

# Sukuk

In this memorandum, the mechanics of Sukuk Issuance is broadly outlined and some key information is provided about the regulations on sukuk issuance in TR.

## Sukuk in general

In essence, Sukuk issuance is an asset based securitization. In our article about murabaha, it is mentioned that the Islamic financial institutions particularly deal with murabaha financings, in that they purchase goods and services from vendors on spot basis and then sell those commodities to their clients on deferred payment basis. As a result of these transactions, the banks accumulate receivables from its clients arising out of the murabaha contracts. Likewise, similar receivables arise out of financial leasing agreements. As is the case with other asset backed securitizations, it is possible for the banks (originator) to transfer these receivables to third parties (special purpose vehicles) in return for a consideration (the capital raised from the sukuk investors). Sukuk issuance steps in the scheme at this juncture.

Once the Islamic banks (originator) or other entities decide to raise

fund through sukuk issuance, they establish a separate legal entity (issuer) and then sell and transfer the ownership and rights of the underlying assets and/or receivables to that special purpose vehicle. The consideration in return for these assets are paid by the special purpose company with the funds raised against sukuk certificates. By segregating the assets and transferring them to another company, the risk of bankruptcy and possible adverse effects of the liabilities of the bank (originator) is avoided. However, the management of the transferred assets (portfolio assets), collection of the receivables and distribution of the revenue shares to redeem the certificate holders are being conducted by the bank (originator). The bank (originator) also guarantees the obligations of the Issuer Company against sukuk holders, which is an important security for corporate investors and individual sukuk holders.

Conservative Islamic scholars prefer tangible assets over sole receivables of murabaha contracts as the revenue producing asset pool. For this reason, a portfolio consisting of receivables from leasing contracts is preferable over receivables from murabaha contracts. Because, a bank has only right to receivables (personal right) out of murabaha financings whereas the title (ownership) of the asset subject to financial lease contract stays vested in the bank (right in rem), which is considered an asset of more definite nature. (Considering that the receivables from murabaha contracts are usually backed by other security agreements and collaterals, in practice, there will be no much difference in terms of soundness of the rights of the bank. But these

theoretical discussions are out of the scope of this article.)

## Sukuk issuance in Turkey

After recent debates on the development of Islamic finance industry in Turkey and around the globe, some attempts were made to regulate and facilitate Sukuk issuance but such early regulatory framework fell short in satisfying the expectations of the market. Following the major regulatory change and enactment of the new Capital Market Law in 2012, secondary legislation also introduced by Capital Markets Board (“CMB”) comprising comprehensive arrangements on Sukuk issuance.

Sukuk issuance in Turkey is basically regulated under the Capital Market Law numbered 6362 and dated December 6, 2012 (the “Law”) and Communiqué on Lease Certificates published by the Capital Markets Board on June 7, 2013 (the “Communiqué”).

General framework about Sukuk issuance (Lease certificates) is provided under Article 61 of the Law. As per the provision, lease certificates are to be issued by asset leasing companies (“Issuer”); the special purpose vehicles to own and administer the segregated portfolio assets from which revenue is generated to redeem outstanding lease certificates. Under the Law, until full redemption of certificates, portfolio assets are privileged against seizure or attachment for public or private debt, and Issuer is banned from pledging such assets or establishing on them in rem rights in favor of third parties. Even though Issuer is not completely bankruptcy proof under law, certificate holder’s rights are superior to those any other

creditors in case of dissolution of issuer and winding up portfolio assets. In practice, corporate guarantee is sought to secure the transaction and redeem sukuk certificates.

The Communiqué defines 5 types of lease certificates based on the structure and purpose of the issuance. In all issuances, the fees determined under Art. 19, based on the maturity period of the certificates, must be paid to the CMB. The income tax ratios to be applied to the revenues derived from the lease certificates also differ based on the maturity of the certificates.

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