UN-IDB Roundtable Discussion on “The Role of Islamic Finance in Sustainable Development”:

Session 3: Partnerships & Resource Mobilization through Islamic Sukuks and Funds

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Resource Mobilization is getting an increased attention from MDBs

• MDBs can **no more rely on their equity** to fund their operations.

• The MDB Working Group on Infrastructure report to the G20 in Oct 2011 set **Resource Mobilization for Project Preparation** as a key objective.

• How this objective can be achieved?
  
  — **Developing Countries** – shall be encouraged to **increase mobilization of resources domesticaly**; possibly through **PPPs** or **co-financing** schemes.
  
  — **Donors and MDBs** – need to ensure that **funding** is accompanied by a commensurate amount of human and financial resources for **project preparation**.
  
  — **The Private Sector**- shall be **encouraged to invest** in projects that have good prospects of recovering their preparation investment by an award of the project. They could also directly invest in PPP projects.
Recent Resource Mobilization efforts by MDBs

• MDBs set an overall **resource mobilization strategy** to address the resource gap stemming from their expanding mandate.

• Two popular financial instruments are increasingly used by MDBs:
  – **Fixed Income** Instruments (such as Bonds and sukuk).
  – **Private Equity** Funds.

• Concrete recent examples include the following:
  – **IFC AMC**’s that raised USD 6.3 billion in six funds from SWFs, Pension Funds and bilateral DFIs.
  – **IDB** that mobilized over USD 7.0 billion from public offerings of Sukuk and USD 3.5 billion through funds.
  – **AFDB** that mobilized USD112 million in 2013 in funds from 7 donor agencies.
What is a Sukuk?

• Sukuk commonly refers to the Islamic equivalent of bonds.

• However, there is a fundamental difference: Sukuk grants the investor a share of an asset, along with the commensurate cash flows and risk; While the conventional bond merely confer ownership of a debt whereby the bond holder earns a debt spread.

• Sukuk securities adhere to Shari’ah principles, which prohibit the charging or payment of interest.

• Sukuks are issued for a purpose namely for a specific project or asset. Hence, they are tied to real economy.
Sukuk is becoming a global phenomena…

• First sukuk programme in Europe was launched in 2004, through a German federal state of Saxony-Anhalt.

• In 2005, the UK issued the region’s first corporate sukuk.

• Increased attraction from sovereign issuers. Some of the ones that are in the pipeline are:
  — Government of UK – around GBP 323.4 million.
  — Societe Generale – around MYR 300.4 million.
Sukuk is a thriving business…

• As of 1Q 2014, Total **global Sukuk issuance** scored **USD32.9 billion**, an increase of **13.8%** over 1Q 2013.

• Sovereign issues accounted for **63%** in terms of capital raised, Corporate **24%** and Quasi Sovereign **12%**.
Sukuk in Infrastructure Projects is by far the largest…

- Between 2001 and 2013, a total of USD 84.3bln worth of infrastructure sukuk have been issued by more than 10 different countries.

- Examples of projects include:
  - GACA Sukuk in Saudi Arabia of size USD 4.06 billion to finance expansions of Abdul Aziz International Airport (KAIA) in Jeddah and King Khalid International Airport (KKIA) in Riyadh.
  - GEMS Education in Dubai of size USD 200 million to finance expansion plans.
  - Kuala Lumpur International Airport 2 Expansion of size USD 0.3 billion in 1st tranche and USD 0.5 billion in 2nd tranche – partnership between Government of Malaysia & Malaysia Airport Holding Berhad.
IDB is a market maker for Sukuks…

• IsDB has demonstrated its commitment to the Sukuk market by regularly tapping into the public markets for the past six years (2004-2014), today about USD 7 billions of issuance.

• There is increased demand for IDB sukuks from institutions outside the region as around 49% come from Asian & European countries.

• Although most issuances are USD denominated, IDB utilized private placement for sukuks in other currencies such as GBP, EUR and MYR.

Central Banks & Government Agencies are the biggest subscribers to IDB’s sukuk

Subscribers are not forcibly Islamic Investors
Despite the progress made, there are still improvements to be made:

- **High Administrative Costs** – related to setting up SPVs, need to obtain rating from international rating agencies.

- **Legal risks** - mainly associated with bankruptcy laws, shariah compliance and regulatory clarity on issues conflicting between civil law and shariah law.

- **Currencies Hedging** – related to available shariah compliant methods related to swapping issuance proceeds into other currencies.

- **Identifying projects to deploy sukuk proceeds** – unlike conventional bonds, sukuks are issued for a purpose and this has to be specifically known in advance before final issuance of a sukuk.
Opportunities in Infrastructure Sukuk

• **Amount of Islamic Liquid Resources** – sovereign wealth funds (SWFs) originating from Islamic countries could be invited to invest in Shari’a compliant infrastructure funds. The investor demand for infrastructure projects, especially in the wake of the region’s economic recovery, remains strong and is expected to grow further, seeing that most institutional investors still have not met their target allocations to infrastructure as an asset class.

• **Increased awareness and participation from conventional & non-Islamic investors** - emerging economies may not be able to depend on infrastructure financing from the advanced economies, as much as they have in the past. This opens up opportunities for the sukuk market, as a mechanism to attract investors who are interested in Shari’a compliant products.

• **Demand for Infrastructure Projects**
  — For instance: in GCC, the total volume of infrastructure projects projected from 2010-2014 is USD 4 tln.
  — In Europe, the total volume of infrastructure projected to meet Europe’ 2020 objectives is about EUR 2 tln.
Private Equity Funds as Resource Mobilizing tool

- Private Equity (PE) Funds are becoming a very popular tool for Multilateral Development Banks intervention.

- PE Funds provide MDBs with a tool to mobilize funds off-balance sheet.

- By Investing in PE Funds, MDBs can be a catalyst to mobilize resources from private institutional investors.

- However, most of MDBs processes and mindset are not yet aligned with PE market practice. Some already established dedicated asset management companies to increase the volume of PE fund activity and align their processes to the PE market practice.
Overview of Islamic Funds Market

- Islamic Funds industry is in its early stages, however it has illustrated steady growth.
- Total AuM has grown at a steady CAGR of 7.33% from 2007 to 2012.
- In terms of Geographical focus Islamic Funds have had a global focus, with 27% of AuM invested globally.
IDB’s financing of infrastructure is one of its key pillars for development…

- IDB has approved investments in infrastructure with an equivalent size of USD 3.29 billion.

- Investments in Power, Water, Transport Infrastructure and Industrial amounted for more than 50% of total investments in Infrastructure.

- While more than 50% is invested in the Middle East, IDB’s investment span across many regions in Africa, and in Asia.
IDB Infrastructure Funds

IDB Infrastructure Fund I:
• Launched in 2001, The IDB Infrastructure Fund was the first private equity investment vehicle to focus on infrastructure development in Member Countries of the Islamic Development Bank.
• The fund had commitments of USD 730 Million, and invested almost USD 600 million in 10 projects in 9 different countries.
• The fund returned an IRR of 19% with 1.75 multiple.

IDB-ADB Islamic Infrastructure Fund:
• Launched in 2009, this fund was a partnership with ADB to make shariah complaint infrastructure investments in Asia.
• The fund raised about USD 250 million and targets the 12 Asian countries that are members in both IDB and ADB.

IDB Infrastructure Fund II:
• Launched in May 2014, this fund is a follow up to the first fund.
• The Fund has raise USD 850 million and is aiming for a target size of US$ 2 Billion.
• The fund will target Shariah complaint investments in Infrastructure Projects in IDB member countries.
Challenges of Islamic Private Equity Funds

- Some markets do not have the regulatory framework to address Islamic finance.
- Challenges in deployment of resources due to limited shariah complaints deals.
- Limited exit options in non developed capital markets.
- Lack of Islamic hedging instruments.
Opportunities of Islamic Private Equity Funds

- The essence of Islamic finance is to grow the economy by sharing risk and building businesses based on real transactions and real assets. In this sense, private equity truly is a perfect ethical fit.

- Islamic PE Market is growing fast and reaching a mature stage.

- There is a growing attention with an explosion of fund managers and steady increase in the number of fund.

- Islamic PE Funds can access funds and investors that might not be accessible conventional funds.

- With the massive gap in infrastructure needs in the developing countries Islamic PE Funds provides yet another option to mobilize resources.
Concluding Take Away Points

• Islamic Finance has the capacity to bring additional resources for sustainable development for the following reasons:

  — Availability of liquidity
  — There is absorption capacity in particular to finance infrastructure
  — Is widely accepted as a financial instrument
  — By being asset backed, Islamic finance is closely linked to the real economy. And hence real development
Thank you