

INTRODUCTION TO SUKUK AL IJARAH

Alhamdulillah, we are grateful to Allah Subhanahu Wataala on the consent of His Majesty the Sultan and Yang Di-Pertuan of Brunei Darussalam for His Majesty's Government through the Ministry of Finance to launch the Sukuk Al Ijarah or Islamic bonds sometime early next year.

Sukuk Al Ijarah, is generally an alternative to conventional bonds. Sukuk Al Ijarah is an Islamic bond as the issuance is backed by the buying, selling and leasing of properties. The structure is endorsed by the appropriate Syariah experts as fully compliant to all the requirements of *hokum* Syara. The main distinction between Sukuk Al Ijarah and conventional bond, is that Sukuk Al Ijarah does not involve the payment of a fixed interest rates. The buying and selling of Sukuk is based on the buying, selling and leasing of properties. As a consequence, the structure of Sukuk does not have any element of Riba which is prohibited in Islam.

As in conventional bond, Sukuk is usually issued or sold by the Government or corporation with the view to raise capital to finance new projects or business expansion.

As an illustration, suppose a company ABC requires \$100 million for the purpose of expanding its business. ABC may sell a piece of its properties valued at \$100 million to a Special Purpose Company (SPC). Company ABC also promise to buy back the property at \$100 million at the end of the 10 year.

SPC will therefore, issue a 10 year Sukuk and offer them to the public/investors. The Sukuk will reach its maturity at the end of year 10. This means SPC intends to buy back the Sukuk from the public/investor at the end of the 10 year period at a price of \$100 million.

SPC will also lease out the property to ABC for a period of 10 years. ABC will pay rent for every, say 6 months, to SPC based on a mutual agreement by both sides. For example, the rent could amount to \$10 million per year. So SPC will collect the annual rents for the period of 10 years and subsequently distribute them to investors/ sukuk holders, proportionate to the amount invested in the Sukuk.

For example, if a person buys and hold ABC Sukuk at a face value of \$100 thousand, he will receive a return of \$10 thousand annually over the next 10 years. At the end of the 10th year, the sukuk holder will be able to sell back his sukuk to SPC at the same face value of \$100. Investors will also be able to sell sukuk they hold before the maturity date. The price will be based on the market prices and based on the agreement of both the buyers and the sellers.

Hence, from the perspective of the issuer or the seller, it is viewed as a way of sourcing capital for example to expand one's existing business.

From the perspective of the public or the buyer/sukuk holder, this is seen as saving deposit or investment because the issuer of the sukuk promise to buy back the sukuk at a later stage, and the issuer will distribute the proceeds from the lease of property to the sukuk holders.

Islamic countries which have issued sukuk Al Ijarah include Malaysia, Qatar, Bahrain, and Pakistan. Meanwhile, the main institutions that had issued sukuk are Islamic Development Bank (IDB) Jeddah, Saudi Arabia, and Guthrie Group, Malaysia. As a matter of fact, the financing of the purchase LNG Carrier, Abadi, by the Brunei Gas Carrier in 2001 was to certain extent utilizing the sukuk concept.

Currently, the total outstanding Sukuk issued in the world is around USD 7 billion.

Nevertheless, all the issuance of the above sukuk, are all long term sukuk. So we should be proud that Brunei Darussalam is one of the pioneering countries in the world to issue short term sukuk.

It needs to be emphasized, that the main objective of the issuance of a government sukuk is an initial step toward the development of domestic capital market in Brunei Darussalam, in line with the development both at regional and international level.

International financial experts have concluded that the main cause of the Asian financial crisis in 1997 was the absence of a strong capital market in the Asian region. In this light, companies in the concerned country borrowed huge sum of money from the local banks for up to 10 years to finance their businesses.

To finance these loans, the banks borrowed US dollars for 3 months from international market and renewed them at every 3 months. When the value of

the local currency depreciates, these banks were forced to sell off more local currencies to secure US dollars to pay their debts. This has aggravated the situation and increase pressure for the local currency to depreciate further and consequently leads to the financial crisis and its contagion effect to neighboring countries.

The financial crisis would have been averted should there be a strong capital market where these companies would be able to issue their bonds or sukuk and not too dependent on loans from the local banks.

Despite the issuance of only short term sukuk at this initial stage, long term sukuk will be issued later on at an appropriate time. As an example in Singapore, there are government bonds with maturity period of 3months, 6 months, 9 months, 1 year, 2 years, 5 years, 7 years, and even 10 years. In other developed countries, bond with maturity period of 20 and 30 years have also been issued.

Capital market is also hoped to provide the benchmark to determine the rate of cost of fund that is more accurate to the business communities both from within and outside of the economy.

Capital market could also provide the benchmark to determine the rate of returns on investments in an economy.

With the issuance of government sukuk, it is hoped that it could encourage major corporations in Brunei Darussalam to issue their respective sukuk.

As a result, these will prevent major corporations from too overly dependent

on bank loans as sources of funding for business expansion. Generally, based on other countries experiences, the cost of sourcing fund through sukuk or capital markets is much lower compared to the cost of sourcing fund through bank loans.

Other benefits, are to provide opportunities to other financial institutions such as TAIB, TAP, Takaful companies as well as the general public to invest safely and in full compliance with the syara' requirements.

In most developed countries, government bonds are usually used as liquid instruments by banks and financial institutions. This means that some of the funds deposited by the public are invested by the banks by buying government bonds or sukuk.

In the event that any of the bank facing a liquidity problem, one of the way to increase liquidity is by selling off such government bonds or sukuk to other banks or to the central bank. In the event that there are more than sufficient liquidity, the bank will buy back such bonds. These activities will occur in the well established secondary market.

Other than that, it is hoped that the development of capital market will help to reduce the outflow of fund from Brunei Darussalam.

In conclusion, the issuance of short-term sukuk Al Ijarah is an initial step to the development of capital market in Brunei Darussalam. The success will definitely be in the long run and will depend on the full support of financial institutions and major corporations in the country.

The success of sukuk is very important particularly in our efforts to place Brunei Darussalam standing at par with other developed countries in the region and at the global level. This is particularly so with respect to the financial and monetary sector. This would also facilitate our efforts to become one of the most attractive and established international financial centre. By focusing on the development of capital market that complies with the *hukum syara'*, we will be able to uphold our national identity as a Malay Muslim Monarchy.

ANNEX 1

1. At year 0, company ABC sells its property to SPC. Company ABC promises to buy back the property at end of year 10.

3. SPC issued sukuk with maturity period of 10 years.

4. SPC leased out the property to Company ABC and distributes the proceeds to investors.

2. SPC lease out the property to ABC.

5. At end of year 10, Company ABC buys back the property and SPC buys back the sukuk at original face value.

