

SPV Structures in Sukuk

Capital Adequacy Requirements

Ahmed Adil

Partner, Business Risk Services (BRS) &
Islamic Financial Services Group (IFSG)

 **ERNST & YOUNG**

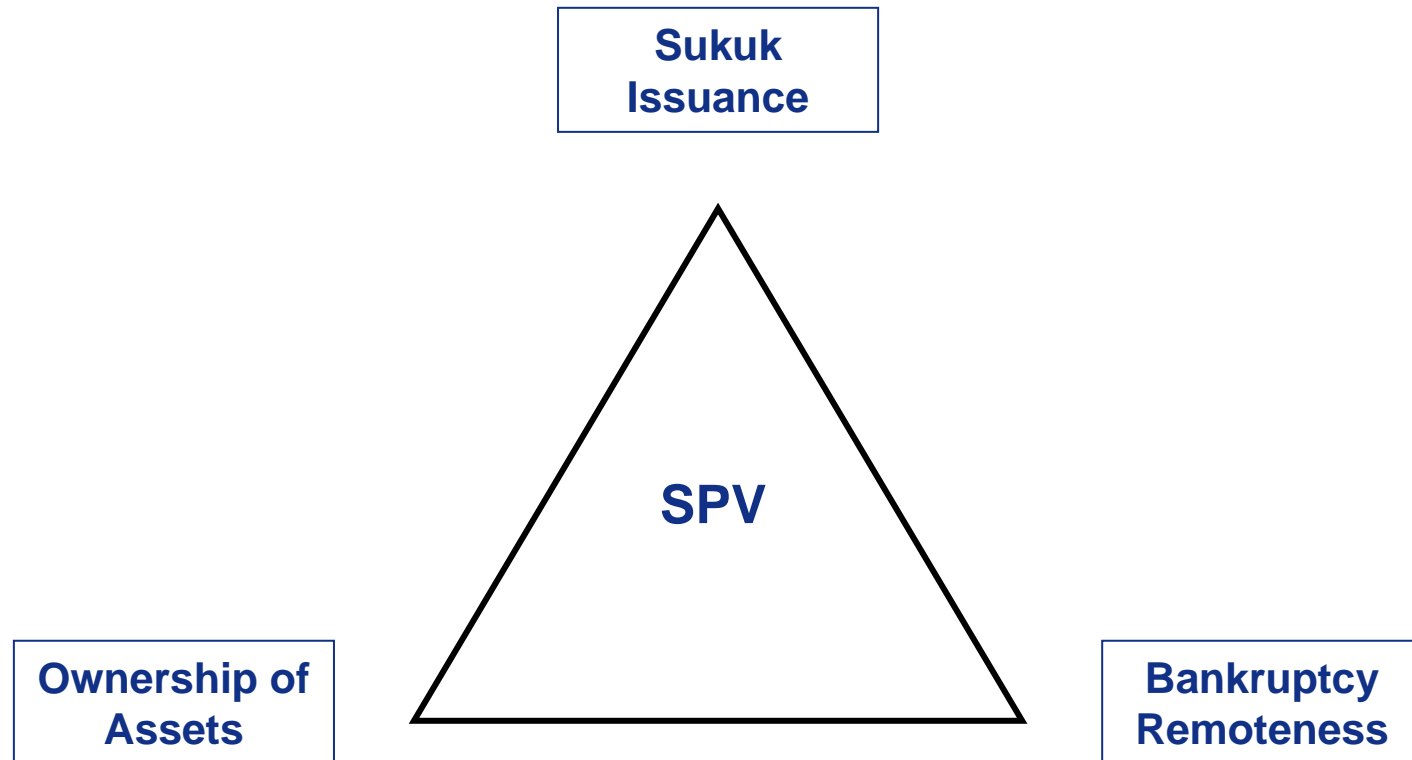
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SPV Structures in Sukuk



What Does SPV Sukuk Structure Represent ?

Equity ?

- Redeemable through sale of investment or liquidation
- Not an obligation on the issuer
- Residual interest on assets and income of the issuer

Debt (Finance) ?

- Guaranteed principal and profit
- Obligation of issuer
- No residual interest on assets and income of the issuer

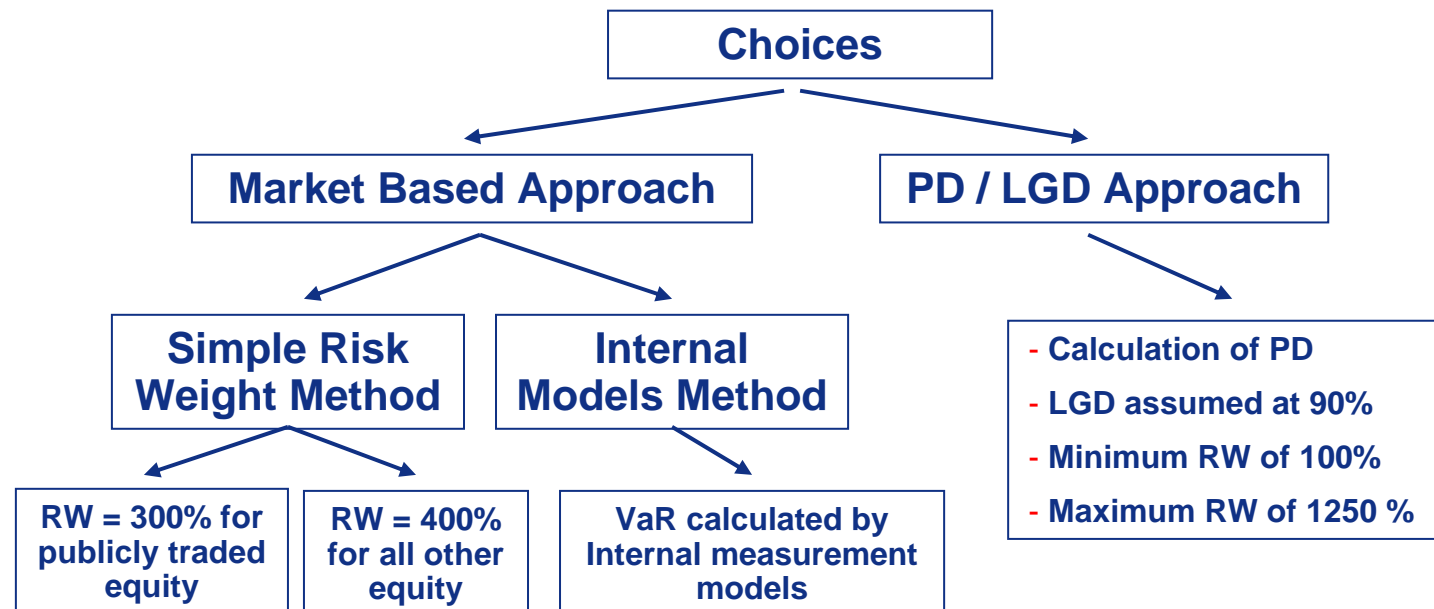
Asset Backed Security (ABS) ?

- Tranched structure in substance
- True sale of assets
- Uninterrupted rights to cash flow of the assets

Sukuk - Equity

Basel II Capital Adequacy Requirements

- > 50% Consolidate or **carve out**
- >20% <50% **Deduct** from capital or pro rata consolidation
- <20% Requirements under Standardised Approach
RW of 150 % or higher reflecting higher risks associated with equity
- <20% Requirements under IRB Approaches



Sukuk – Debt (Finance)

Basel II Requirements

→ Obligor can be a sovereign, bank or corporate

→ Requirements under Standardised Approach

Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
	0 %	20 %	50 %	100 %	150 %	100 %

Banks	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Sovereign	20 %	50 %	100 %	100 %	150 %	100 %
Bank	20 %	50 %	50 %	100 %	150 %	50 %

Corporates	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
	20 %	50 %	100 %	150 %	100 %

→ Requirements under IRB Approaches

$$RWA = (f (PD, LGD, M)) * 12.5 * EAD$$

Sukuk – Asset Backed Securities

Basel II Capital Adequacy Requirements

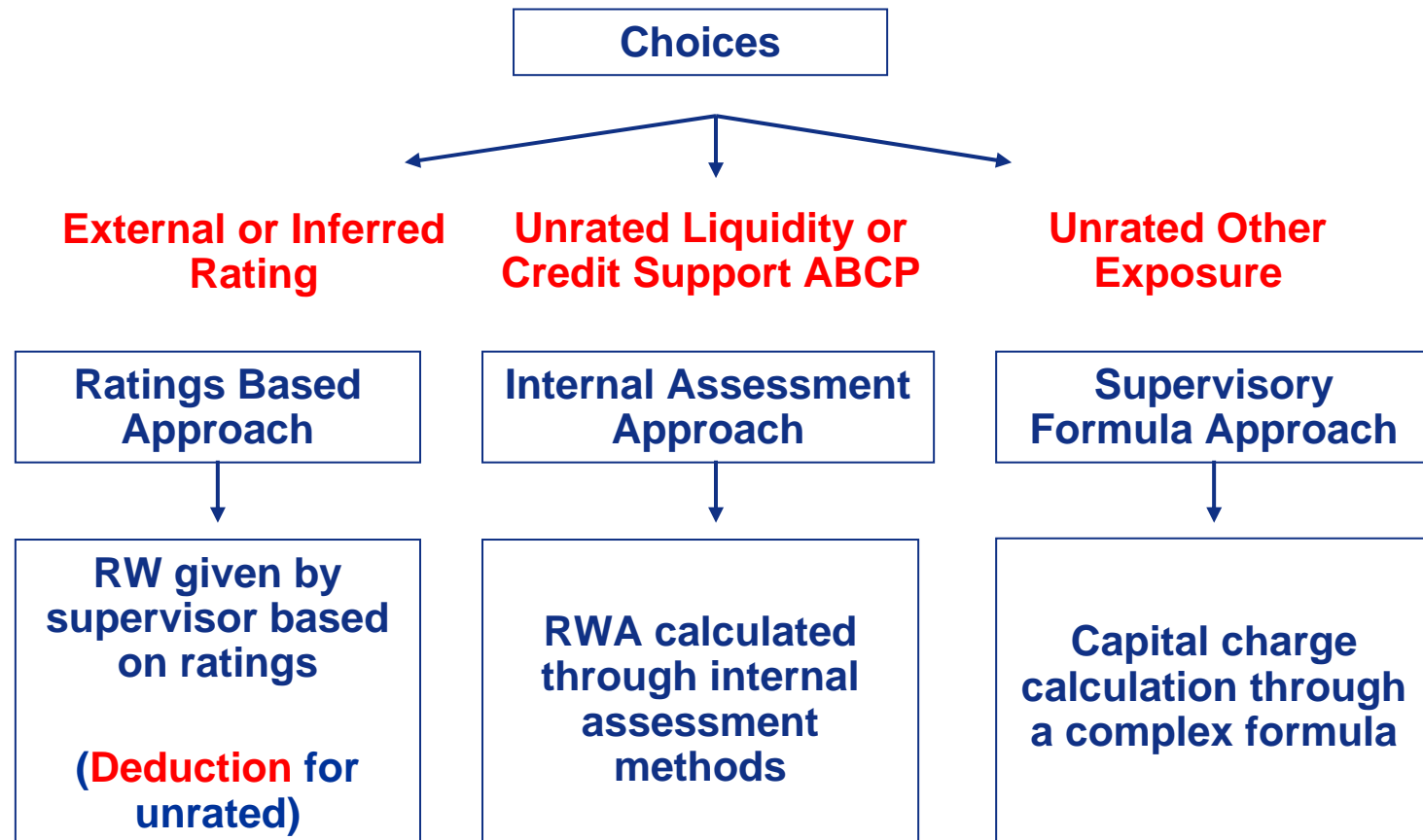
- Originating banks and investing banks
- Crucial question is rating
- Requirements under Standardised Approach

ECA (Long-term rating category)	AAA to AA -	A + to A -	BBB + to BBB -	BB + to BB -	B + and below / unrated
Risk Weight (for investors)	20 %	50 %	100 %	350 %	Deduction (50 % from Tier 1 and 50 % from Tier 2)
Risk Weight (for originators)	20 %	50 %	100 %	Deduction	Deduction

ECA (Short -term rating category)	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings or unrated
Risk Weight	20 %	50 %	100 %	Deduction

Sukuk – Asset Backed Securities Basel II Capital Adequacy Requirements

→ Requirements under IRB Approaches



Sukuk – Asset Backed Securities

Basel II Capital Adequacy Requirements

Rating is crucial

Many issues in rating if not guaranteed by obligor (Fitch Ratings report dated 24th March 2005)

- True sale
- Non consolidation
- Bankruptcy remoteness
- Security structures
- Enforceability
- Choice of law and enforcement of judgment

Contact Information



Ahmed Adil, Partner
Business Risk Services (BRS) &
Islamic Financial Services Group (IFSG)

Ernst & Young, Bahrain

PO Box 140

14th Floor, The Tower

Sheraton Commercial Complex

Manama, Bahrain

Phone: + 973 17 535 455

Fax: + 973 17 535 405

Email: ahmed.adil@bh.ey.com