Fitch Publishes Islamic Finance Reports on Sukuk and Islamic Banking Ratings

Fitch Ratings' Corporate Finance and Financial Institutions analytical teams have today published criteria and special reports that formalise each team's existing ratings approach to the Islamic finance sector, which remains one of the fastest growing segments in the international capital markets.

Islamic finance continues to evolve and there are important differences in structure between conventional and Islamic bonds (Sukuk), and conventional and Islamic banks which must be understood. Despite these differences, Fitch believes that its current rating methodologies and rating scales can continue to accommodate Sukuk and Islamic banks.

It is estimated that the size of the Sukuk market, including both domestic and international issues, is up to USD60bn. In April 2006, Fitch opened a Dubai office to help service Middle East-based demand for credit ratings and also complement its existing Islamic finance coverage through Fitch's network of Asia offices which include Singapore and Jakarta.

"Instead of interest, which is unacceptable under Shariah law, Sukuk investors receive a share of the profits generated by the underlying assets being financed. Depending on the precise structure of the bond, Fitch's rating may be linked to the rating of the originator of the transaction or to the underlying assets if the bond satisfies the agency's requirements for a true securitisation," said Philip Smith, Senior Director in Fitch's Financial Institutions group in London.

"Fitch believes the Ijarah Sukuk structure, which resembles a conventional lease agreement, is likely to be most widely used for entities considering issuing Sukuk. Whilst there are some technical differences in terms of asset ownership and interest penalties, the Ijarah Sukuk functions similarly to a conventional lease agreement, with the owner of the asset leasing it to a third party in exchange for a specified rental payment," said Jeffrey Woodruff, Director in Fitch's Corporate Finance group in London.

"Fitch anticipates growing issuance of Sukuk by banks and corporates in 2007 and 2008, primarily from corporates operating in Gulf Cooperation Council states."

Mark Young, Managing Director in Fitch's Financial Institutions group in London said, "Although the Islamic finance concept of profit and risk sharing contrasts with the conventional concept of lending, Fitch assesses the risk profile of an Islamic bank in the same way, examining its financing and lending policy, risk diversification practice and the general prudence of management. However, whilst the analytical framework is the same, when assigning Issuer Default ratings for Islamic banks certain risks are of greater significance due to the banks' nature and operating environment. This means closer analysis of each bank's risk management processes, funding and liquidity position, legal issues, regulatory oversight, transparency, accounting standards and corporate governance practices."

The reports - "Fitch Ratings' Approach to Rating Sukuk", "Demystifying Corporate Sukuk" and "Islamic Banking - Factors in Risk Assessment" are available at www.fitchratings.com
To support the publication of these reports Fitch will host two teleconferences for the Asia and EMEA regions on Tuesday 6 March. Details for each call are included in an accompanying announcement to be released shortly.

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