backed sukuk enhanced by parcels of real estate and/or other finance receivables, in lieu of the high risk premium for unsecured issuances.

Legislative steps, such as the establishment of the Tadawul sukuk market in Saudi Arabia, are improving the prospects of sukuk becoming an attractive issuance structure, especially for local and cross-border investors. This was successfully demonstrated in Malaysia last year, where we saw a surge in local currency issuances by nearly 100% compared to 2008 levels. Saudi Arabia could potentially also become a major local currency issuer in the GCC, due to its potential local market size and funding and investment needs. This is likely amongst Saudi insurance

and *takaful* companies, which – under Saudi Arabia Monetary Authority (SAMA) regulations – are required to place a considerable proportion of their investments in local currency assets.

We also believe the sukuk market has reasonable potential in other GCC countries, including Kuwait, Qatar and the UAE. These markets, together with Saudi Arabia, still lag behind in terms of sukuk issuance in comparison to their respective stock market size and the needs of many of their relatively sizable Shari'ah-compliant issuer and investor bases. For example, Kuwait has recently approved a new Capital Market Law but its sukuk market is still valued at 1.5% of its 2009 GDP (12% if conventional bonds are included), whereas its equity market is equal to nearly 95% of GDP. We expect this disparity in the GCC markets to be corrected gradually over the next few years.

In 2009, global sukuk market activity witnessed a “post-Lehman” recovery. In 2010, we expect a continued recovery associated with a post-“Dubai World” recovery and a resolution of the conglomerate’s debt standstill with its creditors. We believe a potential transparent and mutually satisfactory settlement to Dubai World’s multi-billion dollar debt may calm investor fears and help other issuers to tap the market regionally. This, together with the various legislative and other developments globally, could lead to sukuk issuance in 2010 being in line with 2009 issuance or slightly better. Nevertheless, we continue to predict that most issuance will more likely take place in H2 2010, when investors’ appetite for risk-taking, global signs of recovery and better corporate performance may be more apparent.

In the meantime, we anticipate that the majority of H1 2010 sukuk issuance will come from supranational, sovereign and government-related issuers.

Global Sukuk Issuance: 2009 Overview

Issuance was in line with expectations, mainly from sovereign, GRI and other creditworthy issuers and in local currency

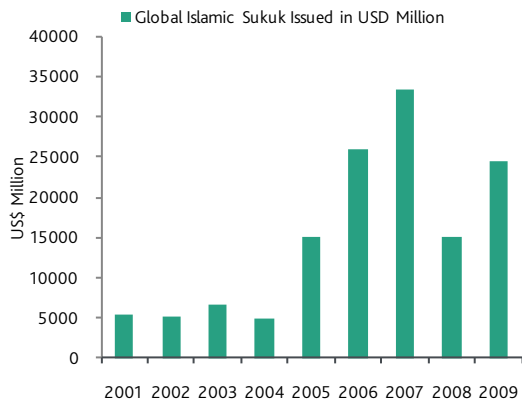
Given the sluggish economic conditions and significant investor churn, most corporates in emerging markets shied away from issuing new debt instruments in 2009, including postponing planned sukuk issuances. In contrast, sovereigns and GRIs became the dominant sukuk issuers given their need to adopt a strategic approach to their financing amid declining economic activity, fiscal deficits and lower energy and commodity prices.

Nevertheless, the sovereign and GRI issuances did encourage a few investment-grade corporates to tap the sukuk market for new issuances, including GE Capital

(Aa2, Stable), which managed to raise a US\$500 million sukuk amongst international and regional investors.

CHART 1

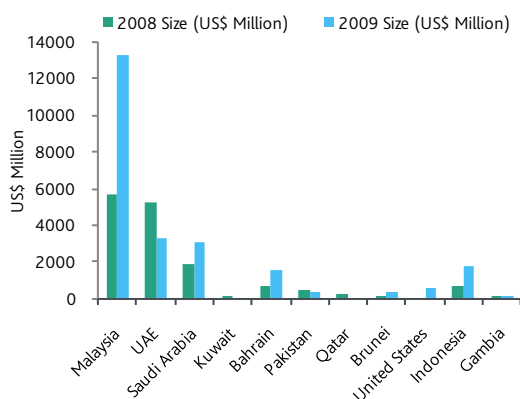
Global Sukuk Issued in US\$ Million



In recent years, there has been a growing interest in issuing local currency sukuk, specifically in Malaysia, Saudi Arabia and Indonesia, which all have sizeable economies, local currency liquidity and locally driven issuance markets. In 2009, these three markets outperformed other markets in terms of local currency sukuk issuances. In particular, Saudi Arabia, as a major GCC issuance market for some of the region's biggest energy and infrastructure projects, raised over SAR6 billion sukuk by Saudi Electricity (A1, Stable), whilst the Kingdom of Bahrain (A2, Negative) managed to increase its issuance through tapping both domestic and international markets.

CHART 2

Global Sukuk Issued by Country



Global Sukuk: 2010 Outlook

New regulations and legislation expected in new sukuk markets, with further developments and growth potential likely in more established markets

We expect 2010 to witness new regulations and legislation being introduced into global sukuk markets, especially in new jurisdictions, following such steps taken in Luxembourg, the UK and Indonesia to facilitate the issuance of Islamic finance securities; France and Australia could become one of the new jurisdictions to implement similar actions. The UK looks set to be the first European jurisdiction to introduce a sovereign sukuk issuance given the advanced legislations that are soon to be approved by the UK Parliament. Nevertheless, the passing of the legislation into law could make it more likely for corporates to issue sukuk rather than a sovereign issuer, given several corporates' pressing funding needs.

Regulatory actions to improve sukuk offerings in new markets are raising its appeal as an issuance structure. Similar legislative actions by governments in the GCC and Asia Pacific have created an environment of confidence, especially amongst international issuers.

We also anticipate further developments in more established markets for the issuance of sukuk, including GCC and Malaysia. Saudi Arabia is currently working on launching its first mortgage and finance law, which is reportedly set to be published during the first half of this year. The new law, once introduced, is expected to drive growth in the local mortgage market, which still lags behind regional and international markets relative to its potential and domestic market needs. Newly established mortgage and finance companies would also be able to facilitate their future lending business, while preserving a form of comfortable security over extended credit. The new law is also expected to bring several benefits for banks and non-bank financial companies that have adopted both the conventional and Shari'ah-compliant funding structures. Moreover, in recent years the Saudi Arabian Monetary Authority (SAMA) has introduced insurance regulations for both conventional and *takaful* operators, which require the latter to have a significant proportion of their investible assets in Saudi riyals, limiting their risk exposure to business counterparties overseas, while attracting issuers to tap a growing source of funding. Moreover, Malaysia has introduced similar incentives to promote sukuk issuances and listing on Malaysia's bourse, by providing a tax-neutral framework and a cost-efficient issuance structure.

Since the inception of the sukuk market, the performance of both local and international sukuk was most evident in

both Malaysia and Bahrain. Both countries have outperformed several other jurisdictions in their issuances relative to their capital market size. By the end of 2009, both countries' sukuk issuances contributed around 38% and 32% of their respective GDP. (If we were to add conventional issuances, the proportions would rise to 86% and 50%, respectively.)

Furthermore, we anticipate that the most promising markets that have so far underperformed their potential are Saudi Arabia, Kuwait, Qatar and, to a lesser extent, the UAE. These four GCC countries are considered well placed to issue further sukuk, given their increased stock market size, relative to their GDP – especially in Qatar and Saudi Arabia – as well as their need to diversify sources of funding and their market capacity and appetite to issue sukuk over the next few years.

Relying on 2008 data collected from the Bank for International Settlements (BIS), global fixed income market volumes exceeded global stock market volumes by 2 to 1. Nevertheless, this does not seem to be either fully or even partially the case in many Islamic finance jurisdictions. By contrast, in the GCC the average stock market size exceeds the sukuk market by 13 to 1. We estimate that, even after including all GCC conventional fixed income issuances in the past five years, the multiple at the end of 2009 was still high at around 5 times.

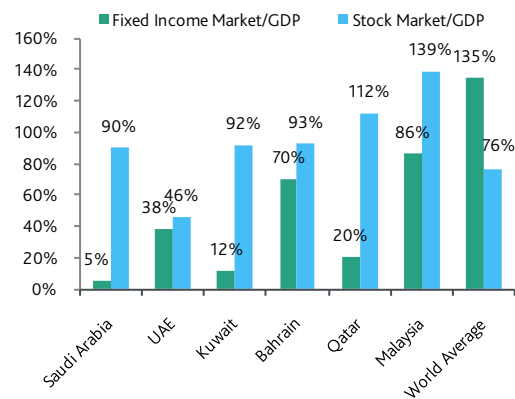
As displayed in Chart (3), the level of capital market maturity in some emerging/new markets in comparison to global markets indicates a historical shift or focus towards investing in the most familiar instrument, i.e. equities, with a clear strong representation /investment concentration in markets such as Qatar, Kuwait and Saudi Arabia, relative to the world average. On the other hand, the lack of a long-term (sukuk) investment culture, instrument availability and the strong stock market performance from 2005 to mid-2008 have prevented fixed-income markets from performing on a par with their stock market performance. After all, sukuk only emerged as a widely used Shari'ah-compliant instrument in the past five years. Hence, we believe that new sukuk and bond issuances in the coming years will gradually reduce this gap, introducing some consistency into capital markets in line with the global lyobserved trend.

We anticipate that Saudi Arabia, the UAE, Qatar and Kuwait will potentially benefit the most given their planned government and private sector investment plans. Nevertheless, we estimate this to be variable across established sukuk markets, mainly driven by:

- » The intense implementation of new legislation and regulatory developments
- » Ongoing disintermediation

- » Growth in fixed income/sukuk as an investment and alternative funding instrument
- » The active role of institutional and fund managers
- » Improving secondary market accessibility and trading.
- » Experience of a variety of sukuk structure issuances, coupled with the return of global markets to a semblance of normality,

CHART 3

Capital Market Performance (% GDP)-2009

Institutional investors and fund managers: an important role that is gradually gaining momentum

A growth in the importance of the domestic bond market in the GCC and Asia Pacific would stimulate a much deeper role of and more active participation of fund managers in sukuk investment, subscription and trading. This would also be a key factor determining the long-term sustainability of a dynamic and active sukuk market in which different market participants, including new investors, would help diversify the investor base, leading to an efficient and active secondary market.

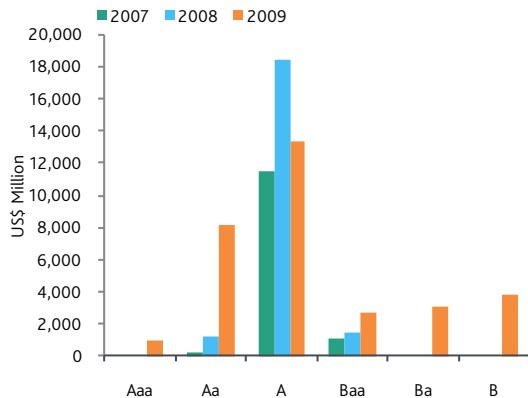
In contrast to the large number of investment-grade ratings assigned to sukuk issuances in 2007 and 2008, 2009 was categorised by a widespread flattening of the curve of our credit rating profile for the sector, with some of the previously assigned ratings in the A and Baa categories moving into the Ba or B categories – many of which were related to actions taken on some of the GRIs in Dubai.

Nevertheless, in 2009 we also saw the assignment of our first Aaa issuer ratings for sukuk, from Saudi Arabia and the US, as well as some new ratings in the Aa category for GRIs in Abu Dhabi and US-based global conglomerates. This development, although relatively modest in size compared to market needs and investors' appetite, has helped establish a much-needed yield curve for sukuk and investment opportunities that institutional and investment funds could

use in their investment portfolios and in working out new strategies.

CHART 4

Rating Performance of Global Sukuk (2007-2009)



In the first quarter of 2009, several sukuk funds were launched, some of which were producing returns in the range of 10% to 15%. The value created by such funds was justified by investors' low risk appetite and declining global capital markets. However, sukuk funds are still in their infancy due to the limited number of sukuk that meet the investment criteria that many fund managers set.

Nonetheless, we believe the recovery in the global economic outlook, the improvement in investor sentiment and new market and jurisdiction issuances should support the gradual introduction of such funds as a new asset class, enhancing both trading and price efficiency in the secondary market. Moreover, the launch of such funds will benefit a wider investor universe, including pensions, *takaful* funds and a large segment of retail investors.

The early 2009 announcement of the establishment of the Tadawul Sukuk platform in Saudi Arabia, a market for the trading and pricing of sukuk, was a noteworthy development that should, over the longer term, create an active and regulated secondary market in the kingdom. We would also expect issuers to be willing to tap the market for new issuances, as transfer of ownership, tradability and market liquidity can be facilitated at minimum transactional cost. This legislative development is a positive step towards strengthening the longer-term sustainability of the Sukuk market; this would attract a larger segment of investors into the market, including institutional investors.

Continued government, supranational and GRI supervision of mega energy, infrastructure and development projects

Sovereigns and GRIs in the GCC region are expected to continue playing an important role in funding infrastructure and energy projects. In this context, investors are likely to be encouraged by Moody's recent sovereign upgrades of Saudi Arabia to Aa3 and Oman to A1 – particularly given the prompt recovery in oil prices in 2009 and improving government finances, especially in Saudi Arabia, Qatar, Kuwait and the UAE, amid the ongoing and persistent banking liquidity crisis and investor risk aversion. These recent improvements in government financing metrics and credit qualities are likely to prompt governments and, to a great extent, GRIs to tap the sukuk and conventional bond markets for further debt issuance, as we believe these entities would be most able to raise new funding through issuing fixed income securities, especially for longer-term tenors. We could also potentially see an influx of international investments from overseas investors, as the world continues to struggle with both a weak global recovery and a sovereign debt crisis in other jurisdictions, mainly in Europe. Significantly, all GCC governments have an abundance of debt capacity, with all six countries having a ratio of government debt to GDP below 25%, with Bahrain the highest at 22%.³

There are early indications that this trend is already taking place, with Saudi Arabia, Abu Dhabi (UAE) and Bahrain planning further issuances through central governments or via their GRIs. Moreover, the Islamic Development Bank (IsDB) (Aaa, Stable) has announced continued support for the issuance of a further US\$5 billion in sukuk over the next five years, starting with US\$1 billion in 2010.

Diversification of the type of issuance (secured vs. unsecured) and of investor appetite and risk aversion

As Islamic market participants are aware, a sukuk should grant the investor a share of an asset or business venture along with the cash flows and risk commensurate with such ownership. While this is indeed the Shari'ah 'ideal', most current structures have more in common with conventional fixed income or 'debt' instruments from a risk/return perspective.⁴ By the end of 2009, only 4% of the US\$ 32 billion worth of sukuk we rate represented secured "asset-backed" sukuk.

In 2010, this trend of "unsecured sukuk" dominance is continuing with Dar Al Arkan (Ba2, Stable) being the first GCC corporate to tap the unsecured issuance market in 2010 with a *wakala* sukuk (10.75% profit yield). This

sukuk was issued through Dar Al-Arkan International Sukuk Company II and reflected the company's immediate funding needs and its leading position in the Saudi real estate sector. However, the company raised US\$450 million, less than the original issuance proposal of US\$750 million. Unlike the company's previously issued sukuk, which had been fully subscribed, this issuance was not well received in the market, a reflection of investors' nervousness to sector exposure and risk aversion to speculative-grade investment. As the global crisis over the past two years will continue to haunt investors, we believe that investors will remain cautious in their risk profiling of different sukuk opportunities.

The credit rating culture in the GCC region and the wider Middle East is still in its infancy. In principle, the intention of issuers is to secure a minimum investment-grade rating, both on a standalone basis and/or for their issuances (unsecured) rating, which is key for their market and financing needs. Nevertheless, this is becoming more difficult to attain, given the issuers' size, franchise value and – especially recently – the lack of an explicit guarantee of parental or government support. Hence, a gradual shift towards new funding structures or access to alternative funding sources – including asset-backed issuances, particularly asset-backed sukuk – is becoming increasingly important. The need to identify appropriate assets for inclusion in structured transactions and investors' more optimistic view of the region are helping issuers tap a wider investor pool with favourable pricing, longer tenors and potentially achieving a higher investment-grade rating. Given the Aa foreign and local currency ceilings of all GCC countries, this ability to potentially attain this higher rating level has proven to be of paramount importance in the recent global crisis.

The ability of private and public-sector companies and GRIs (i.e. those with no explicit government support) to target new sources of asset-backed funding, coupled with the existing asset-based (i.e. unsecured) issuances, could increase the appeal of the fixed-income market, for issuers and investors alike. In addition, the nature of the Islamic finance industry, in particular its limitation on *gharar* (uncertainty) and *maysir* (speculation), should help investors draw comfort from not being associated with some elements of the global derivative markets, which have proven to misrepresent underlying credit and market risk. Nevertheless, this is only likely to happen once further advances in the GCC's regulatory and legal environments have been achieved, coupled with more progress in terms of Islamic finance, particular as regards sukuk structuring techniques, increased Shari'ah consensus/interaction and improving risk management practices.

Considerable uncertainty continues to surround the potential level of new sukuk from both unsecured and secured issuances, depending on the magnitude of the global recovery and the impact of the resolution of the credit standstill for Dubai World (not rated). This relates in particular to the asset-backed receivables of real estate companies or finance receivables of banks and non-bank financial companies. We are actively looking into several asset-backed sukuk and bonds that are currently being structured in the Middle East, mostly in the GCC and specifically in the UAE and Saudi Arabia. In fact, some of the sukuk that Moody's rated during the crisis were backed by assets, including Tamweel Residential ABS CI (1) Ltd (Aa2, stable).

Sukuk Issue Rating

GE Capital

In late 2009, Moody's assigned a provisional (P)Aa2 rating to the sukuk trust certificates of GE Capital Sukuk Ltd. (the Trustee). We anticipate assigning a definitive Aa2 rating and stable outlook to the certificates at closing, subject to a review of the final documentation.

The rating and outlook are consistent with the Aa2 senior unsecured rating and stable outlook of General Electric Capital Corporation (GECC). GECC provides a guarantee in full support of the purchase and performance obligations of Sukuk Aviation Leasing Inc. (SAL), a GECC subsidiary and the servicing agent and obligor under certain of the transaction agreements.

The Trustee is a special purpose entity created to issue the certificates to investors (the certificate holders) and use the proceeds to acquire aircraft assets, including interests in aircraft and associated aircraft leases, from subsidiaries of SAL. The Trustee will hold these assets as an undivided beneficial interest on behalf of the certificate holders.

However, the transaction documents do not confer to the certificate holders any lien or security interest over the assets, thus limiting their control over the assets in the event of a GECC default.

SAL, as servicing agent, will collect rental income from the aircraft leases to GECC customers and provide periodic distribution amounts to the certificate holders. Unfunded and funded reserves administered by SAL provide a backup source of funds to satisfy distribution requirements should rental income be insufficient. At the scheduled termination date and under certain other circumstances, including aircraft shortfall and termination events, SAL will procure

the purchase of the aircraft assets from the Trustee at an amount equal to the face value of the certificates plus accrued periodic distributions and, if required, make-whole and other amounts. These purchase obligations are to effect the repayment of principal to the certificate holders.

GECC guarantees SAL's obligations under the transaction agreements, including the Purchase Undertaking, the Service Agency Agreement, the Purchase Substitution Undertaking, the Declaration of Trust, and other associated agreements. We have reviewed legal opinions regarding the validity, enforceability and ranking of GECC's guarantee obligations. In our opinion, GECC's guarantee rank equally with GECC's other senior unsecured obligations.

The *ijarah*-based structure has a five-year, fixed-rate dollar-denominated sukuk, at a pricing of 5-year treasury plus 175 basis points. According to bankers involved in the deal, 50% of the investors came from the Middle East, while the remaining 50% are a mix of Asian and European investors.

Note on Data:

- » This report aims to capture and discuss the volumes of Islamic finance issuance in EMEA and Asia-Pacific, mainly Shari'ah-compliant securities (sukuk). The volumes reported include all publicly rated and unrated transactions that closed or launched between 1 January 2002 and 31 December 2009.⁵⁶
- » For issued sukuk, a number of resources were used to account for total issued volume and accumulated issued sizes since inception. Sources include Moody's, the Malaysian Securities Commission, Bank Negara, Bursa Malaysia, Kuwait Finance House, BIS, World Federation of Exchanges, Bloomberg and Zawya.
- » Moody's is aware of other sources of information related to sukuk in the market domain that can be different from those quoted in this report. Every effort has been made to include and quote the majority of data sources that are accessible to Moody's.
- » All currencies have been converted into US dollars to facilitate easy comparison. The exchange rate was taken at the time of the closing of the respective transaction.
- » Moody's is aware of the different schools of law – or *fiqh* (Islamic jurisprudence) – among different countries across the Middle East and Asia-Pacific. Hence, these schools differ in the *fiqh* methodology and the acceptance of certain sukuk structures. Furthermore, Moody's review of sukuk transactions has been made on the basis of their legal binding and contractual features that affect the creditworthiness of the sukuk, without opining on their compliance with Shari'ah law.

Appendix 1: Sukuk Transactions Rated by Moody's

COUNTRY	ISSUER	ORIGINATOR NAME	ISSUANCE AMOUNT (US\$ MILLION)	ISSUE RATING/RATING OF SENIOR NOTES
UAE	ADIB Sukuk Co. Ltd.	Abu Dhabi Islamic Bank	5,000	A2
UAE	DIB Sukuk Co. Ltd.	Dubai Islamic Bank PJSC	750	Baa1
UAE	DP World Sukuk Ltd.	DP World	1,500	Ba1
UAE	Dubai Sukuk Center Ltd.	DIFC Investments LLC	1250	B2
UAE	DEWA Funding Ltd*	Dubai Electricity and Water Authority	872	Ba2
UAE	EIB Sukuk Co. Ltd. Programme	Emirates Islamic Bank PJSC	1000	A2
UAE	JAFZ Sukuk Ltd.*	Jebel Ali Free Zone FZE	2,043	B1
UAE	Tamweel Sukuk Ltd	Tamweel PJSC	272	Baa3
UAE	HBME Sukuk Company Ltd	HSBC Middle East Limited (HBME)	5,000	Aa3
UAE	Tamweel Residential ABS CI (1) Ltd.	Tamweel PJSC	210	Aa2
UAE	DB Sukuk Ltd	Dubai Bank PJSC	5,000	A3
UAE	Sukuk Funding (No. 2) Ltd.*	Aldar Properties PJSC	1021	Ba1
UAE	TDIC Sukuk Ltd.	Tourism Development and Investment Company	1,450	A1
UAE	Sun Finance Ltd.	Sorouh Real Estate	1009	Aa3
Malaysia	Malaysia Global Sukuk Inc.	Government of Malaysia	600	A3
Malaysia	Sarawak Corporate Sukuk Inc.	State of Sarawak	350	Baa1
Malaysia	MBB Sukuk Inc. (Subordinated)	Maybank	300	A3
Kuwait	NIG Sukuk Ltd.	National Industries Group Holding S.A.K.	475	B1
Qatar	Qatar Alaqaria Sukuk Co.	Qatar Real Estate Investment Co	300	Baa1
Malaysia	Petronas Global Sukuk Ltd.	Petroleum Nasional Berhad	1500	A1
Indonesia	Indonesia Global Sukuk	Republic Of Indonesia	650	Ba3
Saudi Arabia	IDB Trust Services Ltd.	Islamic Development Bank	850	Aaa
Saudi Arabia	Dar Al-Arkan International Sukuk Company II	Dar Al-Arkan Real Estate	450	Ba2
USA	GE Sukuk	GE Capital	500	Aa2
USA	Al Hilal Sukuk	IFC	100	Aaa
Total amount of Sukuk issuances rated by Moody's:			32,452	

* Actual Issuance in AED, USD Equivalent listed

Appendix 2: Glossary of Islamic Finance Terms

al adl: a trusted and honourable person, selected by both parties to a transaction. Somewhat analogous to a trustee.

al Maqasid al Shari'ah: the objective of Shari'ah.

amanal/amanah: literally means reliability, trustworthiness, loyalty and honesty, and is an important value of Islamic society in mutual dealings. It also refers to deposits in trust, sometimes on a contractual basis.

bai'lbay': contract of sale, sale and purchase.

bai al-salam: advance payment for goods. While normally the goods need to exist before a sale can be completed, in this case the goods are defined (such as quantity, quality, workmanship) and the date of delivery fixed. Usually applied in the agricultural sector where money is advanced for inputs to receive a share in the crop.

Diminishing *musharaka*: a form of partnership that ends with the complete ownership of a partner who purchases the share of another partner in that project by a redeeming mechanism agreed between both of them.

fatwa (pl. *al fatawa*): an authoritative legal opinion based on the Shari'ah.

fiqh: practical Islamic jurisprudence. Can be regarded as the jurists' understanding of the Shari'ah. There are four Islamic jurisprudence, including al-Shaifi, al-Hanifi, al-Maliki and al-Hanbali.

gharar: uncertainty in a contract or sale in which the goods may or may not be available or exist (e.g. the bird in the air or the fish in the water). Also, ambiguity in the consideration or terms of a contract – as such, the contract would not be valid.

hadith: the narrative record of the sayings, doings and implicit approval or disapproval of the Prophet.

halal: permissible, allowed, lawful. In Islam, there are activities, professions, contracts and transactions that are explicitly prohibited (haram) by the Qur'an or the Sunnah. Barring these, all others are halal. An activity may be economically sound but may not be allowed in Islamic society if it is not permitted by the Shari'ah.

haram: unlawful, forbidden (see halal). Describes activities, professions, contracts and transactions that are explicitly prohibited by the Qur'an or the Sunnah.

hawala: bill of exchange, promissory note, cheque or draft. A debtor passes on the responsibility of payment of his debt to a third party who owes the former a debt. Thus, the responsibility of payment is ultimately shifted to a third

party. Hawala is used in developing countries as a mechanism for settling international transactions by book transfers.

ijarah/ijara: lease, hire or the transfer of ownership of a service for a specified period for an agreed lawful consideration. This is an arrangement under which an Islamic bank leases equipment, a building or other facility to a client for an agreed rental.

ijarah wa iqtinalijarah muntahla bittamleek: a leasing contract used by Islamic financial institutions that includes a promise by the lessor to transfer the ownership of the leased property to the lessee, either at the end of the lease or by stages during the term of the contract.

ijtihad: literally effort, exertion, industry, diligence. As a legal term, it means the effort of a qualified Islamic jurist to interpret or reinterpret sources of Islamic law in cases where no clear directives exist.

istisna' al'istisna: a contract of sale of specified goods to be manufactured with an obligation on the manufacturer to deliver them on completion. It is a condition in istisna that the seller provides either the raw material or the cost of manufacturing the goods.

maisir/maysir: the forbidden act of gambling or playing games of chance with the intention of making an easy or unearned profit.

manfa'a: a form of contract in which one party gains the right to use or benefit from the use of an asset.

mudarabah/mudarabah: a form of contract in which one party (the rab-al-maal) brings capital and the other (the mudarib) personal effort. The proportionate share in profit is determined by mutual consent, but the loss, if any, is borne by the owner of the capital, unless the loss has been caused by negligence or violation of the terms of the contract by the mudarib. A mudaraba is typically conducted between an Islamic financial institution or fund as mudarib and investment account holders as providers of funds.

mudarrib: the managing partner or entrepreneur in a mudaraba contract (see above), see also rab almal.

murabaha: a contract of sale with an agreed profit mark-up on the cost. There are two types of murabaha sale: in the first type, the Islamic bank purchases the goods and makes them available for sale without any prior promise from a customer to purchase them, and this is termed a normal or spot murabaha; the second type involves a promise from a customer to purchase the item from the bank, and this is called murabaha to the purchase order. In this latter case,

there is a pre-agreed selling price that includes the pre-agreed profit mark-up. Normally, it involves the bank granting the customer a murabaha credit facility with deferred payment terms, but this is not an essential element.

musharaka/musharakah: an agreement under which the Islamic bank provides funds that are mingled with the funds of the business enterprise and possibly others. All providers of capital are entitled to participate in management, but are not necessarily obliged to do so. The profit is distributed among the partners in a pre-determined manner, but the losses, if any, are borne by the partners in proportion to their capital contribution. It is not permitted to stipulate otherwise.

qard al hasan/qard hassan: a virtuous loan in which there is no interest or mark-up. The borrower must return the principal sum in the future without any increase.

rab-al-maal: the investor or owner of capital in a mudaraba contract (see above).

rahn: a mortgage or pledge.

riba: interest. Sometimes equated with usury, but its meaning is broader. The literal meaning is an excess or increase, and its prohibition is meant to distinguish between an unlawful exchange in which there is a clear advantage to one party in contrast to a mutually beneficial and lawful exchange.

riba al-buyu: a sale transaction in which a commodity is exchanged for the same commodity but unequal in amount or quality, or the excess over what is justified by the counter-value in an exchange/business transaction.

sadaqa: voluntary charity.

salam: a contract for the purchase of a commodity for deferred delivery in exchange for immediate payment.

Shari'a/Shariah/Shari'ah: in legal terms, the law as extracted from the sources of law (the Qur'an and the Sunnah). However, Shari'ah rules do not always function as rules of law as they incorporate "obligations, duties and moral

considerations that serve to foster obedience to the Almighty".

shirkat al-aqad: a joint-venture partnership.

shirkat al-milk: a co-ownership partnership.

saak: participation securities, coupons, investment certificates. Plural sukuk.

Sunnah: the way of the Prophet Mohammed including his sayings, deeds, approvals and disapprovals as preserved in the hadith literature. It is the second source of revelation after the Qur'an.

takaful: a Shari'ah-compliant system of insurance based on the principle of mutual support. The company's role is limited to managing the operations and investing the contributions.

tawarruq: literally monetisation. The term is used to describe a mode of financing, where the commodity sold is not required by the borrower but is bought on deferred terms and then sold to a third party for a lower amount of cash, so becoming "monetised". The reverse of murabaha.

ummah: the community or nation. Used to refer to the worldwide community of Muslims.

urf: the customs of a community.

wa'd: a promise or unilateral undertaking.

wadiah: a deposit.

wakala: agency, an agency contract that generally includes in its terms a fee for the agent.

wakeel al-Istithamr: an investment agent.

waqf: a charitable endowment.

zakah/zakat: a tax that is prescribed by Islam on all persons having wealth above an exemption limit at a rate fixed by Shari'ah. Its objective is to collect a portion of the wealth of the well-to-do and distribute it to the needy. The way it is distributed is set out in the Qur'an. It may be collected by the state, but otherwise it is down to each individual to distribute the zakat.

Related Research

For a more detailed explanation of Moody's approach to this type of transaction as well as similar transactions, please refer to the following reports:

Rating Methodologies

- » Securitisation in New Markets: Moody's Perspective, September 2006 (SF74362)
- » Moody's Approach to Rating RMBS in Emerging Securitisation Markets – EMEA, June 2007 (SF97186)

Special Comments

- » Islamic Banks: Their Strategies and Ratings, May 2009(115565)
- » The Future of Sukuk: Substance over Forum, May 2009 (154199)
- » Frequently Asked Questions: Islamic Finance, Oil Prices and the Global Crisis, February 2009 (114816)
- » Global Sukuk Issuance: 2008 Slowdown Mainly Due to Credit Crisis, But Some Impact from Shari'ah Compliance Issues, January 2009 (SF149211)
- » Gulf Islamic Banks Resilient Amid Global Credit Woes, November 2008 (112431)
- » Frequently Asked Questions: Notable Trends in Global Islamic Finance, August 2008 (110404)
- » Islamic Finance in France: Strong Potential, But Key Obstacles Persist, July 2008 (109676)
- » Islamic Finance: Glossary of Usual Terms and Core Principles, June 2008 (109441)
- » Islamic Banking in East Asia - Growing but not without Challenges, April 2008 (108469)
- » Islamic Banks and Sukuk: Growing Fast, but Still Fragmented, April 2008 (108331)
- » Islamic Finance Explores New Horizons in Africa, March 2008 (108071)
- » Islamic Banks in the GCC: a Comparative Analysis, March 2008 (107856)
- » The Benefits of Ratings for Islamic Financial Institutions and What They Address, February 2008 (107502)
- » Risk Issues at Islamic Financial Institutions, January 2008 (107175)
- » Understanding Moody's Approach to Unsecured Corporate Sukuk, August 2007 (103919)
- » Asian Sukuk Poised for Fast Growth: Market Review and Introduction to Moody's Rating Approach, August 2007 (104446)
- » Moody's Approach to Analyzing Takaful Companies, May 2007 (102910)
- » Takaful: A Market with Great Potential, October 2006 (98913)
- » Shari'ah and Sukuk: A Moody's Primer, May 2006 (103338)
- » A Guide to Rating Islamic Financial Institutions, April 2006 (97226)
- » Moody's involvement in Rating Islamic Financial Institutions, April 2006 (97113)
- » Regulation and Supervision: Challenges for Islamic Finance in a Riba-Based Global System, January 2004 (81128)
- » Culture or Accounting: What Are The Real Constraints for Islamic Finance in a Riba-Based Global Economy?, January 2001 (63369)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Moody's publishes a weekly summary of structured finance credit, ratings and methodologies, available to all registered users of our website, at www.moodys.com/SFQuickCheck.

¹ Please refer to Moody's Special Comment entitled "[Arabian Gulf Corporates: 2009 Review & Key Themes for 2010](#)", January 2010.

² This will be expanded upon in a forthcoming Moody's Special Comment.

³ Moody's estimate.

⁴ Please refer to Moody's Special Comment entitled "[Asset Backed Sukuk: Substance Over Form](#)", May 2009.

⁵ Please refer to Appendix 1 overleaf, which includes all Sukuk issues rated by Moody's since their inception.

» contacts continued from page 1

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