Comparative study between bonds and sukuks

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Introduction
Sukuks and Bonds are two kinds of financial instruments, despite their differences, they share similar responsibility of fund mobilizing from surplus (spending) units to shortage units. Sukuk can resemble conventional bonds by some of its features, but it is technically neither debt nor equity. It is complex to understand the exact nature of sukuk and differentiating them from Bonds.
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Conclusion
Chapter I : Definition and Types Of Bonds
A- Definition of Bonds

• In **finance**, a bond is an instrument of indebtedness of the bond issuer to the holders. It is a debt **security**, under which the issuer owes the holders a debt and (depending on the terms of the bond) is obliged to pay them **interest** (the **coupon**).

• In addition, the issuer must have to repay the principal at a later date, which is termed the **maturity** date. Interest is usually payable at fixed intervals (semiannual, annual, sometimes monthly). Very often the bond is negotiable, that is, the ownership of the instrument can be transferred in the secondary market. This means that once the transfer agents at the bank medallion stamp the bond, it is highly liquid on the secondary market.
B- The different types of Bonds

a- Convertible Bond:
• A convertible bond gives the bondholder the right to convert the bond into a fixed number of shares of common stock in the issuing company.

b- Fixed Rate Bonds:
• In fixed Rate Bonds, the interest remains fixed throughout the tenure of the bond. Owing to a constant interest rate. Fixed rate bonds are resistant to changes and fluctuations in the market.
B- The different types of Bonds

c- Floating Rate Bonds:
• Floating rate bonds have a fluctuating interest rate – coupons- as per the current market reference rate.

d- Zero Interest Rate Bonds:
• Zero Interest Rate Bonds do not pay any regular interest to the investors. In such types of bonds, Issuers only pay the principal amount to the bond holders.
Chapter II: Definition and Types of Sukuks
A- Definition of sukuks

- The AAOIFI “Accounting and Auditing Organization for Islamic Financial Institutions” define the Sukuks as being: titles of co-ownership representative of a tangible asset, the yield on which is linked to the performance of an underlying asset. One or several concerned assets can be services, properties or rights or the usufruct of these properties or rights.
Sukuks can adopt one of the two formulate:

• Asset Based: that is based on assets, themselves object of the securitization. In this case of figure, the risk or the appeal is placed on the transmitter, through its commitment of repurchase with ending.

• Asset Backed: that is leaned in assets, which are underlying generative of income. In this case, the risk or the appeal is on the underlying assets.
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<th><strong>Advantages</strong></th>
<th><strong>Disadvantages</strong></th>
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<td><strong>Asset Backed</strong></td>
<td>• Ownership of assets.</td>
<td>• Issuer must be able to dispose of its assets</td>
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<td></td>
<td>• Surpluses of the income of the underlying assets</td>
<td>• No guarantee on the performance or the refund</td>
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<tr>
<td><strong>Asset Based</strong></td>
<td>• Guarantee of an entity of the transmitter.</td>
<td>• Financial profile close to obligations</td>
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<td>• Appeal by a promise of repurchase of assets</td>
<td>• No division of the possible earnings realized by the appreciation of assets</td>
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B- Types of sukuks
Sukuk Al Mousharakah:

- Certificates of equal value that are issued for the special purpose vehicle of musharaka for creation of a new project, developing an existing project or financing a business activity on the basis of sharia complied partnership contract.
Sukuk Al Moudarabah:

- Equity shares which represent projects or activities managed according to the principles of Moudaraba. The moudharib is indicated for the management of the project without any capital inflow. The subscribers (holders of certificates) are owners of the assets of Moudaraba.
Sukuk Al Ijarah:

- Titles with equal values emitted by the owner (or a financial intermediary the representative) of assets rented or intended for the rent. The broadcast of these Sukuk has for objective to sell assets and to recover the sale price through the subscriptions.
Sukuk Al Murabaha:

• Sukuk mourabaha is an agreement between a buyer and seller for the delivery of an assets. The price includes the cost of the asset plus an agreed upon profit for the seller.

• The buyer can pay the price on the spot or in installment.
Sukuks Al Salam:
• are titles of prefinancing of raw materials, generating income of commercial margins. It is vouchers emitted by the State or by another transmitter for the benefit of the savers.

Sukuk Istisna’e:
• are titles(securities) of financing of equipments, generating income of sales margin.
Chapter 3: The difference between sukuks and bonds
Although a common starting point for explaining sukuk is to bonds as a comparison point, it is important to understand that there are certain fundamental differences.

There are five important differences between sukuk and bonds:

1. **Sukuk** indicate ownership of an asset, while **bonds** indicate a debt obligation.
2. The assets that back sukuk are compliant with Shariah, while assets backing bonds may include products or services that are against Islam.
3. **Sukuk** are priced according to the value of the assets backing them, while bond pricing is based on credit rating.
4. **Sukuk** can increase in value when the assets increase in value, whereas profits from bonds correspond to fixed interest, making them Riba.
5. When you sell **sukuk**, you are selling ownership in the assets backing them, while the sale of bonds is the sale of debt.
This is not to say that bonds and sukuk are not similar in certain ways. Both can be turned into cash by selling them on the secondary market by institutions. There is also similar variance in bond and sukuk designs and issuers, allowing consumers to have a variety of options when looking into these financial instruments.
Chapter 4: Evolution of bonds and sukuk Market
A - Evolution Of Bonds Market

1812 New York City issues first municipal bonds

1920-1933 the Great Depression

1940 Period of Occupation

1980 Period of Expansion

2008 The Subprime Crisis
B- Evolution Of Sukuk Market

• The debut of sukuk began in 1990 with the issuance of RM125 million (USD 30 million) Al Bai’ Bithaman Ajil sukuk by Shell MDS Malaysia.

• In September 2001, the state of Bahrain issued the world’s first sovereign sukuk for USD 250 million. This sukuk Al Ijarah carried a fixed lease payment for 5 years.

• In December 2001, Kumpulan Guthrie, a Malaysian government linked company issued a USD 150 million sukuk Al Ijarah with a floating rate of return.

• In 2002, the federation of Malaysia issued a USD 600 million sukuk Al Ijarah that was listed in Luxembourg Stock Exchange and rated by standard & poor’s and moody’s.
B- Evolution of Sukuk Market

Global Sukuk Issuance
USDbiln

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<td></td>
<td>25.5</td>
<td>46.0</td>
<td>20.6</td>
<td>28.0</td>
<td>45.1</td>
<td>85.1</td>
<td>131.2</td>
<td>119.7</td>
<td>118.8</td>
<td>66.1</td>
<td>74.8</td>
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Source: Thomson Reuters, MIFC estimates
**B- Evolution of Sukuk Market**

- In 2016, global sukuk market witnessed a rebound after three consecutive years of decline following its peak in 2012. Global sukuk issuance posted a solid growth of 13.2% from previous year to reach USD74.8 billion.
The Pulse of the Global Sukuk Market: Malaysia

2016 Global Sukuk issuance

- Malaysia: 46%
- Indonesia: 14%
- UAE: 6%
- Saudi Arabia: 6%
- Bahrain: 6%
- Turkey: 7%
- Others: 10%
- Others: 11%
Malaysia has been the pulse of the global sukuk market developments and continued to be the main driver for sukuk issuance for 2016 commanding global market shares of 46.4% and 52.6% respectively. Followed by Indonesia and the United Arab Emirates (UAE), accounting for 9.9% and 9.0% share, respectively. Total issuances of GCC countries stood at USD19.6 billion, Turkey recorded a notable rise in sukuk issuance at USD4.1 billion for the year.
### Top sukuk markets in 2016

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Malaysia</th>
<th>Gulf Cooperation Council</th>
<th>Indonesia</th>
<th>Turkey</th>
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<td>Issued amount &amp; global market share</td>
<td>USD34.7 billion, 46.4%</td>
<td>USD19.6 billion, 26.2%</td>
<td>USD7.4 billion, 9.9%</td>
<td>USD4.1 billion, 5.5%</td>
</tr>
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</table>
| Top sectors                   | 1. Financial services  
2. Government  
3. Power and utilities.  
4. Transportation | 1. Financial services  
2. Government  
3. Industrial manufacturing | 1. Government  
2. Financial services  
3. Oil and Gas | 1. Financial services  
2. Government |

Source: Thomson Reuters, MIFC estimates
Conclusion

Sukuks are among the most recent products that are created using structural application in the Islamic financial markets. In order to design flexible securities that could respond to different financing needs of economic agencies in the capital market on one hand and to comply with Islamic principles and standards.
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Thank you for your attention