



Sukuk Investor Relations – we cannot wait any longer

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A process that will promote trust, reduce uncertainty, and – most importantly – build confidence.

With uncertainty and a lack of confidence still besetting capital markets, the results of the Gulf Bond and Sukuk Association's recent survey were perhaps unsurprising: they showed that most investors think issuers do not provide them with sufficient information.

Debt capital markets, including the Sukuk market, have lagged behind other financial markets in developing proper IR programmes, but today's information demands mean we cannot wait any longer. A new information model is needed, which must provide investors with a deeper understanding and allow them to manage risk more effectively.

Uncertainty and volatility – capital markets today

The after-effects of the financial crisis still weigh on global capital markets. Markets are more closely intertwined today than ever before, while volatility and uncertainty remain high.

What is clear is that issuers will not be raising capital in the same old ways. Changes to capital-raising are likely to be driven by three forces:

- I. The first driver is simply financial. Along with new financing needs, the wave of refinancing on the horizon presents issuers with an immense challenge in the current uncertain environment, forcing them to find new ways to attract market participants.
- II. Secondly, socio-political developments are propelling change. Uncertainty and heightened risk aversion since the credit crisis are being bolstered by situations as diverse as the eurozone's sovereign debt problems and social unrest in North Africa. Pressure from worried populations is undoubtedly colouring the decisions of political leaders.
- III. Regulatory change has widely been the response of political leaders anxious to avoid a repeat of the credit crisis. While there is likely to be further harmonisation across many international markets, changes are also likely to provide potential for regulatory arbitrage in markets that do not take part.

The uncertainty caused by these changes is leading to a number of different reactions among market participants, including more issuances of secured debt. Other participants have been pledging their own shares to a deal, or sourcing less traditional asset types such as oil tankers and commodities.

Achieving greater transparency in the information provided to investors is essential to regaining that confidence in capital markets.

It is clear that in the future, issuers will be required to communicate information with greater thoroughness and transparency.

These changes compel investors to become familiar and comfortable with new products, new jurisdictions and new ways of doing things. While there is some debate over whether refinancing deals will increasingly be cross-border or remain local (or some combination of the two), investors will need assurance that their access to all of these markets operates smoothly and efficiently.

Restoring faith

It was apparent from the credit crisis that investors had underestimated the amount of risk they had taken on, based on the information they had received.

The ensuing loss of faith and lack of confidence have been the biggest problems facing capital markets since then. Until that faith is restored, markets will have difficulty in recovering.

Gulf Bond and Sukuk Association

As part of efforts to improve the GCC capital markets, the Gulf Bond and Sukuk Association (GBSA) aims to deepen and widen the regional market, in order to diversify the sources of capital available for business and government. The GBSA also aims to achieve harmonisation of regulation and market practice.

Attractions of information agents can mask risks

As well as noting that a majority of investors considered issuers' information to be lacking, the GBSA's recent survey also noted that equity and bond investors have different needs. In addition, fixed income investors require more information in times of stress.

In order to achieve this, a new information model is needed, which must provide investors with a deeper understanding and allow them to manage risk more effectively. Not only will regulatory changes demand a new model, reflecting the demands of investors and counterparties, but soon issuers themselves are likely to count on it.

This new model must encapsulate these four elements:

- I. Content - information must be comprehensive, accurate and timely
- II. Usefulness - information has to be meaningful for investors
- III. Thoroughness - information must endeavour to be as transparent as possible
- IV. User-friendliness - information that is comprehensible - not "black box"

Sukuk Investor Relations

Sukuk IR is the main tool which issuers can use to deliver more transparent information to investors.

At a time when the region is seeing new attitudes towards risk, the role of Sukuk IR becomes ever more important in addressing investors' demands. As well as promoting engagement between issuers and investors, it provides investors with the clear information they need to make educated investment decisions.

Different types of Sukuk structures differentiate them from conventional bonds. Sukuk IR therefore has a central role to play in helping investors achieve clarity about the bonds' structure, the guarantor, the obligor and the underlying assets.

Debt capital markets, including the Sukuk market, have lagged behind other markets in communicating clear information.

Investors' new information demands mean they cannot wait any longer to develop proper IR programmes.

A programme would not discriminate based against a particular recipient or their prior opinions

Consistent with Islamic principles

The key functions of IR generally are fundamentally consistent with Islamic principles that limit moral hazard, minimise risk and ensure that investments are without injustice to any of the participating parties.

By ensuring that communications between issuers and investors are systematic and transparent, Sukuk IR can also help improve the quality of due diligence and allay concerns about corporate governance.

In practice - ensuring transparency

Sukuk IR can promote engagement between issuers and investors across the whole spectrum of Sukuk transactions.

For asset-based transactions, Sukuk IR works in a similar way to equity IR by providing broad information about the corporate, where the primary risk resides.

For asset-backed deals, investors are naturally concerned about the quality and performance of the underlying asset. The issuer therefore would be required to provide investors with details of the risk exposures and value of the underlying asset. Independent third-party service providers can have a valuable role to play both in collecting this information and assuring investors that there are no conflicts of interest.

Building trust - communicating widely and without prejudice

In order to achieve credibility, corporates would have to establish a formal Sukuk IR programme, with a designated IR office, IR officers, and an IR website that clearly identifies those individuals responsible for communicating to investors.

A fundamental requirement of the programme would be that a majority of investors would have access to the information. Furthermore, the programme would not be allowed to discriminate among recipients of information, based on their profile or prior opinions.

In order to meet the diversity of investors' needs, like its equity counterpart the Sukuk IR office would aim to use all available communication channels, including:

All of these IR tools cater to the need of the investor to be regularly updated about changes and unexpected events.

Sukuk IR - not an alternative to regulation

It is important to note that Sukuk IR is no replacement for the region's regulatory requirements - particularly with regard to price-sensitive information that is subject to mandatory laws.

The objective of Sukuk IR is to ensure that investors have a clear understanding of the current risk profile of their investment. While Sukuk IR has a crucial role to play in enhancing dialogue between issuers and investors, there are formal limits on Sukuk IR. Certain types of information, for example, have to be communicated only through formal channels in the first instance. An example of this would be a trigger event, which has to be announced through formal notice procedures.

Conclusion

The nervousness that continues to dog capital markets can still be felt within the GCC, and is illustrated by ongoing high levels of volatility.

These after-effects of the credit crisis have inestimably changed the terms on which issuers and investors do business. On the one hand, issuers are seeing changes to their means of capital-raising, driven by a variety of forces, from socio-political to new regulation. Investors, meanwhile, are demanding greater transparency and a clearer understanding of the underlying risks of their investments.

While it is clear that the old ways of doing things have to change, the speed of change means we cannot wait any longer. It is time that debt capital markets – including the Sukuk market – caught up with their equity counterparts in developing proper IR programmes.

Sukuk IR can enhance transparency, in order to build the trust that is essential for the market's recovery.

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