

# Contributing to the Development of the Islamic Capital Market: The Dow Jones Citigroup® Sukuk Index

Dow Jones Indexes<sup>SM</sup> and Citigroup Inc. made history in the Islamic finance space in April 2006, with the launch of the Dow Jones Citigroup® Sukuk Index (the “Sukuk Index”). By monitoring the performance of companies compatible with Islamic principles, the Sukuk Index ‘hit’ a number of touch points in the Islamic finance space. Serving as a benchmarking and analytic tool it helped to raise awareness and strengthened education. Furthermore, it serves as a basis for investable and tradable financial products. However, there are still a number of challenges to face for the Sukuk Index if it is to make a vital contribution to the development and growth of the Islamic Capital Market (ICM).

## Islamic Finance: Investing & Financing

Islamic finance can be culled down to two generally recognized and accepted propositions: Shari’ah-compliant investing and Shari’ah-compliant financing. Dow Jones Indexes can be said to have raised the awareness and profile globally for Shari’ah-compliant equity-market performance measurement in 1999, with the launch of the Dow Jones Islamic Market Index<sup>SM</sup>. Having addressed one important aspect of the Islamic capital market, i.e. the screening of Shari’ah-compliant equities for market performance measurement, Dow Jones Indexes kept moving forward and embarked upon the Islamic fixed-income side, as Islamic bonds (Sukuks) were becoming an increasingly prominent tool for raising compliant capital for sovereigns, quasi-sovereigns and corporates. Dow Jones Indexes partnered with Citigroup, a global institution with established operations in many Muslim countries—and market leadership and competence in constructing all kinds of bonds.

Dow Jones Indexes provided the Shari’ah screening guidance, through its independent Shari’ah Supervisory Board. Citigroup, with its years of building high-profile globally accepted bond indexes, provided the Islamic bond index construction and calculation methodologies. The Shari’ah issues were generally resolved by using AAOIFI’s guidelines for the Sukuk issues. To be considered for the index, a bond must have a minimum issue size of US\$250 million, a minimum maturity of one year and an investment-grade rating.

The Sukuk Index is calculated using The Yield Book®, Citigroup’s fixed-income analytical software. The Yield Book offers portfolio, trade and single-security analysis. It provides market-tested financial

models for valuation as well as powerful tools for risk management, scenario analysis, return attribution and portfolio optimization in conjunction with a benchmark. Extensive databases with access to a broad set of historical data are available in addition to flexible reporting capabilities and easy automation.

## Objectives

There were a number of objectives in launching the Sukuk Index. The first set involved educating investors about Sukuk, building awareness of the vehicles, and improving market transparency. Just as the Dow Jones Islamic Market Index was the first standard from an index provider to provide Shari’ah-based equity screening, the Sukuk Index was the first standard for selecting liquid compliant Sukuk issues. Thus, if a sovereign from the Commonwealth of Independent States (CIS) or South America—or a corporate/municipality from the U.S. or Europe—wanted to issue a Sukuk, there was a universe of securities that met the pre-conditions of a compliant Sukuk that could be explored before engaging the investment bankers, underwriters and lawyers.

The second set of objectives entailed providing a benchmark, thus allowing the performance of a Sukuk issue (or even a Sukuk fund) to be compared to a Sukuk Index. Benchmarks provide a measure of the underlying market, allowing like comparisons.

A third major objective for the Sukuk Index was that it would be used by the marketplace as a basis for investable and tradable products. However, this requires a liquid secondary market trading, and, unfortunately, at this stage of the Sukuk development lifecycle, investors are taking a ‘buy and hold’ approach. The sub-prime fiasco and ensuing credit crunch have had an indirect impact on Sukuk issuance; Sukuks have been delayed, reduced in size or issued in local currency (Saudi Riyal or UAE Dirham) as pricing of credit has increased and there have been fewer available buyers.

An interesting phenomenon concerning the GCC Sukuk issues is that more than 50% have been purchased by non-Islamic investors. This is actually good for the secondary market trading as non-Islamic buyers do not have fixed-income supply constraint issues, and therefore can and will sell a Sukuk and replace it with, for example, a conventional bond, unlike Islamic financial institutions/funds.

## Components of the Dow Jones Citigroup Sukuk Index

NAME	Coupon*	Maturity	Country	Par	Quality
Dubai Global Sukuk	3.333	11/04/2009	UAE	1000	A+
Sarawak International	4.282	12/22/2009	Malaysia	350	A-
Islamic Development Bank	3.302	06/22/2010	Supranational	500	AAA
State of Qatar	4.416	10/09/2010	Qatar	350	AA-
Abu Dhabi Islamic Bank	3.219	12/12/2011	UAE	800	A
Dubai Islamic Bank	3.534	03/22/2012	UAE	750	A
Emirates Islamic Bank	3.119	06/12/2012	UAE	350	A
Dubai International Financial Centre	3.194	06/13/2012	UAE	1250	A+
National Industries Group Sukuk	3.857	08/16/2012	Kuwait	475	BBB
DP World Sukuk Ltd.	6.250	07/02/2017	UAE	1500	A+

Source: Citigroup Index LLC., November 2008

\*Amount in US \$ Millions

### Sukuk Challenges

In any emerging industry, there are growing pains, and the Islamic finance community has a number of challenges it will need to address over time concerning Sukuks.

- Sukuk contracts will need to be standardized, as there is an element of fragmentation in their interpretation between GCC/Pakistan and South East Asia (Malaysia). The variance is not unexpected due to influence of culture, school of law and time.
- More English-versed and qualified Shari'ah scholars will be needed who understand capital market products. Moreover, more-qualified bankers with a better grasp of Sukuk structuring and documentation will be needed. The language of international trade and commerce is English, and Sukuk documents, in areas like infrastructure project financing, are massive.
- More communication between Bahrain-based AAOFI and Malaysian counterparts will be needed to bridge the differences between Sukuk contracts.

At the same time, the following trends are likely to have a positive impact on the future of the Sukuk market:

- More Sukuks will likely be listed publicly, addressing to some extent the supply constraints for secondary-market liquidity.
- More Islamic countries will likely establish Trust laws for true securitizations of Islamic mortgages (ijara and musharaka) for listed residential/mortgage-backed Sukuks, helping to address supply concerns.

- GCC sovereigns will likely issue large Sukuks in hard currencies with long-term maturities, thus helping to establish an Islamic long-bond yield curve.
- Islamic banks or 'windows and subsidiaries' of conventional banks may increasingly travel to debt-issuing geographies to educate potential issuers about alternative ways of raising funds, given that the GCC is awash in liquidity looking for geographically diversified opportunities.
- Banks may examine the merits of issuing smaller (less than U.S. \$250M) non-hard currency Sukuks, once issues related to liquidity and pricing availability are addressed.

### Conclusion

A bond market implies a maturing capital market, and the establishment of a Sukuk market implies a convergence, where all (Islamic and non-Islamic) issuers, investors and traders can raise money, invest and trade as long as the rules of Shari'ah are adhered to. As these markets evolve, Dow Jones Indexes will continue to seek to measure them, and the Dow Jones Citigroup Sukuk Index may only be the beginning. Should the market demand them, Dow Jones Indexes will consider expanding its Sukuk index lineup with offerings to measure sectors, sizes, regions and/or currencies. As with any of its offerings, Dow Jones Indexes will seek to continue to measure the changing pulse of the Sukuk marketplace.

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