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**FINANCING THE ENERGY SECTOR IN THE GAMBIA
THROUGH IJARAH SUKUK**

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FORWARD

All praise be to ALLAH subhaanahuwata'ala the Lord of the creation, prayers and salutations be upon our Prophet MUHAMMAD sallallaahualayhiwasallam and his family, his companions and all those who rightly follow them.

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ABSTRACT

The fundamental objective of this paper is to take opportunity of the enormous amount of liquidity in the hands of wealthy investors both Islamic and conventional for the ultimate goal of funding the energy sector which has over the past years been grossly inadequate, inefficient, erratic and extremely unreliable, negatively impacting on production. The Gambia is among many African countries that have huge infrastructure projects for example roads, housing, electricity, schools etc. Supplies are mostly available in the cities and provincial centers of rural areas. The body that runs the sector does not operate on commercial basis and lacks the required funds to buy new generators to improve capacity. Access to easy funding involves an unending paper work and high interest rates which have diverted the attention of investors to alternative sources of funding such as Islamic Financial instruments. To address this issue, we proposed **Ijarahsukuk** as the financing instrument through a Special Purpose Vehicle (SPV) which will be mandated by the ministry of Energy to sell the certificates to investors. The paper argues that due to the higher dominance of Muslims in the Country, the IjaraSukuk can serve as a vehicle to raise funds from local as well as international investors. However, to take advantages offered by the Sukuk a few challenges need to be addressed such as the reform of the regulatory and tax frameworks to cater for the specificities of Islamic Finance.

Résumé

L'objectif fondamental de ce projet est de saisir les opportunités qu'offre l'énorme quantité de liquidité entre les mains de riches investisseurs musulmans et non musulmans dans le but ultime de financer le secteur de l'énergie en Gambie. En effet, ce secteur a été, au cours de ces dernières années, inefficace, inadapté et peu fiable; ce qui a négativement impacté la production économique dans le pays. La Gambie est l'un des nombreux pays Africain qui ont d'énormes projets d'infrastructures dans les domaines des routes, du logement, de l'électricité, de l'éducation etc. Dans la plupart des cas, les villes et les centres provinciaux sont mieux dotées que les zones rurales. L'organisme qui gère le secteur de l'énergie en Gambie ne fonctionne pas sur une base commerciale et ne dispose pas les fonds nécessaires pour acquérir de nouveaux générateurs afin d'améliorer les capacités de production. L'accès au financement est

difficile et les taux d'intérêt sont élevés. C'est pourquoi il importe de se tourner vers d'autres sources de financement telles que les instruments financiers islamiques. C'est dans ce sens que cette étude propose le financement du secteur de l'énergie en Gambie par le biais d'IjarahSukuk. Ainsi, le ministère de l'énergie mandante le Fonds Commun de Titrisation ou SpecialPurposeVehicle (SPV) pour vendre des certificats d'investissement ou Sukuk aux investisseurs. L'étude fait observer qu'en raison de la proportion élevée des musulmans dans le pays, l'ijarahSukuk permettrait de lever les fonds nécessaires sur le plan local comme international pour satisfaire ce besoin de financement. Cependant, pour bénéficier des opportunités et avantages offerts par le marché desSukuk, il faut entreprendre des réformes couvrant des domaines comme la réglementation et la fiscalité pour prendre en charge les spécificités de la Finance Islamique.

LIST OF ABBEVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AGIB	Arab Gambian Islamic Bank
BOT	Build Operate Transfer
CESAG	Centre Africain d'Etudes Supérieures En Gestion
CBG	Central Bank of The Gambia
CDVM	Conseil Déontologique des Valeurs Mobilières
ETP	Economic Transformation Program
et al	et alia (and others)
e.g.	Exempligrata
ECOWAS	Economic Community Of West African States
GCC	Gulf Cooperation Council
GBA	Greater Banjul Area
GUC	Gambia Utility Cooperation
GRA	Gambia Revenue Authority
HIPC	Heavily Indebted Poor Countries
IFSB	Islamic Finance Shariah Board
IEA	International Energy Agency
<i>IFIS</i>	<i>Islamic Finance Information Service</i>
KHF	Kuwait House Finance
MBF	Master enBanque et Finance
MDRI	Multilateral Debt Relief Initiatives
NAWEC	National Water and Electricity Company
OPM	Other People Money
PURA	Public Utility Regulatory Authority
SWT	SubhaanahuWaTa'ala
SAWS	SallallaahuAlaihiwasallam
SWOT	Strength Weakness Opportunity Threat
SPV	Special Purpose Vehicle

UHC	Utility Holding Corporation
VAT	Value Added Tax
WAPP	West African Power Tool

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CHAPTER ONE: INTRODUCTION

1.1 Contextual background of the study

Islamic finance is the broad term used to describe a wide range of financial transactions that have been approved by a recognized authority as compliant with Sharia (Islamic jurisprudence). The economic growth in many Muslim countries has meant that an ever increasing number of Muslims and non-Muslims are seeking to invest their wealth in a sharia compliant system. This explains why the modern –day Islamic finance industry is developing at a considerable rate since its inception.

The key difference between Islamic finance and conventional finance is the prohibition of riba (interest) under Sharia .Given that the payment and receipt of interest is essential to conventional lending, procuring finance in a way that is sharia compliant would appear difficult in the first instance. However, industry experts have developed a number of structures that are intended to create viable investment for Islamic investors, which although structured in a different way, are intended to yield the same economic gains as conventional financing. Sharia prohibits the fixed or floating payments or acceptance of specific interest or fees (known as riba or usury) for loans of money. Investing in business that provides goods or services considered contradictory to Islamic principles is also haram (sinful or prohibited).

Generally, Islamic finance focuses on the issue of elimination of interest from the system. However, Islam allows certain rate of return deriving from risk taking activities. Consequently, an investment system in which the return for the use of money fluctuates according to actual profits made from such use would be consistent with the precepts of shariah.

Islamic finance has grown and continues to gain strength with the creation of various supports and infrastructure institutions expanding from being banking based industry to a broader domain which promotes capital based products and services. Islamic finance facilitates the transfer of investible funds from economic agents in financial surplus to those requiring funds (Ali, 2008).As explained by Dr. Diaw (2011),it solves the problem of illiquidity in financial markets

by selling Shariah compliant Islamic financial instruments, for example sukuk to fund huge infrastructure projects. In this way wealth changes hands from wealthy investors to illiquid sectors of the market.

According to the IFSB (Islamic Finance Shariah Board), by the year (2012), the global financial asset will reach USD 1.6tln as a result of an increasing demand for sharia compliant assets. Infact by 2020, it is estimated that the Islamic financial asset will surpass the US\$ 4tln. Mark (Kuwait House Finance, 2011).

According to the Accounting and Auditing Organization International Financial Institution (AAOIF) definition, Sukuk means “certificates of ownership in a pool of underlying assets in which the certificates are of equal value”. They are mainly issued for establishing a new project; develop an existing one or financing a business activity (AAOIFI, page 298).

The Islamic financial instrument is in competition with conventional bonds which although similar in nature yet different. For example bonds attract interest while Sukuk is based on profit sharing justified by an underlying economic activity.

An increasing number of African countries are considering issuing sukuk to fund their large infrastructure investment needs and diversify their fiscal funding, according to a Feb. 22, 2013 report from Standard & Poor’s rating. In recent years, several African countries and institutions have announced their intention to issue sukuk including South Africa, The Nigeria Central Bank, Mauritania etc. Following the Arab spring, the rising influence of governments aligned to Islamic teachings and principles in some countries have also put the development of Islamic Finance on their development agenda. For example Egypt has already presented a law allowing sovereign sukuk issuance which will help to finance the country’s high fiscal deficits and also provide funding for the Current Account deficit (World sukuk report, 2011). Sudan is the only African country that has structured its economy and financial institutions in accordance with Islamic teachings. However, over the years we have witnessed a change in this trend as more countries join the race for the Sharia compliant system of economy.

The reason is not far-fetched. Africa is home to some 540 million Muslims who found investment in the shariah compliant instruments more fitting and ethical than conventional finance thus fulfilling the objectives dictated by Shariah (www.islamicpopulation.com,KFHR 2010).

This paper aims at looking into the possibilities of financing the energy sector in The Gambia through **IjarahSukuk**.As a result the concept of sukuk, its different forms and application will be explained in detail in chapter two (Allah willing).

The project work will also delve into the problems of access to sustainable electricity facilities in The Gambia notably the rural areas that are less privileged to benefit from the meager facilities, challenges facing the current system and will make recommendations to improve the sector.

The Gambia has gone very far in developing operational regulatory bodies that govern Islamic financial institutions. The Central bank of The Gambia CBG issues three months, six months, and one year salaam sukuk certificates in order to manage liquidity, support growth and fiscal deficit. As at 6th July 2011, a total of 144 sukuk were issued by the central bank of the Gambia (KFH, 2010). The Gambian sukuk market can take advantage of the active role played by Arab Gambian Islamic Bank (AGIB) and Takaful Insurance Ltd. AGIB being the only Islamic bank in the midst of twelve other conventional banks continues to augment the Islamic financial market by issuing sharia compliant products hence contributing towards the improvement of the Islamic financial market in The Gambia.

However, despite efforts to establish regulatory guidelines towards incorporating Islamic finance in a conventional dominated system, there still remain a lot of hitches for Islamic Financial Instruments to operate within the framework of the shining sharia.

Initially, sukuk were issued as an Islamic alternative to conventional bonds which function more as fixed income instruments. With time, it has become clear that they are different from conventional bonds. For instance, under the mechanisms of sukuk, returns to sukuk are justified by an underlying economic activity (e.g. Commercial and Investment activities).

1.2 Problem statement

The popularity of the product has increased both the demand and supply of the sukuk market. Most importantly there is enormous amount of wealth in the hands of Muslim investors especially in the GCC's (Gulf Cooperation Council).

The Gambia's objective towards attaining vision 2020 has seen a lot of infrastructure development projects notably in the energy sector. It is no doubt that such projects require huge funding. For example we have seen GCC's that have the ambition of setting up infrastructure projects worth 2trillions from 2008 to 2013. (KHF, 2011). This will be an important lesson to learn from.

The Gambia has a valuable window of opportunity in the area of Sukuk Financial instruments as the country embarks on large infrastructural projects. A well propelled Sukuk market will attract both domestic and foreign investors thus tapping into new funding sources through funds and sukuk issuance. Thus providing Shariah compliant/ethical financial services and products to Muslims and Muslim customers in The Gambia.

Similarly, the establishment of Shariah compliant funds as well as alternative asset classes such as commodity and infrastructure will open investment opportunities for Fund Managers and guarantee financial inclusion of more Gambians.

Government in her efforts to improve growth, reduce poverty and provide a better standard of living can attain this through the sukuk market.

Given the country's growing middle class and large young population, Islamic financial instruments can serve as an opportunity for Islamic financial institutions to offer retail products including vehicle and asset financing.

Emerging Islamic financial institutions such as Arab Gambian Islamic Bank (AGIB), Takaful Insurance Company Ltd which are the only two financial institutions operating within the framework of Islamic finance in The Gambia has created a level playing necessary for financing sukuk based markets.

After the global financial crisis, Islamic Banks and other financial institutions were less affected so this has made the sharia compliant product more popular among Muslim and non- Muslim investors. Hence this was one of the reasons for conventional financial institutions and corporations to diversify their sources of funding instead of putting all their eggs in one basket (Diaw, 2011 and Dieye, 2011).

A credible sukuk project would thus be attractive to such investors by providing opportunities of investing in shariah compliant financial instruments and businesses that are in conformity with ethics. Thus this research study explains how The Gambian government can take advantage of the opportunities offered by the sukuk market to finance one of the key sectors of the economy.

1.3 Research objectives

The problem addressed by this project is geared towards tapping the huge amount of liquidity in the hands of wealthy investors looking for Shariah compliant to finance The Gambia's Energy sector which is badly in need of external funds to improve capacity and sustainable electricity generation.

1.4 Purpose of the study

The purpose of the study is aimed at achieving the following objectives:

- The project aims at improving the Electricity system in The Gambia by proposing alternative mode of financing such as Islamic financing structures, for example sukuk.
- Provide government and other financial institutions with information to efficiently manage liquidity by providing opportunities for alternative investment such as sukuk.
- Present interested persons in the sukuk market with information regarding the marketability of the product in The Gambia, its advantages, constrain and recommendations to improve the quality of the product and the sector which it intends to finance (electricity).

- Assist government in its objective to provide sustainable electricity to Gambians hence meeting some of her key objectives of vision 2020.

1.5 Significance of the study

The Project professional could be useful for Islamic Financial Institutions in The Gambia such as AGIB (Arab Gambian Islamic Bank), Takaful Insurance Ltd and potential investors. It could also assist government in decision making and policy formulation. Besides, it will be instrumental for the CBG in terms of monetary policies and managing liquidity, fiscal policies and economic growth. This paper can also be a tool for reference for students at CESAG and other readers who need to gain basic knowledge and background on sukuk.

Over the years, the Government through the Ministry of Energy has mandated NAWEC (National Water and Electricity Company) to manage and supply electricity for the population. The paper presents an opportunity for NAWEC to attract Muslim and non-Muslim investors seeking to diversify their funds by investing in infrastructure projects.

1.6 Limitation of the Study

Access to relevant information and materials on both the Energy sector, The Gambian sukuk market and the time allocated for the study pose limitations for the study.

1.7 The philosophy of Islamic Finance

Islamic Finance is broadly based on some prohibitions and encouragements. The prohibition of riba and permission to trade, as enshrined in verse 2:275 of the Holy Qur'an (Allah has allowed profit from trade and prohibited riba), drive the financial activities in an Islamic economy towards asset backed business and transactions. This implies that all financial transactions must be representative of real transactions or the sale of goods, services or benefits. In addition, Islam

has also prescribed a moral/behavior standard that is almost common in all civilized societies of the world.

1.7.1 Shari'ah

Sharia governs all aspects of an individual's life from matters of state such as governance and foreign relations to issues of daily living and financial transactions. It is the set of rules Muslims believe expresses Allah's (God) guidance on the way individuals should lead their life. Sharia is derived from two primary sources, QUR'AN AND SUNNAH. The Qur'an is the word of God revealed to the prophet Muhammad (SAWS), (570-630 AD). The Sunnah is the recorded collection of the sayings, acts and approvals of the prophet Muhammad (SAWS¹). Specific rulings are derived from these sources to create a body of law known as FIQH. A number of accepted schools of thought have emerged that differ in their methodology for deriving fiqh² (Diaw, 2011, Dieye 2012).

Sharia lays down general and specific principles which govern how financial transactions should be conducted. Some of them are discussed below...

1.7.2 The principle of permissibility

All transactions that have not been mentioned as prohibited by the fundamental sources of sharia are considered lawful and permissible as long as it conforms to the established principles of Shariah as stated by Mufti Taqi Usmani (2001).

1.7.3 Prohibition of Riba (interest)

Islam prohibits riba in transactions. Linguistically the word riba means "increase". In a commercial context, the sharia context of riba is similar to the payment of interest in conventional financing. Riba occurs when money is lent and paid back with interest, whether

¹ Invocation dedicated to the Prophet

² The knowledge of one's rights and obligations (mainly) derived from the Qur'an and Sunnah of the prophet, or the consensus of the opinion among the learned (Ijma) or analogical reasoning (Qiyas) (Ialdin, 2006 p.6)

fixed or floating. It also occurs when currency or money is exchanged in unequal amounts (riba al fadl) or in equal amounts with one or both payments differed (riba al –nasia). In principle, sharia requires that returns of capital must be linked to the success of a business venture rather than emanating from a mere act of lending money.

In the QUR’AAN, ALLAH (SWT) does not declare war on anyone except the people who deal in ribaa:

"Those who take Ribā will not stand but as stands whom the demon has driven crazy by his touch. That is because they have said: 'Trading is but Like Ribā'. And Allah has permitted trading and prohibited Ribā. So, whoever receives an advice from his Lord and stops, he is allowed what has passed, and his matter is up to Allah. And the ones who revert back, those are the people of Fire. There they remain forever. Allah destroys Ribā and nourishes charities. And Allah does not like any sinful disbeliever. Surely those who believe and do good deeds, establish Salah and pay Zakah, have their reward with their Lord, and there is no fear for them, nor shall they grieve. O those who believe fear Allah and give up what still remains of the Ribā if you are believers. But if you do not, then listen to the declaration of war from Allah and His Messenger. And if you repent, yours is your principal. Neither you wrong, nor be wronged. And if there be one in misery, then deferment till ease. And that you leave it as alms is far better for you, if you really know. And be fearful of a day when you shall be returned to Allah, then everybody shall be paid, in full, what he has earned. And they shall not be wronged." [Al-Baqarah2:275-281].

This is sufficient to explain the abhorrence of this deed in the sight of Allah (SWT). One may easily discern the extent of its devastation, whether at the individual and international level, caused by dealing with riba—such as bankruptcy, recession, economic stagnation, inability to repay loans, high unemployment, collapse of many companies and institutions etc. Daily toil has become a never-ending struggle to repay off interest on loans and societies have become class ridden structures in which huge wealth is concentrated in the hands of few. Perhaps all this is manifestation of the war threatened by ALLAH (SWT) to those who deal in riba.

1.7.4 Prohibition of Gharar (uncertainty)

Agreements that contain a material degree of uncertainty neither are not recognized as valid under shariah. It would not be acceptable to enter into a sale agreement, for example, where the existence or material characteristics of the assets are unknown. Therefore care should be taken when drafting documentation to ensure that there is certainty of the relevant subject matter and any other payment obligations. If these fundamental elements are not determined in advance, the transaction would not usually be approved as shariah compliant.

1.7.5 Prohibition of Maisir (gambling)

Transactions that rely on mere chances are not permitted in sharia. Returns from a business venture should result from the efforts of the parties to a transaction. On account of this prohibition, certain types of derivatives such as futures and options that are employed for speculative returns are considered prohibited.

1.7.6 Prohibition of Haram (prohibited investments)

In addition to giving guidance as to how a transaction should be structured, shariah stipulates that the nature of the underlying investment must also be acceptable from a sharia perspective. Capital therefore cannot be used to promote unlawful investments. Investments in the alcohol trade, armaments and gambling are some examples of prohibited investments (Dieye, 2012).

1.7.8 Profit and loss sharing (“Al-Ghunm bi al-Ghurm”)-partnership contracts

This is an alternative form of remuneration for lending in the absence of interest. It establishes a relationship between an investor and a beneficiary instead of a simple creditor/debtor relation.

1.8 Organization of the study

The study is structured as follows:

Chapter one deals with the conceptual framework, research problems, scope, objectives, and general background of the study.

Chapter two summarizes the literature on the Sukuk market and presents the concept of ijarahsukuk and its utilization in financing economic activities on one hand and the energy sector on the other which includes definition of key terms used in the study such as Islamic Finance, Ijara, and musharaka, Madaraba, Murabaha, Salam Sukuk, Riba, Gharar and Maisir³. In this chapter, the meaning of sharia and its rulings on different Islamic financial instruments with respect to their compliance will be detailed.

Chapter three deals with the research methodology used to arrive at the findings. The different tools applied to collect and analyze data. It also shows the presence of enormous amount of excess liquidity in the hands of potential wealthy investors which can be used to finance infrastructure projects thus moving funds from liquid to illiquid sectors of the market. It further explains the need for funding such projects with sukuk and it covers the methodology applied in the study.

Chapter four explains **the sukuk model** to be exploited in order to finance the electricity sector. An objective feasibility study is conducted to analyze the performance of the project when established in the sector. The reader can also find in this chapter, the demand and supply related to the product in a market deemed to be faced with great risk in term of return on investment. The chapter delves into the operational activities of the financial instrument, investing procedures, amount of funding, maturity, profit or loss sharing agreements. This affords the reader the opportunity to evaluate and assess the viability of the project. In addition, the chapter gives an analytical view of SWOT (Strength Weakness Opportunity Threats) in a predominantly conventional market.

³ Correspond to all types of gambling, betting and speculation.

Chapter Five concludes the study and deals with some relevant deductions and considerations with genuine recommendations on how to improve the sukuk market in The Gambian economy. This chapter also summarizes the study; it further looked at policy implications of the project and its limitations.

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CHAPTER TWO: LITERATURE REVIEW

In chapter one, we have discussed how sukuk can be an alternative mechanism of funding huge infrastructure projects in order to complement government efforts towards improving the quality of electricity system. Now it will be appropriate to review the literature on the sukuk financial market, present the concept of ijarah sukuk and its utilization in financing economic activities and the energy sector on the other hand.

2.1 The concept of Ijara sukuk and its application in financing economic activities

The issuance of sukuk on the basis of the rules of the sharia of Islam is among the objectives of Islamic Finance, and is also one of the greatest means of establishing Islamic Economies in society. This however is on condition that the tools used to develop and structure sukuk are in consonance with the fundamental principles which distinguish Islamic Finance from Conventional Finance.

Ijarah sukuk represent ownership of equal shares in an asset (rented generator in this case) or the usufruct of the generator. These sukuk give their owners the right to own the generator, receive the rent and dispose of their sukuk in a manner that does not affect the right of the lessee, i.e. they are tradable. The holders of such sukuk bear all cost of maintenance of and damage to the generator (AAOIFI, 2008).

Ijarah sukuk are the securities representing ownership of well-defined existing and known assets tied up to a lease contract, rental of which is the return payable to sukuk holders. Payment of Ijarah rentals can be unrelated to the period of taking usufruct by the lessee. It can be made before beginning of the lease period, during the period or after the period as the parties may mutually decide. This flexibility can be used to evolve different forms of contract and sukuk that may serve different purposes of issuers and holders (IFR, 2013).

2.1.1 Features of Ijarahsukuk

- It is necessary for an ijarah contract that the assets being leased and the amount of rent both are clearly known to the parties at the time of the contract and if both of these are known, ijarah can be contracted on an asset or a building that is yet to be constructed, as long as it is described in the contract provided that the lessor should normally be able to acquire, construct or buy the asset being leased by the time set for its delivery to the lessee(AAOIFI,2003:140-157). The lessor can sell the asset provided that it does not hinder the lessee to take benefit from the asset. The new owner would be entitled to receive rentals.
- Rental in ijarah must be stipulated in clear terms for the first term of lease and for future renewable terms, it could be constant, increasing or decreasing by benchmarking or relating it to any well-known variable.
- As per shariah rules expenses related to the corpus or basic characteristics of the assets are the responsibility of the owner, while maintenance expenses related to its operations are to be borne by the lessee.
- As regards procedure for issuance of ijarahsukuk, an SPV is created to purchase the asset(s) that issues sukuk to the investor, enabling it to make payment for purchasing the asset. The asset is then leased to third party for its use. The lessee makes periodic rental payments to the SPV that in turn distribute the same to the sukuk holders.
- Ijarahsukuk are completely negotiable and can be traded in the secondary markets.
- Ijarahsukuk offer a high degree of flexibility from the point of view of their issuance and marketability. The central government, municipalities, awqaf or any other asset users, private or public can issue these sukuk. In the Gambia, sukuk are issued by the central Bank. Any other Islamic financial institution that wishes to issue the Islamic financial instrument must get approval from the Bank (Banking act, 2009).

This ijarahsukuk issue for the energy sector aims to diversify the investor base for the project and broaden possibilities for The Gambian capital markets.

2.2 The sukuk market and its evolution

The Global Islamic finance has shown significant signs of growth over the past years with total assets growing from only 150bn in the mid 1990's to an amount of over USD 1.0tn in 2010(KFH,2011).

The main driver and development of Islamic finance is the growing demand and preference for Shariah compliant financial markets backed by wealth and excess liquidity (KFH Research Ltd, 2011).

Sukuk is plural for sakk which means "legal documents, deed check. It is an Arabic name for financial certificates but it can be seen as Islamic alternative of the conventional bonds.

According to the AAOIFI, "sukuk are defined as certificates of equal value representing undivided shares in ownership of tangible assets, usufructs and services or(in the ownership of) the assets of particular projects or special investment activity ".(page 298 of AAOIFI's Shariah standards for financial Institutions.

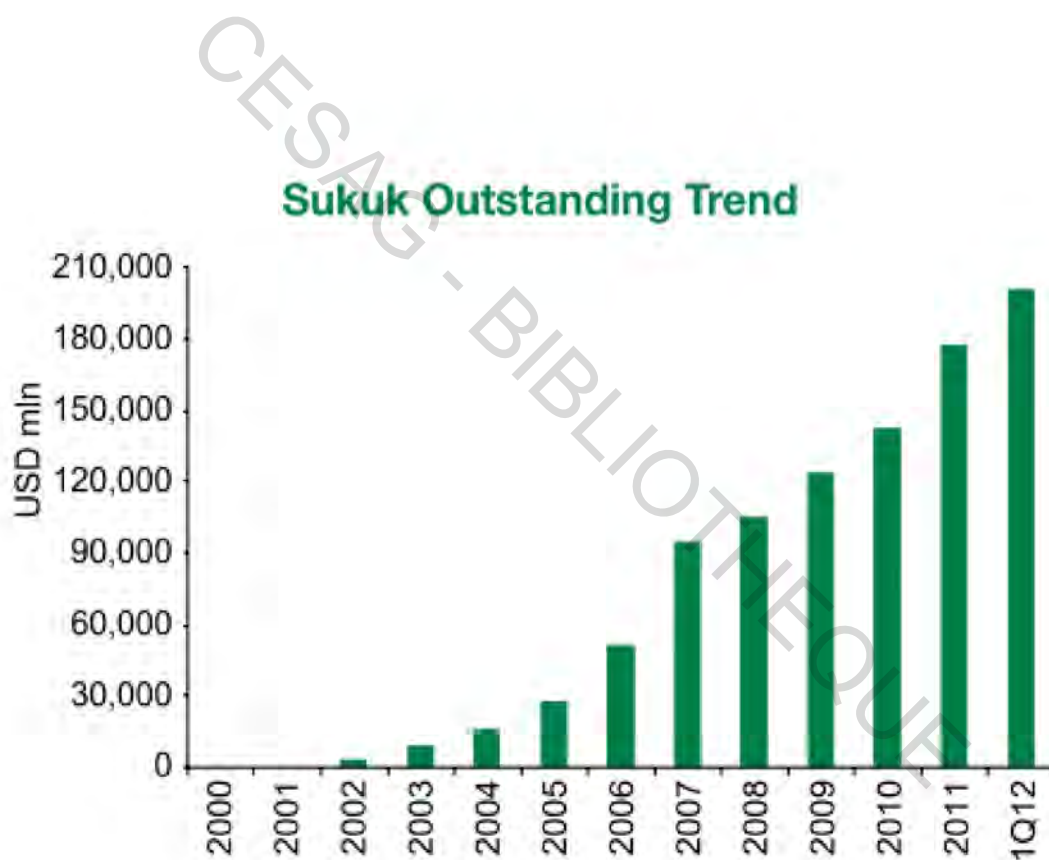
It will be strange to find out that sukuk originated from a non-Islamic company Shell PDS, around the 1990 in the predominantly Muslim country, Malaysia.

Sukuk was issued at the international level by the government of Bahrain in 2001. Since then the global markets has seen more issuance such as the first quasi-sovereign global sukuk which was issued by a Malaysian Corporation .As of June, 2009 the total Global sukuk issuance increase from a size of just over US\$1billion towards the end of 2001 to US\$136billion as of June 2009(Ijlal Ahmed Alvi, 2008).

Over the last decade there has been an increase in the number of sukuk issued from 3 in 2000 to a total issuance of 794, in 2010. Amongst those trading in sukuk, the private corporations have been the major players and in a little over a decade they were able to realize a total sukuk issue amounting to 1809 which was valued at US\$ 93.14 billion, quasi-sovereign and sovereign figures stood at 197 and 439 amounting to US\$ 47.92 and 53.21 respectively (IFIS, 2011).

According to different sources (Bloomberg, IFIS, Zawya etc.), the global sukuk market closed with a record high issuance of US\$ 85 billion in 2011. We saw the first quarter closing on this trend with 40.5 billion in terms of new issuances. This huge growth was felt amongst the majority of the Islamic financial markets.

Exhibit1: The Sukuk Outstanding Trend



Source: Bloomberg, IFIS, Zawya, KFHR

Some of the factors that explain this growth include:

- The Arab uprising has reduced the turnover/yield in sovereign conventional bonds.
- Certain Western areas have experienced drainage in liquidity.
- After the global financial crisis, there was high uncertainty amongst investors.

- The likelihood of another recession created fear and panic.

Perhaps the most convincing factor was that after the global financial crisis, Islamic banks were less affected because of their low exposure to toxic products.

Although the sukuk market commenced in Malaysia, but there were few sukuk deal. As explained by CDVM et al. (2011:15) the central bank of Malaysian Islamic Bank alone issued 43% of the total sukuk in the primary market. Besides Malaysia, other countries like United Arab Emirates, Saudi Arabia, Qatar, Indonesia and Bahrain followed suit. It was not until 2001 that the world saw its first US dollar –denominated international corporate sukuk by a Malaysian corporate. Since then the sukuk market has seen rapid development across the globe and it was introduced in over 20 countries including Turkey, The UK and the USA.

2.3 Opportunities for sukuk financing

According to a report by Standard & Poor, in 2012, the GCC market reached 19 billion which was seen by many as a very significant figure. This was driven by the following reasons: relatively high liquidity, low yields, large capital expenditure needs and strong investor appetite.

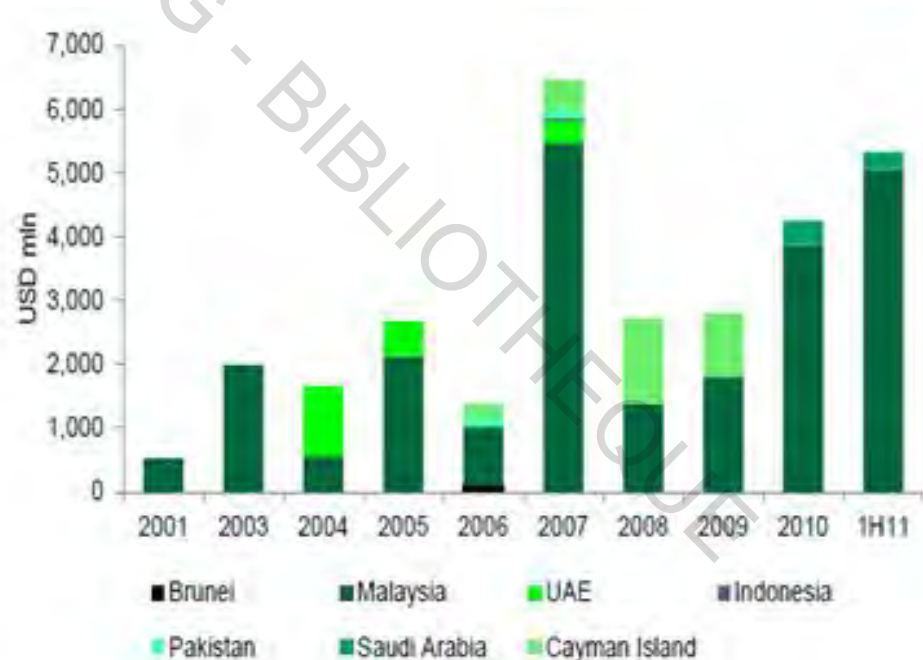
The demand for sukuk is very high and compared to conventional bonds they have a larger pool of natural buyers because they are sought by both Islamic and conventional investors. The strong growth in the Islamic Finance industry and strong appetite for shariah compliant securities combined with debt crisis in US and Europe and restriction on credit facilities from conventional banks have all increased interest in the Islamic capital market.

Africa's largest infrastructure needs are in the power sector. Islamic financing structures through sukuk are particularly suitable for this since the underlying projects are productive investments benefitting the majority of the people. Furthermore when analyzed deeply, such sectors tie in heavily to the real economy, avoiding the debt –heavy nature of conventional financing options. Many GCC countries rely on government expenditure to finance infrastructure projects rather than Islamic Financing solutions. However looking at the Gambian context, access to such liquid

revenues are not available compared to the oil rich countries. Sukuk offers an opportunity to mobilize large amount of funds needed to finance such projects.

Since 2001, the infrastructure sector has seen a large portion of the raised funds directed to development projects around the globe. A study by KHF (2011) maintain that the last ten years has seen a combined worth of US\$29.5 bln of sukuk funds channeled into financing projects. Among these projects are long distance highways, the building of multiple and maintain a clean and proper water projects, **electricity supplies** etc.

Exhibit2: Sukuk issued for infrastructure projects



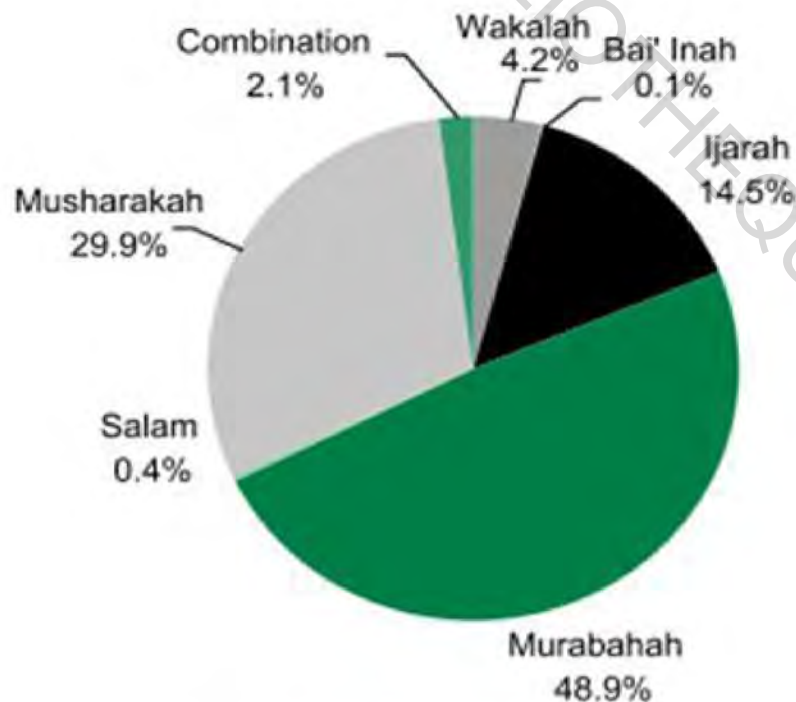
Source: IFIS, KFHR

The emergence of the young market in 2001 saw a considerable increase in amount to USD 136 billion. But this rapid surge did not live long as a result of the global financial crisis. The product being new in the financial markets was prone to the shocks that affected big markets worldwide. As the world witnessed the collapse of big financial institutions, many investors were rather preoccupied recovering their dues back than committing themselves in other investments

whether conventional or Islamic. In other words the confidence built on such markets ceased to exist among investors. (M. AYUB, 2007).

Islamic financial experts structured the sukuk market in to different types based on their nature. First there was the **Ijara** based sukuk and musharaka based sukuk. After sometime, the other structures emerged such as murabahah and mudarabah which were participatory based (IIFI, 2011). Among all these instruments, Murabaha Sukuk dominated issuance in the primary market. It gained a market share of 48.9% while Musharakah and **Ijarah** sukuk represented 29.9% and 14.5% respectively. However, it is widely noticed that Murabaha sukuk cannot be exchanged in the secondary market due to shariah compliance principles.

Exhibit3: Sukuk issuance by Structure (2012)



Source: Bloomberg, IFIS, Zawya, KFHR

The sukuk market although in its early stages, it has shown great potential for economic development in The Gambia through capital formation and also serves as a medium of raising needed funds for government and private individuals to finance large projects within the framework of Shariah⁴.

Government through the central bank can use sukuk for managing and controlling liquidity at the macroeconomic level by contractionary or expansionary open market operations. The sukuk instrument can be used for collecting national savings and encouraging investment by spreading savings awareness which in turn will lead to more investment. A good example is the Sudanese sukuk market.

The Introduction of Islamic financial papers has become a nucleus for assisting in the development of capital markets and stock exchange. It serves as one of the instruments of monetary policy which enables central bank to formulate and implement an effective monetary policy within the frame work of an integrated financial and monetary program.

The most common mechanism of funding development projects is through OPM (other people's money) for example loans. Governments and private sector can meet this need through sukuk issuance which is a perfect alternative to conventional lending which do not conform to the precepts of sharia. From the above, it will be correct to say that sukuk can serve as a vehicle which contributes towards mobilizing savings on a big scale. Diaw(2011) is of the view that the active agents in this markets benefit from the gains derived from sukuk financing for example governments, investors, and businesses.

The Gambia is one of many African countries that rely heavily on tax, foreign aid and huge debt to finance its infrastructure. Most of these conventional loans come with government restructuring conditions for instance the World bank loan scheme requiring government to reduce civil service to be able to pay off some of her borrowings and the huge amount of interest attached to these loans renders government more indebted than alleviating the problem. As stated

⁴ The sum total of Islamic teaching and system which was revealed to prophet Muhammad SallallaahualaihiWasallam recorded in the Qur'an as well as deducible from the prophets divinely guided lifestyle called Sunnah(Ialdin,2006 p.3)

by IQBAL and KHAN (2004), the system of Build-Operate Transfer (BOT) combined with the various sukuk structures, can be a perfect alternative to the interest based conventional finance.

People not conversant with Islamic Finance may assume that the idea of profit and loss sharing schemes renders the whole market risky but as shown by Adam(2005), funds invested in sukuk continue to increase since its inception more than a decade ago. Most importantly it provides investors with an alternative to diversify their funds.

Musharaka, Mudaraba and **Ijarahsukuk** are seen by many Islamic economists as the suitable Islamic financial instruments to finance infrastructure projects. This may be because they represent genuine assets and business transactions as per the respective rules and norms related to fair play, transparency and justice.

2.4 Islamic Financing structures

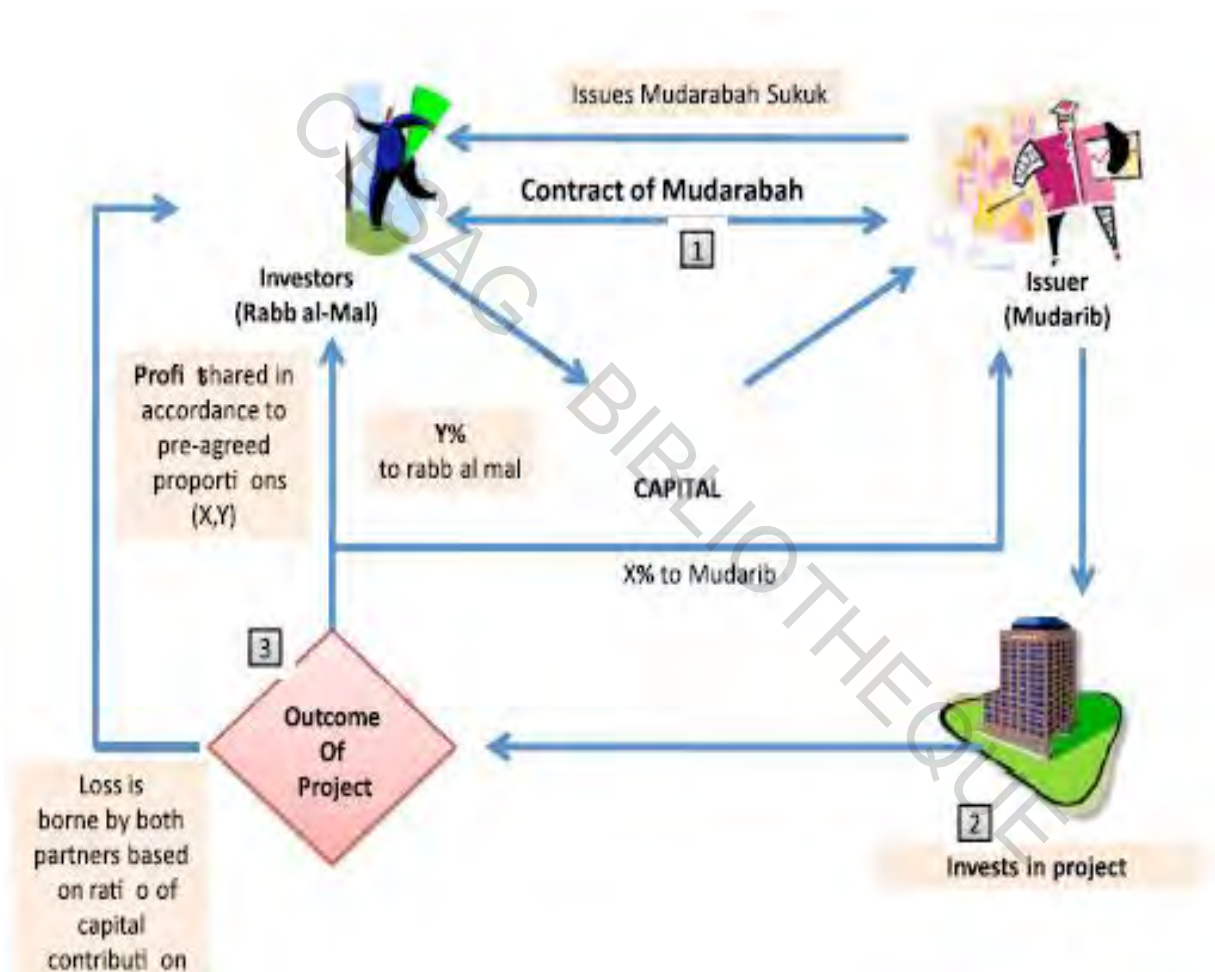
The key principles that have been set out above shape the way in which sharia compliance transactions are structured. Although in principle, sharia requires an Islamic investor to assume a propriety interest in the asset or project being financed. Sharia compliant investments can be structured to yield returns that resemble both equity and debt type returns. Equity structures mainly use partnership models. Debt structures use such devices such as leases, forward sales and differed payment obligations on asset or real estate which achieve the economic effect of returns on lending (Khan, 2010). Some of the salient Islamic debt structures are discussed below.

2.4.1 Mudarabah (silent partnership)

Under a Mudarabah agreement, an investor (rab al –mal) - usually the financier –provides the capital to an entrepreneur (Mudarib), who is given the sole responsibility to manage the investment. Both the investor and the entrepreneur are entitled to profits, which must be distributed in accordance with a pre –agreed percentage formula. The investor however bears all the risks of any loss in the absence of any fraud or negligence by the entrepreneur. The entrepreneur cannot provide a guarantee to the investor in respect of the capital amount or any

profits from the investment. Many Sharia scholars believe that musharakah and mudarabah represent the desired form of Islamic financing (Muneer Khan, 2010).

Exhibit4: Depicts a basic illustration of a Mudharabasukuk transaction structure



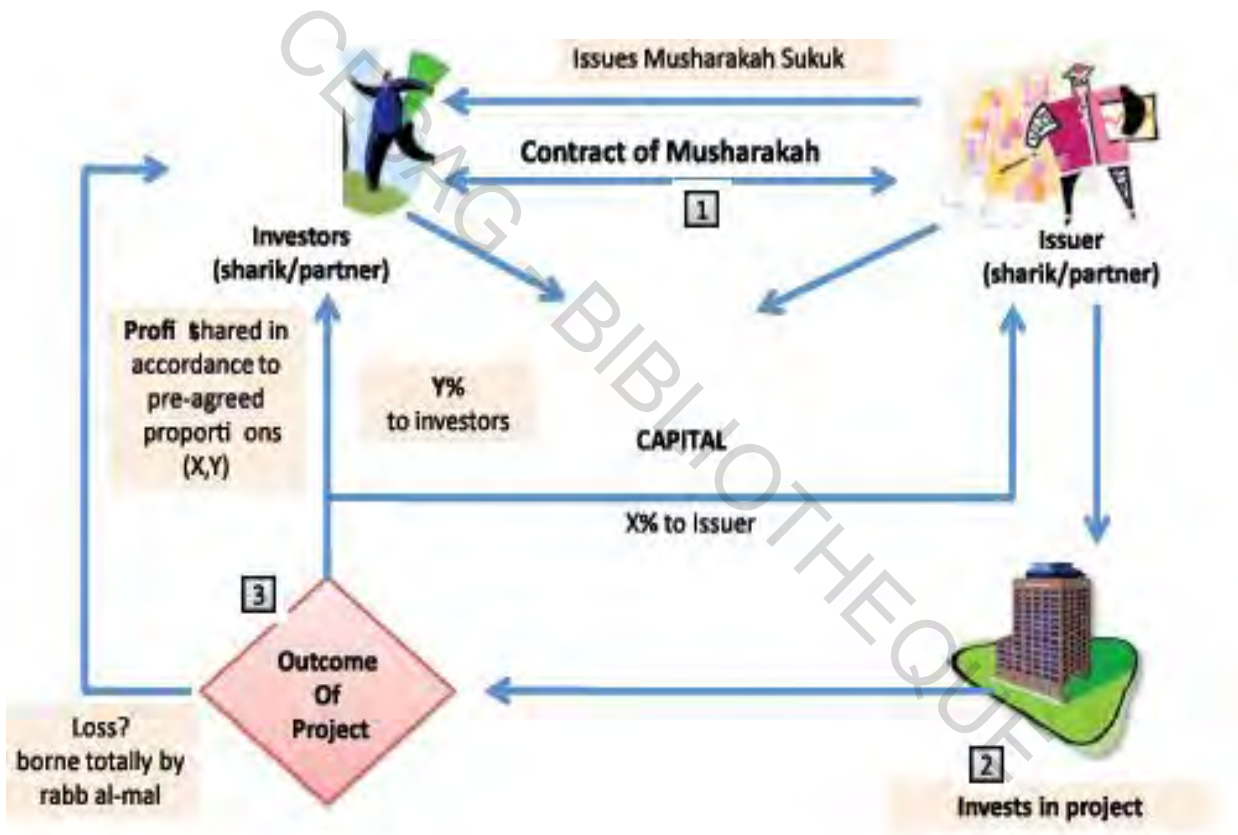
Source: ISRA (International Shariah Research Academy For Islamic Finance)

2.4.2 Musharakah (partnership financing)

Musharakah agreement is a joint enterprise or partnership in which each partner shares in any profits or losses emanating from the activities of the business venture. The partners distribute

returns according to pre – agreed formula based on percentages and agreeing to a fixed profit to one partner would not be compliant with shariah. Partners are required to allocate losses according to their capital contributions to the enterprise. Management of the enterprise can be delegated to another entity (DIAW, 2009:24).

Exhibit5: Depicts a basic illustration of a Musharakahsukuk transaction structure.



Source: ISRA (Islamic Shariah Research Academy for Islamic Finance)

2.4.3 Murabaha (cost plus financing)

A murabahah is an agreement in which a seller sells an asset to its customer at a price while disclosing to the customer the relevant profit mark-up. Frequently, the seller (in this case, the

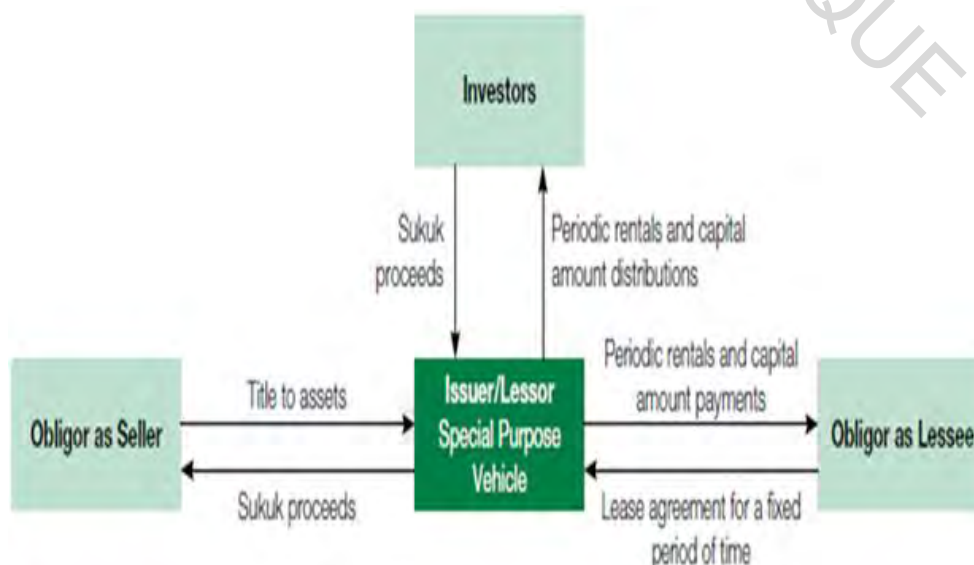
financier) appoints the customer as its agent to purchase the assets from a supplier on its behalf in order to make the murabaha arrangement.

The price payable by the customer is invariably differed, which creates a debt obligation .This structure is commonly employed to facilitate the trade finance activities of Islamic financial institutions.

2.4.4 Ijarah (lease financing)

Ijarah is leases where the benefit available from a specific asset is made available and must retain value throughout the term of the lease .Assets that are consumed by their use are therefore not permissible lease assets. The lessor assumes the responsibility for major maintenance and insurance of the assets. Different rental assets may be fixed for different rental periods. A variation of the Ijarah structure is a right to purchase the asset at the end of the lease period (ijarahmumtahila bi-tamlik).The leesee under this alternative structure agrees to make a capital payment to purchase the asset in question at the end of the lease period.

Exhibit6: Structure of a generic ijarah sukuk



Source: Islamic Finance Advisory Board, KFHR

2.4.5 Advantages and Constraints

Musharakah sukuk has many advantages compared to other forms of Islamic Financing. The same way it is also faced with constraints /challenges that deter its development. As will be explained in this chapter, it involves high risk taking on both investors and fund managers compared to *IjarahSukuk*.

-Advantages:

Big projects can require huge funding benefit from sukuk financing. Musharakahsukuk are asset backed and the need for such huge funding in The Gambia presents an opportunity for the Musharakah certificates.

Looking at the characteristics of sukukmusharakah, they are structured in such a way that they facilitate easy mobilization of funds. This widens and diversifies its investor base which could lead to competitive and sometimes lower pricing thus leading to capital allocation. It also presents the opportunity to invest in a new asset class.

The certificates also enjoy a wide range of investors from Islamic and Conventional Investors. This creates competition between conventional and Islamic Investors thus bringing it in to competition with conventional funding.

-Constraints

All Islamic financing structures require risk taking and the musharakah and mudarabahsukuk are no exceptions. This is because they involve profit and loss sharing schemes. The undertaking to purchase the share of one partner at the predetermined price defeats that spirit of Musharakah as one partner will have guaranteed return, whatsoever as to the outcome of the venture (Diaw, 2011).

There are different types of risk associated with Musharakahsukuk: Business risk for the investor, Credit risk, and Liquidity risk.

- Business risk refers to the uncertainty associated with operating cash flows. All these is possible with a sound economy and the profitability of the sector ,management , foreign investors and our competitors' should all be taken into account.
- Credit risk is the risk associated with a borrower not meeting the conditions of the creditor as per the timely repayment and interest in conventional debt (Fabozzi and Modigliani, 2009, p 454).In essence Credit risk in a Musharakahsukuk would mainly mean the uncertainty surrounding the principal repayment at the time of maturity.
- Liquidity risk comes in to effect when there are no sukuk buyers in the secondary market which mean that they will be sold at premium of illiquidity thus forcing sukuk holders to hold them until maturity.

2.5 The Gambia Sukuk market

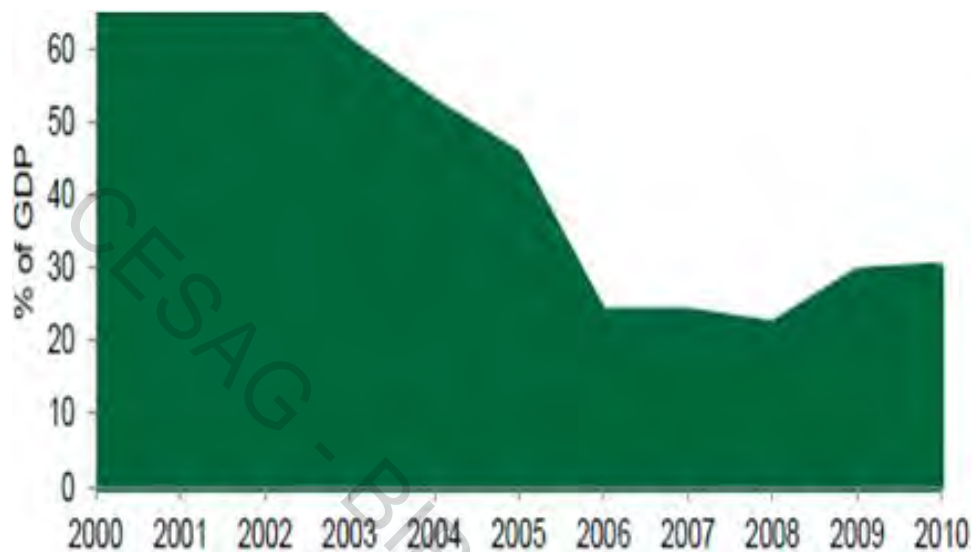
The Gambia has a valuable window of opportunity to build up further its financial markets. As a country that embarks on large infrastructure projects over the next decade, the scope for sukuk issuance is considerable. Reforming the current environment by rendering it more inviting environment to investors would attract large flows of capital, bring in additional foreign expertise and lower the financing cost of the infrastructure projects.

By many standards, The Gambia has a stable and favorable business environment. As mentioned earlier, there is an increasing interest by local, international investors and companies alike in the creation of a sukuk market as a potential alternative to the conventional borrowings which attract huge interest. However the use of sukuk may not be familiar to entities unfamiliar with the legal underpinnings of these instruments (Shariah compliance).

The Gambia has made great progress towards long term debt sustainability following the grant of debt relief from both HIPC (heavily indebted poor countries) and MDRI (Multilateral debt relief initiatives) initiatives. However, The Gambia continues to require considerable loans to finance its development agenda as envisioned by vision 2020, needing a borrowing framework that helps

to raise the required resources at optimal cost and gradual reduction of its long term dependence on extreme aid (KFHR, 2009).

Exhibit7: The Gambia Debt Outstanding



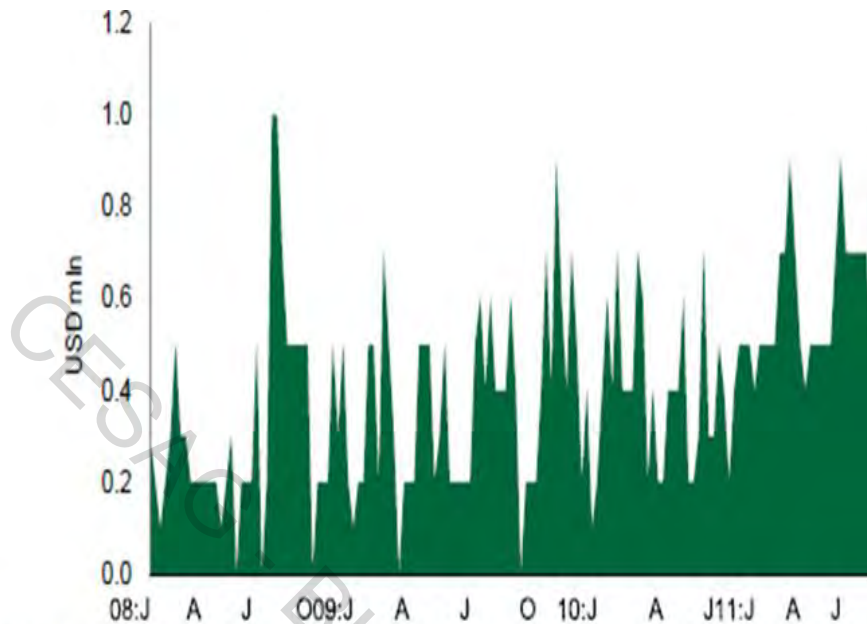
Source: African Development Bank, KFHR

Marketable interest bearing debt constituted 87.0% of the domestic debt portfolio as at 30th September 2009 of which 85.0% comprised of T-Bills with maturities of 91 –days, 182-days, and 364 days and 2.4% Sukuk-al-salaam bills with maturities of 91 days (Global sukuk Issuance, 2010).

The CBG (Central Bank of The Gambia) in its policies towards satisfying the demand for an Islamic instrument initiated the short dated shariah compliant sukuk Al-Salaam bill in November 2007, which operates on Shariah principles just like the T-Bills would in conventional market.

Gold has been chosen as the notional asset which the central bank is given the mandate to sell and issue Al-Salaam bills recorded on a book entry system. The title is then surrendered to the central bank at maturity in exchange of cost plus mark-up.

The central bank has issued 145 short-term sukuk worth a combined amount of 60.0mln of which only 6.6mln is outstanding. T-bills and Sukuk Al-Salaam are published on weekly basis (auctions).

Exhibit 8: The Gambia Sukuk Issuance Trend

Source: Zawya, KFHR

A genuine sukuk market must be backed by assets. The SPV a separate legal entity could be seen as the representative of the sukuk holders. So it will sell the sukuk and keep the ownership title on behalf of the sukuk holders. There is no legal restrictions on the creation of SVP and The Gambia does not possess an unambiguous framework for the establishment, management and accounting procedures for these vehicles.

However, the sukuk market has some constraints that need to be addressed to determine its future. For example the absence of a predictable set of rules (Shariah board) poses serious issues of uncertainty in sukuk and thus rendering the Islamic instrument unattractive to Muslim investors. Managing and administering Islamic Financial instruments requires expertise in the area which is lacking in The Gambia.

Therefore to address the problem, a comprehensive and acceptable framework of governing the sukuk issuance and their management would certainly encourage their use by companies and investors alike. Furthermore, the introduction of securitization of these instruments would go a long way towards improving the sukuk market.

2.6 Liquidity

The Gambia financial system has great opportunities to emulate the Malaysian one which established a conducive framework that enables the issuance of sukuk through a SPV (Special Purpose Vehicle) called the Malaysian Sukuk Inc. The objective was geared towards financing huge infrastructure projects such as hospitals, government living headquarters etc.

The sukuk market is linked to the presence of cash-liquid investors. Most Muslim investors who find conventional banking and finance unethical would rather prefer holding their monies in savers at home rather than investing in non shariah compliant enterprises which impact negatively in the economy. Recent fire outbreaks that ravaged homes of some wealthy people proved that huge amount of cash was kept at homes instead of invested or saved in conventional banks.

It is well documented that both Islamic and conventional bank treasuries have become regular buyers of sukuk thus receiving a large allocation of issuance as they would like because there is confidence that the assets are likely to be held to maturity (Diaw, 2011).

Having assessed the Gambian sukuk market in this chapter, it has become evident that the sheer size of its sponsors' clout set it apart from comparable offerings. The main issuing body i.e. the CBG has longstanding connections with local banks so should not struggle to cover its funding needs even when international investors retrench. Given that the central bank is backed by the government, the chances of anything happening to prevent it from honoring its obligations seem negligible.

The Gambia's first sukuk financed project may open the floodgates to similar deals hence creating an unassailable credit, a liquid market, and a perennially desirable commodity combined to allow a remarkable innovative financing.

2.7 The Energy Sector, The Gambia

The Gambia is part of the West African Power Pool (WAPP) comprising of 14 nations which aims to develop energy production facilities and interconnect individual country grids. The country is also involved in the second phase of expansion of the Economic Community of West African States (ECOWAS) in their efforts to improve grid inter-connection and corporation between states.

The economic development of any country lies in her efforts to achieve reliable and sustainable energy for production purposes. In the Gambia, the description is not in any way less true and authorities have since realized the importance of the sector in national development. An important variable for development is the availability of reliable supply of electricity that impacts direct on poverty. Past experience suggests a close relationship between energy use and poverty reduction through sustainable growth (International Energy Agency, 2006).

According to a review of The Gambia's energy sector, the energy resource base is limited and the energy supply unreliable and unstable (National Planning Commission, 2011). The over reliance of the city and major urban centers on fuel wood (fire and charcoal) is destroying the country's forest resources and natural vegetation at an alarming rate, causing general environmental degradation.

The country's electricity is supplied by the main provider National Water and Electricity Company (NAWEC). It was founded in 1996 and was embedded as a limited company by share (Company Act of 1995). The principal generator serving the Greater Banjul Areas (GBA) is located at Kotu. As the sole company in this sector, NAWEC provides electricity, distributes drinking water and sewage services for domestic, industrial and commercial purposes. PURA (Public Utility Regulatory Authority), an independent body serves as arbitrator between providers and consumers by regulating tariffs.

The electricity sector has witnessed significant changes since 1972 with the creation of GUC (Gambia Utilities Corporation) which was task to supply electricity and water to the general public, industry and domestic households. After the failure of GUC to meet the demand of the public, private enterprises and industries, the government deemed it necessary to replace it with

two joined companies i.e. Management Services Gambia (MSG) and Utilities Holding Corporation (UHC). Until 1996, these two companies existed before amalgamating to form what is NAWEC today (www.Nawec.gm).

The Gambia is heavily dependent on electricity for production purposes. Nationwide as of 2001, the urban electrification stood at 60 percent, with approximately 30 percent of rural households having electricity access, 93 percent of the population of Banjul the Capital, has electricity access. The north Bank Region and the Central River Region are currently the least electrified with 7 percent and 8 percent respectively having electricity access in those regions.

In 2000, a rural electrification project was launched with the construction of 6 power plants and transmission lines to supply a large number of Towns and Villages. Also in 2000, the government approved a project which consisted of the construction of six power stations combined capacity of 6.2 MW and the installation of 141 miles (227) of transmission and distribution lines to supply power to 46 towns and villages. As of 2009, approximately 2.2 MW of this target has been achieved. The total cost of the project was estimated at US\$19 million.

Heavy reliance on imported petroleum fuels resulted in balance of payment deficits. The impact has been an acute shortage of electricity supply, with low investments and productivity impacting on the overall economy. The lack of reliable household electricity supply for the majority of the population has led to the endemic use of traditional Biomass fuels.

NAWEC, the public utilities supplier is not operating on a commercial basis and is not able to generate sufficient financial revenues to maintain and upgrade the systems and infrastructure. As a result, the electricity sector is facing serious constraints such as under investment, an inflexible tariff system, rising fuel prices distribution and transmission losses. According to SERN(2011:02) transmission losses was estimated to be around 40 percent as a result of non-payment of areas, particularly by large commercial and industrial consumers. Hence we have seen the company facing serious difficulties in meeting its operative cost, investing in generating capacity and replacing obsolete equipment.

Feasibility studies in the energy sector area have shown that there is high opportunity for Renewable Energy in The Gambia given the long hours of sunshine year round. This is another area that needs exploitation to reduce cost.

In 2000, government set up a Gambia Divestiture Agency in order to dismiss state participation in several enterprises including (NAWEC, <http://www.nawecgambia.gm>). In the same year the government signed an agreement with a South African Eskom who according to the deal would acquire 50 percent stake in NAWEC and participate in a US\$75 million investment program to overhaul NAWEC's generating plants over the following 5 years. The government in a similar vein abandoned a project from the World Bank after three years and the credit was cancelled (dbpedia, 2009).

Based on the above observation, we are of the view that the system requires significant private sector investment to operate efficiently and meet growing demand. The sukuk market in particular presents interesting opportunities to provide the needed funds to meet the financing needs in The Gambia energy sector.

Tariffs are very high in The Gambia and the sector is characterized by a lack of transparency. This may explain why in 2006, the electricity law was passed opening up the generating component of the electricity sector to private investors (the law allows private sector participation in electricity distribution). For instance government signed an agreement with a Malaysian company, Clearlink to improve the capacity of electricity and infrastructure related to the Kotu power station as well as rehabilitation of the country's distribution network (Clean Energy Information, 2009).

CHAPTER THREE: RESEARCH METHODOLOGY

This chapter explains the methodology used in other to attain the objectives of the paper work. The chapter details the research method, research instruments, data collection and data analysis. It presents the enormous amount of excess liquidity in the hands of wealthy investors which can be used to finance infrastructure projects thus moving funds from liquid to illiquid sectors of the market. It further explains the need for funding such projects with sukuk.

The nature of this study involves analysis of issues, examining materials and data collection using both quantitative and qualitative approaches.

Quantitative research approach: Data collection on various sukuk issuances from 2001-2012. The main focus in this methodology is to collect data from writing materials relating to the topic of the research. This includes publications, articles, magazines, online research, information service providers etc related to the Gambian sukuk market. In this study, materials collected are used in the quantitative method by looking at the sukuk issuances and geographical distribution, the Gambia energy sector with specific reference to The National Water and Electricity Company, the body responsible for supplying electricity and water.

Qualitative research approach: The main focus in this methodology is to collect and analyze materials or data in respect to sukuk issuance acceptability considering the market in The Gambia. This includes the types of structures used, legal and shariah implications.

The paper used desk research (secondary data) to access information on the sukuk market and the energy sector in The Gambia. Contacts were made with NAWEC staff that provided valuable information about the Energy sector. The financial supervision department at The central bank of The Gambia was instrumental in defining the legal implications of the project.

3.1 Research design

The analysis proceeds in these steps: The opportunities presented by the sukuk financial instrument in mobilizing funds to finance huge infrastructure projects, the impediments curtailing capacity building and sustainable energy production are identified and discussed.

The research work will as well present **Ijarahsukuk** as the financing instrument and make recommendations on how to improve electricity supply using sukuk as the financing instrument. The projet professionnel used collected data through research conducted on documents such as papers, publications, books relevant to sukuk Market.

Research on publications, papers, articles facilitated the paper's definition of the sukuk concept and the market in which it exist.

Data collected through the CBG website, NAWEC, and PURA (Public Utilities Regulatory Authority), National Think Tank Commission, facilitated the project to conduct a feasibility study in the energy sector and gauge the opportunities presented by sukuk financing.

CHAPTER FOUR: THE SUKUK MODEL

4.1 Basic Information

The sukuk will be issued by the government of The Gambia. Arguable this will be the first of its kind to be issued in the country. The main issuing body will be the Ministry of Energy and Petroleum through a Special Purpose Vehicle (SPV) to be named **The Gambia Sukuk Inc.** in order to finance the purchase of generators for the National Water and Electricity Company (NAWEC) who are seeking to improve their capacity of production within the Greater Banjul Area (GBA). The financing of the project will be denominated in US\$ and the estimated cost is \$100 million. It will be open to both local and international investors who wish to participate in the purchase of the certificates.

4.2 The structure of the issue

Although Musharakah and Mudarabahsukuk funding have over the years gained popularity amongst investors, they have been found to be risky to venture into sometimes due to their profit and loss sharing structure. We have therefore preferred the sukuk project to be structured around the Islamic principle of **Ijarah**. Being the only sukuk funded project in the country, it will make use of the most basic and Shariah compliant fund raising mechanisms and revolve around the following major Shariah compliant contracts: namely the purchase agreement, the master Ijarah agreement, the purchase undertaking agreement and the sale undertaking agreement. Through the purchase agreement, the SPV mandates the National Water and Electricity Company that operates the electricity system to purchase new generators that will form the subject matter of the sukuk.

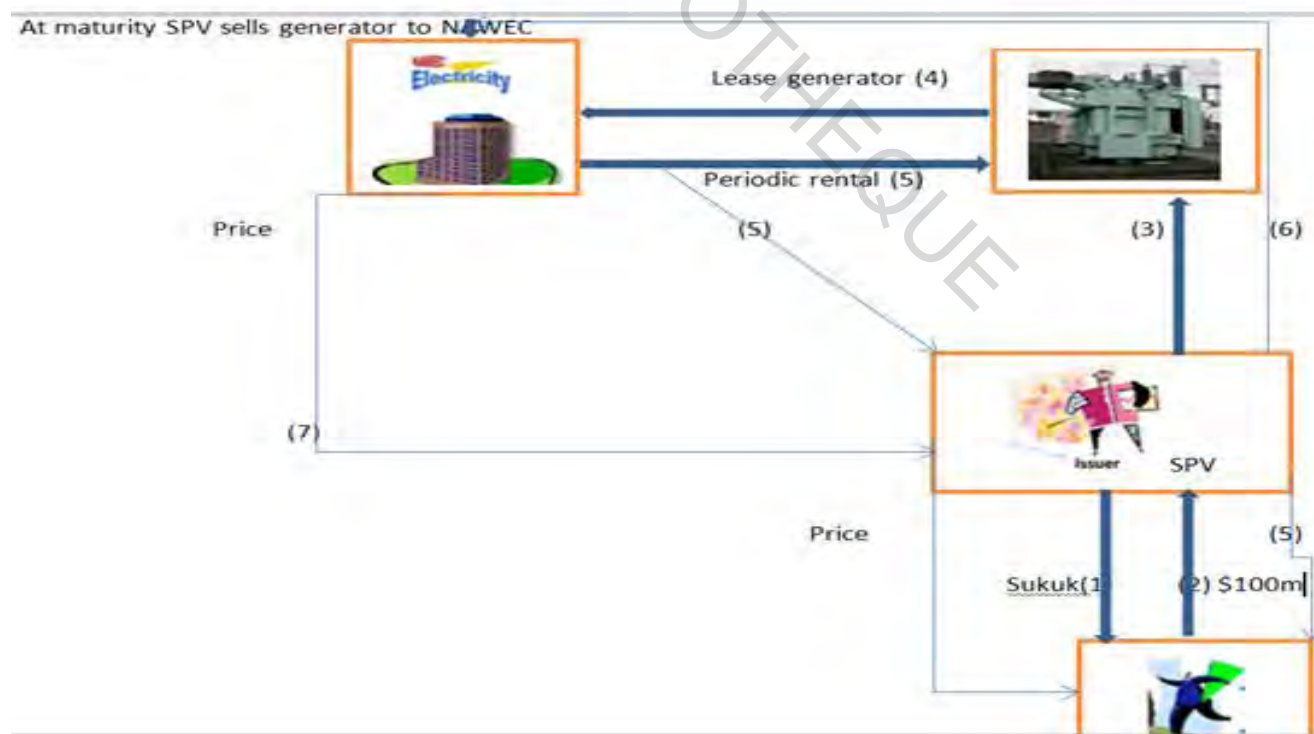
National Water and Electricity Company remains the registered operator of the generators. however according to the terms of the agreement, it will sign a trust agreement signifying that it will hold the registered proprietorship to the generator as trust for and on behalf of the SPV. Therefore the structure will be characterized by two declaration of trust, one appointing NAWEC as a trustee of the proprietorship of the generator on behalf of the SPV and another one appointing the SPV as trustee of the beneficial title to the generators on behalf of the

sukukholders. Based on the master Ijarah agreement, the SPV leases the generators to the government /Ministry of Energy through the operating body NAWEC for a period of five years(in the form of renewable six monthly leases which is the norm of all **Ijarah based sukuk**) in return for semi -annual rental payments.'

The principal payment which may equal to the face value of the sukuk is affirmed beforehand through the SPV executing rental undertakings deed and the Ministry/government executing a purchase undertaking deed under which the later obliged to buy the generators at the fixed price of \$100 million or at market price at the end of the 5 year period.

Because of the irrevocable undertakings by the Ministry of Energy/government to purchase the generator (Trust Asset) at the end of the lease period, **The Gambia sukuk Inc.(SPV)** is assured the sovereign guarantee of the government in case of default of payment because the deed could come into effect even prior to maturity as a result.

Exhibit 9: An illustration of the sukuk model (The Gambia Sukuk Inc.)



Source: The author

Arguably, we are the first to propose funding the energy sector in The Gambia using Islamic financing Instruments (**Ijarahsukuk**). The project will therefore take the following structure:

- After meeting all the legal requirements of the issuance and securitization, the SPV is issued a certificate of compliance to Shariah with regards to funding Islamic financial instruments.
- The SPV then issues sukuk certificates which represent joint participation in a fixed asset of an Enterprise (in this case it's the purchase of a generators).
- Investors subscribe for sukuk and deposit funds (the principal) to the SPV. The SPV will certify to manage the collected funds for the investors (as well as all other assets acquired by the collected funds before maturity).
- With the sukuk issuance proceeds, SPV pays the purchase price to NAWEC which buys the generator on behalf of the SPV and issues a unilateral promise to buy the generator at maturity (5 years) according to AAOIFI rules.
- The SPV rents/leases the generator to NAWEC by virtue of **Ijarah** contract for a spread period equal to the maturity of the contract (5 years).
- The SPV mandates NAWEC to assume the responsibility of (Management, Insurance (Takaful) and tax payment). NAWEC as a trustee can claim remunerations for rendering these services.
- NAWEC pays rent for using the generator to the SPV on regular intervals/periods. The distribution of regular payments is equal to the rental amount. This amount can be calculated using the fixed or variable rates according to the sukuk issuance.
- The SPV will pay periodic distributions to investors. The SPV may keep part of the money as reserve to absorb fluctuations in rent /lease and unexpected circumstances.
- At maturity, (in this case after 5 years) SPV sell the generator to NAWEC at the initial price of US\$100 million, or at market price which represents the repurchase price stipulated in the unilateral agreement.
- SPV uses the repurchase amount to pay termination amount to investors.
- End of contract and dissolution of SPV after operation.

4.3 Feasibility Study

Before introducing the product in the market, an objective feasibility study was done to determine its potentials in the midst of competitors. As a result this section of the paper will put more emphasis on the demand, supply and how the sukuk instrument is expected to meet customer expectation. To determine this, the paper conducted SWOT analysis in order to examine the market.

Demand for sukuk would be centered on the willingness of investors to purchase the product while supply on the other hand focusses on the issuance of the product by the government through a Special Purpose Vehicle. We will discuss each separately.

4.3.1 Demand

Funding huge projects has been a common problem in The Gambia. Access to loans involves an unending paper work to determine credit worthiness of borrowers. Besides, such loans attract very high interest rates the purpose for which such institutions were built. The inclusion of some technical clauses not understood by creditors makes the situation even worse. In a nutshell, it will be correct to say that there is conflict of interest between the ability of borrowers to pay off their loans and the significance of the project.

Investors faced with such challenges have now started to look for alternative sources of funding such as Islamic finance instruments which centers around trade based on real assets. In essence sukuk which is asset backed with huge beneficial factors for societies such as supporting an equitable distribution of wealth would be a perfect alternative to such conventional loans.

For several years now government have been making laudable efforts to regulate electricity with the signing of several projects for instance the recent Rural Electrification Project but this sector is confronted with high cost of fuel and gas, huge cost on installations and some illegal connections by unscrupulous individuals have all caused serious setbacks for the energy sector.

Besides, many Muslim investors prefer to invest in Sharia compliant financial markets because of the services offered by Islamic Finance which among many of its benefits facilitates easy access to funding projects.

4.3.2 Supply

The sukuk Al-Salaam which is issued by the CBG alongside the conventional T-bills has become very popular among Muslim and non-Muslim investors who wish to diversify their businesses thus bringing it into serious competition with the T-bills. The innovative mechanism of the product will add to its preference for investors. Therefore with the introduction of new products such as **Ijarahsukuk**, musharaka and mudarabhsukuk into the financial market, investors will be provided with a wide range of alternatives to diversify their investments.

With conventional finance in the process of recovering from the recent shock, Islamic financial instruments have great opportunities to make their presence felt in the market.

4.4 SWOT Analysis for The Gambia sukuk Inc.

The paper conducted SWOT analysis (Strength, Weakness, Opportunities and Threats) for the The Gambia sukuk Inc. project to determine its chances in the market. To better examine this, we conducted a feasibility study on The Gambia's sukuk market and the energy sector. Against this background, comparison was made between convention lending to finance projects and adopting ijarah sukuk as an alternative form of mobilizing funds using shariah compliance measures.

4.4.1 Strength

- The first Shariah compliant project in the Gambia will in no doubt benefit from the advantages of monopoly in the market.
- The project might receive government backing to prevent it from bankruptcy and failing to honor its commitments to sukuk holders.

- Domestic investors will take pride in the project and give it the support it needs to grow in the market.
- The Islamic financial instrument ensures resource mobilization due to inclusion of Islamic investors.
- It will offer alternative investment with floating or fixed returns and a choice of varied risk and maturity.
- Gives rise to tradable asset and provide liquidity to the market.
- The project will ensure prudent borrowing and also assist growth in the Takaful market.
- Growing institutional and geographical diversity.
- As a project that operates on shariah compliant, it will enjoy a competitive advantage over conventional forms of lending.
- Ability to address broader policy issues.
- The project creates linkages between the finance and the real economy.

4.4.2 Weakness:

- The Gambian financial market is small compared to other countries practicing Islamic Finance for example Malaysia who undertook various projects in the Economic Transformation Program (ETP) in which a total of RM 98bln was allocated for the plan. Thus the failure of the project to attract foreign investors exposes it to the risk involved in investing in sector.
- Many people are not familiar with Islamic finance instruments which creates a vacuum in investment because investors don't want to take too much risk.
- The energy sector is not very profitable compared to the cost incurred in installations, fuel, gas, and human resource. Such an unfamiliar market can be too risky to venture.
- Administrative cost may be very high and limited secondary market implies higher cost of issuance.

4.4.3 Opportunities

- The high interest rates that accompany bank funding will attract investors to look for sukuk as an alternative means for funding.
- The Gambia sukuk Inc. Being the sole Islamic financial Institution funded through sukuk may benefit from flexible taxes by government given the importance government attaches to the energy sector.
- The recent global financial crisis in the conventional financial sector has made Islamic financing structures more desirable to both Muslim and non-Muslim investors.
- With the excess liquidity in the Gulf and growth prospects in Africa, many investors would be interested in investing in Africa in general and in The Gambia, in particular.

4.4.4 Threats

- The sukuk market faces serious threats from the conventional Treasury –bills issued by the central bank. It therefore risk getting secondary treatment compared to the T-Bills.
- The Gambia does not have a shariah board that monitors the compliance of Islamic Financial Institutions and the lack of qualified persons in the field.
- There is high currency risk associated with foreign issuance in term of fluctuations in exchange rates.
- Sukuk issuance is bound to face Legal risk associated with bankruptcy laws and shariah compliance.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of the funding

Over the past decades, the Islamic Finance industry has made significant progress by offering increasing saving instruments and investments opportunities for investors and issuers. It is undisputable that these Islamic financial instruments have attracted the attention of many investors both Islamic and conventional. As maintained in chapter two, we saw that most Islamic financial instruments were held by non-Muslims.

The overall conclusion of this research included in this study will be clearly understood through the conclusion of the professional that sukuk as mentioned in the previous chapters can become a very important instrument in financing infrastructure projects in The Gambia such as the energy sector. The fact that it is accepted worldwide by Muslim and non-Muslim investors have given it those unique characteristics hence the competitive advantage over conventional funding for infrastructure projects.

The sukuk market became popular due to its distinguishing features and ability to mobilize funds for huge infrastructure projects. It has developed around a number of financial instruments such as Musharakah, Mudarabah, Murabaha, Ijarah and Istisnasukuk for fund mobilization. The paper argues that the electricity sector which no doubt is one of the most important sectors of the economy is confronted with serious constraints consequently its strategies to invest in capacity building and providing sustainable electricity are deterred.

It is in this vein that our project intends to exploit the **Ijarahsukuk** instrument and seize the enormous advantages it presents and utilize its mechanisms to mobilize funds for the energy sector. Our study has shown that this form of fund raising will go a long way towards making NAWEC not only efficient but also resourceful enough to maintain stable and reliable electricity system in the Greater Banjul Area and beyond.

Although the sukuk market has seen a dramatic growth on both the demand and supply globally especially in the GCC countries, considerable challenges remain which hinder its otherwise resilient development in The Gambia. There are many factors which explain the growth of the instrument ranging from an increase in shariah compliant real money investors such as fund managers to a seemingly inelastic taste for high grade Islamic securities by rich investors have all contributed to the demand side of the sukuk market.

On the supply side we have seen the central bank issuing salaam sukuk which is a deferred delivery structure for agricultural products to manage its liquidity and fiscal deficit. Besides, government has several infrastructure projects that are estimated to cost millions of dollars while borrowing from the bond market proves costly and very slow. Therefore as shown in this paper, the sukuk market stands a strong chance of winning such contracts.

Feasibility studies and SWOT analysis have all confirmed that there is great public interest in The Islamic financial instrument. A level playing ground will make investors and issuers resort to such financial instrument as an alternative.

Moreover it will be important to note that sukuk issuance is not only limited to listed companies in the sovereign market but it can also be a complementary to banking products thus facilitating the funding of small businesses which meet certain legal requirements(Sharia compliance).

5.2 Policy Implications

The setting up of Sukuk financial instruments in the financial sector requires strict observance of certain legal regulations. So far there are no unambiguous legal laws impeding the creation of Special Purpose Vehicles in The Gambia. However, the tax system is very high compared to many countries in the region. The recent introduction of VAT (Value Added Tax) which was passed by government legislation through The Gambia Revenue Authority (GRA) must ensure flexibility so as to facilitate the financing of projects of this kind.

The AAOIFI has observed that in most of the sukuk structures currently in place, only the beneficial title to the property or asset and not the actual proprietorship passes on to the SVP.

The Gambia is among countries that practice the English Law which governs the majority of sukuk which states that such transfer is not recognized as a true transfer of ownership or property rights. At the end sukuk holders may be deprived from holding legal rights on the trust assets.

5.3 Limitations

As explained in chapter two there is an increasing interest by local investors and companies alike in the creation of a sukuk market as a potential alternative to conventional funding. However, the use of sukuk may not be straight forward for entities unfamiliar with the legal underpinnings of these instruments. For instance the issuance of sukuk must be linked to one or more underlying assets; these in turn are transferred to a Special Purpose Vehicle (SPV) for a period equal to the maturity of the sukuk.

As an additional limiting factor, The Gambia lacks an organized shariah board which monitors the conformity of Islamic financial instruments and the required body of professionals with expertise in this field. As a result operating within the required framework of shariah is difficult to gauge. Lack of standardization with regards to compliance to the shariah creates bottlenecks in the development of sukuk.

The Gambia which is a tax based economy and heavily relies on custom duties. If proper measures are not taken to make the system more flexible, sukuk issuance risk becoming costlier than conventional bonds.

One of the most entrenched structural constraints to the growth of sukuk is the very nature of sukuk end-buyers. There is wide concern that the “hold to maturity” nature of investors is constraining liquidity thus greatly affecting demand.

Islamic finance is based on honesty and trust between partners but the unscrupulous behavior of one partner by concealing business activities and breaching of contracts defeats the objectives of shariah.

5.4 Recommendations:

We therefore wish to use this paper to shed more light on the potentials of **sukuk** as an alternative shariah compliant Islamic financial instrument which if exploited may attract investors to the benefits of abundant liquidity in order to finance the energy sector.

Achieving a lasting solution in the energy sector requires private sector intervention. To this effect, we have proposed Islamic financial instrument such as **Ijarahsukuk** to mobilize the needed funds to finance the project.

In order to develop the sukuk market the government needs to put in place a clear legal framework for the establishment, management, and accounting of SPVs underpinning the issuance of sukuk and develop through the ministry of Justice/finance a legal framework for sukuk securitization (pool/funds of sukuk). In the same vein, upgrading the country's financial system should be one of the country's main ingredients in the authorities' overall strategy for diversifying The Gambia economy. Given the high tax rate of the country, we recommend government sponsored legislation to address taxation laws and stamp duties to ensure the tradability of the instrument. We recommend for The Gambia to follow the footsteps of Malaysia given its Tax neutrality initiatives which have provided the impetus for the ringgit denominated market to constitute the majority of the Global sukuk market.

A general assessment of The Gambia sukuk market reveals that all issuance stems from the government sovereign institution i.e. The Central Bank of The Gambia with no issue from corporates. A tax incentive system will attract corporates into the sukuk market given the fact that they rely heavily on bank lending.

To address the know how gap, sukuk stake holders (The government, CBG, AGIB, Takaful Insurance and other standardization bodies) should engage in sensitization process to educate investors on the fundamentals of Islamic Finance.

Moreover, the establishment of broad sukuk trading lines by investors with market participants across the region would significantly enhance their distribution networks and provide sukuk buyers with exit options prior to maturity. It is also incumbent on the Islamic finance industry to

raise awareness amongst sukuk buyers on the different risks associated with holding sukuk to maturity as opposed to holding securities in trading books or available for-sale books (where market risk, liquidity risk and profit rate risk factor in). We believe that raising awareness of sukuk offering at the micro-level, marketing these options vis-à-vis branches and introducing frameworks to meet the concerns of retail sukuk investors will be a step in the right direction.

Greater private sector participation in the sukuk market will contribute to increase liquidity and stability which will add a new dimension to the growth of sukuk markets in The Gambia.

Based on the above outline, parties who wish to raise debt financing in The Gambia are strongly advised to use sukuk structures for their deals. In the current investment environment, apart from strong economic reasons related to high liquidity of the Islamic Finance market, the use of Shariah compliant instruments gives the investor clear legal advantages. One should not also neglect the behavioral aspect of using the Shariah compliant structures where the sponsors and managers of the underlying project have higher moral and legal responsibility to honor their duties because, firstly, they will have not only business but also religious reasons for being diligent and secondly, from the outset they will have a clear understanding that they are dealing with assets belonging to others and not themselves.

Finally, while talk on Islamic Finance as a passing fad is long gone in The Gambia, what remains to be proven is whether the sukuk market can overcome these bottlenecks, fulfill its potential and truly get to the next level.

WASSALAAMUALAIKOUM WARAHMATOULLAH WABARAKATUHOU.

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ANNEXES

ANNEX 1: Difference between Sukuk and Conventional bond

Sukuk vs. Conventional Bond

Parameter	Sukuk	Conventional bond
Issuer	<ul style="list-style-type: none"> A sukuk issuer shall be engaged in Shariah-compliant business activities 	<ul style="list-style-type: none"> An issuer of conventional bonds is not limited in its business activities
Investor base	<ul style="list-style-type: none"> Enjoys a wider investor base from both Islamic and conventional investors 	<ul style="list-style-type: none"> Conventional bonds can only tap the conventional investors
Ownership	<ul style="list-style-type: none"> Investors take direct ownership of an underlying asset or pool of assets 	<ul style="list-style-type: none"> A conventional bond is purely the financial debt of the issuer
Administrative cost	<ul style="list-style-type: none"> Additional fees in terms of legal and Shariah advisory fee 	<ul style="list-style-type: none"> No additional administrative costs associated with conventional bond issues
Financing cost	<ul style="list-style-type: none"> A larger pool of sukuk investors creates more demand, hence may help to achieve slightly more competitive pricing 	<ul style="list-style-type: none"> A comparatively smaller pool of conventional bond investors suggests that there is less demand for the paper

Source: HSBC Amanah, KFHR

ANNEX 2: Selected announced Sukuk for 2012

Sukuk Name	Domicile	Structure	Currency	Issue Size (USD mln)
Government of Senegal	Senegal	Ijarah	-	200.0
Abu Dhabi National Energy Company	UAE	Murabahah	MYR	1,101.3
Majid Al Futtaim Holding	UAE	-	USD	500.0
Projek Lebuhraya Utara-Selatan Berhad (PLUS)	Malaysia	Musharakah	MYR	-
General Authority of Civil Aviation	Saudi Arabia	-	-	-
Government of South Africa	South Africa	-	-	-
Pemerintah Republik Indonesia	Indonesia	-	IDR	-
Qatar Islamic Bank	Qatar	-	-	500.0M - 1,000.0
Gamuda Berhad	Malaysia	-	MYR	251.7
Bank Asya Sukuk Limited	Turkey	-	USD	300.0
IDB Trust Services Limited	Saudi Arabia	Wakalah	USD	600.0
PT Multi Nitrotama Kimia (MNK)	Indonesia	Ijarah	IDR	-
PT Multi Nitrotama Kimia (MNK)	Indonesia	Ijarah	IDR	-
Gamuda Berhad	Malaysia	-	MYR	31.5
HP Multimedia	Malaysia	-	MYR	40.9
International Islamic Liquidity Management (IILM)	Malaysia	-	MYR	-
Jati Cakerawala	Malaysia	Musharakah	MYR	269.0
KNM Group	Malaysia	-	MYR	-
Konsortium Lebuhraya Utara-Timur Sdn Berhad	Malaysia	-	MYR	15.7
Konsortium Lebuhraya Utara-Timur Sdn Berhad	Malaysia	-	MYR	245.4
Korea Development Bank (KDB)	South Korea	-	MYR	-


Source: (Zawya, KFHR)

ANNEX 3: Central bank of Sudan Ijarah certificates

Year	Total Certificates held with CBoS & Banks	Certificates Sold	Certificates Purchased	Net Balance of Certificates with Banks
2005	21,9800	17,7400	42,400	13,5000
2006	24,3871	33,6500	33,3000	13,8500
2007	24,3871	86,7000	68,2600	18,4400
2008	24,3871	52,1365	31,4740	20,6625

Source: Central Bank of Sudan and In-house IIFM Sukuk issuance database

Annex 4: Islamic Financial Instrument-Sukuk Al –Salaam

ISLAMIC INSTRUMENT- SUKUK AL-SALAAM		
<p>Competitive Bids MM 0001A TO: Director Banking Department Central Bank of The Gambia 1-2 ECOWAS Avenue BANJUL, THE GAMBIA</p>	 <div style="background-color: black; color: white; padding: 5px; border: 1px solid black;"> <p>SUKUK AL-SALAAM TENDER For Direct Bidding to CBG (D5, 000,000 and above)</p> </div> <p>For Tender Instructions, See Form MM 0002 & MM0 005</p>	
<p>TYPE OR PRINT IN INK ONLY – TENDERS WILL NOT BE ACCEPTED WITH ALTERATIONS OR CORRECTIONS</p>		
<p>1. BID INFORMATION <i>(Must be completed)</i></p> <p>Face Value: D _____ Bid Price: D ----- • ----- per D100.00 D _____ <i>Amount in words</i> <i>(Sold in units of D5, 000)</i> <i>Dalasis</i></p>	<p>ISSUE DATE</p> <hr/> <p>OFFICIAL USE ONLY</p>	
<p>2. TERM SELECTION <i>(Must be Completed - Fill in One Only)</i></p> <p>SUKUK AL-SALAAM</p> <p><input type="checkbox"/> 3-Month <input type="checkbox"/> 6-Month <input type="checkbox"/> 12-Month</p>	<p>3. NAME Please Type or Print <i>(Must be completed)</i></p> <p>_____</p> <p>4. ADDRESS</p> <p>_____</p> <p>_____</p> <p>5. TELEPHONE</p> <p>_____</p> <p>6. DATE</p> <p>_____</p>	<p>ACCEPT <input type="checkbox"/></p> <p>REJECT <input type="checkbox"/></p> <p>REASON</p>
<p>7. PURCHASE METHOD AND PAYMENT INFORMATION</p> <p>Cheques D _____ I/we undertake to accompany full payment with the application and submission for such amount(s) of Sukuk Al-Salaam Bills applied by means.</p> <p>Matured Bills D _____</p> <p>Total Payment D _____ Sign</p>		
<p>9. AUTHORISATION <i>(Original Signature Required)</i></p> <p>Tender Submission: I submit this tender pursuant to the Primary Dealer Guidelines, General Conditions of Issue and Redemption and the applicable offering announcement. I certify that all the information provided on this form is true, correct and complete</p>		
<p>10. AGREEMENT CONTRACT</p> <p>This agreement is between the Central Bank of the Gambia, hereafter referred to as the Seller (at commencement of contract) and the Buyer (at the expiry of contract) and the concerned Primary Dealer, hereafter referred to as the Buyer (at commencement of contract) and Seller (at the expiry of contract) for the sale of gold as notional asset underlying the issuance of Islamic Financial Instrument of equivalent value and the termination of the related sales contract.</p> <p>_____ Signature(s) Date</p>		

Source: (CBG)

TERMS GLOSSARY:

AAOIFI	The Accounting and Auditing Organization for Islamic Financial Institutions.
GHARAR	Preventive uncertainty.
HARAM	Sinful activity such as direct or indirect association with lines of business involving illicit products.
MAISIR	Speculation, betting and gambling including the speculative trade or exchange of money for debt without an underlying asset.
IIFM	International Islamic Financial Market.
SHARIAH	Islamic Laws as revealed in the Holy Quran and the example of the Prophet.
SHARIAH COMPLIANT	Means an act or activity that complies with the Islamic law requirements.
SHARIAH BOARD	A Shariah board is the committee of Islamic Scholars available to an Islamic Financial Institution for guidance and supervision in the development of Shariah compliant products.
SUKUK	Sukuk (plural for sakk) is an Arabic word which means (certificates).It has similar characteristics to that of a conventional bond with the certificates being that they are asset backed, sukuk represents proportionate beneficial ownership in the underlying asset.
SUKUK IJARA	Ijarahsukuk is a certificate the holder of which owns in common part of an asset that has been transferred on the Ijarah contract basis.
SUKUK SALAM	Salam is a sale where by a seller undertakes to supply a specific commodity to the buyer at a future date in exchange of advanced

price paid in full on the spot, the price is cash but the supply of the purchased good is differed.

SUKUK MUSHARAKAH Musharakah contract is an investment partnership between two or more entities which together provide the capital of the musharakah and share in its profits according to a stipulated ratio and share losses on the basis of equity participation.

MUDARABAH Mudarabah is an investment partnership between two entities where by one entity is mainly a provider of capital and the other is mainly the manager.

RIBA Interest, usury.

SUNNAH Speeches, acts and approvals of the Prophet (SAWS).

TAKAFUL Islamic Insurance.