



THE IMPACT OF THE FINANCIAL CRISIS ON INVESTORS IN COUNTRIES GOVERNED BY ISLAMIC BANKING AND FINANCE: THE CASE OF THE DUBAI WORLD STANDSTILL

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Abstract: The financial crisis has had a devastating impact on financial markets in the US and other western countries. Particularly hard hit were investors who purchased mortgaged backed securities, since as the value of the asset declined below the amount of debt, investors took large losses. Countries that follow Islamic Banking and Finance (IBF) have largely been spared this loss due to the types of bonds that are allowed. This research summarises the problem in the Western World and then compares it to a similar problem faced by Dubai World who had a 'standstill' when they were unable to make a required payment. It appears that holders of Dubai World sukuk will be spared losses because of Islamic banking laws. We examine both the short term and long term effects.

Keywords: financial crisis; Islamic banking; sukuk; Dubai World.

INTRODUCTION

In the US, government policy has always encouraged home ownership. As early as 1932 when then president Herbert Hoover said, "As a people we need, at all times, the encouragement of home ownership" government policy has followed this view. Through government sponsored home mortgages and special tax treatment for homeowners

who could deduct home mortgage interest expense from their tax liability, government policy attempted to get as many households as possible to own, rather than rent, homes. In 1994, the US government made a concentrated effort to increase the percentage of households that own homes from the existing 62% to 70%. This was accomplished when the Clinton Administration set a

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'National Homeownership Strategy' which had the goal to put forth "financing strategies fueled by creativity to help homeowners who lacked the cash to buy a home or the income to make the down payments."

Government policy influenced market conditions through stimulation of demand. This was accomplished by lowering the credit standards necessary to qualify for mortgages. While this may appear to create more risk for banks and mortgage companies that issued mortgages, Fannie Mae and Freddie Mac, quasi public agencies, were willing and eager to purchase these 'sub-prime' mortgages from the originators. Thus the default risk was transferred from the mortgage originator to the quasi public agencies who eventually would package and sell the mortgages to the investment community (Makin, 2009).

After 2000, this effort intensified in three areas. Firstly, the Federal Reserve's interest rate policy drove down the cost of borrowing to historic lows. Secondly, the government created special loan programs so that even those who could not afford home ownership became qualified. And thirdly, the private agencies that determine security risk and value were overly generous in their assessment of financial derivatives which were collateralised by mortgages.

Between 1997 and 2006, the price of a typical American house increased by over 120% (The Economist, 2008). This surge in housing prices resulted in many homeowners refinancing their homes, but more specifically, increasing spending by taking out second mortgages secured by the price appreciation. An increase in loan packaging, marketing incentives, such as easy initial terms and a long-term trend of rising housing prices, encouraged borrowers to assume difficult mortgages in the belief they

would be able to quickly refinance at more favourable terms sometime in the future. In the financial markets, investment bankers created Asset- and Mortgage-Backed Securities (ABS and MBS) and Collateralised Debt Obligations (CDO), which derived their value from variable rate auto loans, credit cards, mortgage payments and housing prices. These securities were assigned safe ratings by the credit rating agencies who assumed historic default rates. This enabled financial institutions to obtain investor funds to finance sub-prime lending, extending the housing bubble while generating extremely large fees. Sub-prime, adjustable rate mortgages remained below 10% of all mortgage originations until 2004, when they spiked to nearly 20% and remained there through 2006 (Bernanke, 2007).

By September 2008, the upward adjustments to the mortgage rates resulted in increases in defaults forcing the average US housing price to decline over 20% from the 2006 peak (Standard and Poor's, 2008). High default rates on sub-prime and adjustable rate mortgages began to increase quickly thereafter. As housing prices declined, major global financial institutions that had borrowed and invested heavily in sub-prime MBS reported significant losses. Falling prices also resulted in homes worth less than the mortgage loan, providing a financial incentive for the homeowner to enter foreclosure. As prices continued to decline, borrowers with adjustable-rate mortgages could not refinance to avoid higher payments associated with rising interest rates so defaults increased further. In 2008, lenders began foreclosure proceedings on nearly 2.3 million properties, an 81% increase from 2007. By August of 2008, 9.2% of all US mortgages outstanding were either delinquent or in foreclosure. One year later, this figure rose to 14.4% (Standard and Poor's, 2008).

The collapse of a US housing market led to a global housing bubble collapse, which caused the value of securities tied to real estate pricing to plummet, damaging financial institutions globally. Questions regarding bank solvency, declines in credit availability, the lack of liquidity, and damaged investor confidence, all had an impact on global stock markets, where securities suffered large losses during late 2008 and early 2009. Economies worldwide slowed during this period as credit tightened and international trade declined (World Economic Outlook, 2009).

THE OIL PRICE SURGE AND DUBAI WORLD

Another important part of the financial crisis as it relates to Dubai World and their standstill, is the oil price surge that was created following the collapse in the housing bubble. The price of a barrel of crude oil nearly tripled from \$50 in 2007 to a peak of \$147 in July of 2008. As the financial crisis began to take hold in late 2008, oil prices plummeted by nearly 75% to a low of \$37 in December 2008 (Futures Trading Charts, 2008). The price of oil is the lifeblood of the Persian Gulf economy, especially in Dubai, where high oil prices are a crucial support to Dubai property values. Real Estate, the other mainstay for Dubai, was quick to follow the US housing market collapse and plummeting oil prices. With prices for real estate falling, big developers such as Nakheel, a subsidiary of Dubai World, began halting construction and laying-off staff.

The extremely large decrease in the price of oil hit the Middle East very hard in 2009. The reversal of capital inflows combined with deterioration in external financing conditions created serious problems for the region. Local property and

equity markets were put under intense pressure, domestic liquidity conditions deteriorated and credit spreads soared for some firms (World Economic Outlook, 2009). Financial system strains emerged in a number of countries and many sovereign wealth funds suffered substantial losses from investments in global markets. Furthermore, export growth and tourism revenues sharply declined. Particularly in the UAE, the exit of external funds, which had entered the country on speculation of a currency revaluation, contributed to a large contraction in liquidity, a sizable fall in property and equity prices, and substantial pressure in the banking system (World Economic Outlook, 2009).

More specifically, Dubai had been struggling with a very large debt burden since the bursting of the property bubble in the fall of 2008. The UAE entities were aggressive borrowers in international markets over the previous years, with Dubai Inc. entities leading the way. In total, UAE raised \$135 billion from external public syndicated loan and bond markets during 2006–2008, an amount equivalent to 53% of GDP, the highest of any major emerging market. Additionally, the local banking sector experienced rapid credit growth, averaging around 33% annually for the prior three years (Nazim, 2009). The total credit portfolio of the UAE banking sector reached an estimated \$275 billion in June 2009 which was 108% of GDP. While specific information about Dubai Inc. in particular is not public information, analysts estimate that banks in Dubai and Abu Dhabi have lent a total of \$40 billion to Dubai Inc. entities, and a further \$20 billion to the Dubai government. Added to the \$47 billion of Dubai Inc. cross-border debt of loans and bonds, it can be estimated that the total borrowing of Dubai Inc. corporations was approximately \$75 billion (Razgallah, 2009).

In addition to the collapse of local asset values, refinancing needs were a pressing concern in Dubai. In February 2009, the government of Dubai launched \$20 billion bonds, easing default worries, and UAE central bank immediately subscribed to \$10 billion. With the exception of the Dubai government, however, no Dubai entity was able to raise funds in public markets in 2009 (Nazim, 2009). Therefore, Dubai entities would need assistance in order to meet debt maturities due in 2010. While Abu Dhabi, the capital of UAE, had been supportive, providing over \$15 billion over the course of 2009 helping to refinance maturing debt, the fiscal position of the government of Dubai remained under severe strain. The majority of the government's revenues are from fees, including fees related to land transfer, mortgage registration, immigration and tourism. With the impending economic slowdown, especially in the real estate sector, Dubai finances became particularly vulnerable.

In Dubai, issuance in international debt markets increased sharply, totaling \$72.6 billion between 2006 and 2008, or 88% of Dubai's 2008 GDP. This debt issuance was used mostly to finance the expansion of the real estate sector and activity of conglomerates, which accounted for 25.1% and 26.4% of debt issued during this period, respectively. This debt had an average maturity of four and a half years and was channeled toward long-term projects, especially in the real estate sector (Razgallah, 2009). The concentration of issuance over the recent years explains the heavy redemption schedule for Dubai entities between 2010 and 2013. The size of the maturity mismatch may explain the extreme impact of the financial crisis on Dubai.

THE DUBAI WORLD STANDSTILL

The debt, put on 'standstill', were three issuances by Nakheel, totalling over \$5.2 billion (Nasdaq Dubai 2009). The issues can be summarised:

Sukuk	Listing date	Maturity	Amount	Type	QPO yield
Nakheel Development Limited	14 December 2006	2009	US\$3.52 billion	Sukuk Al-Ijara	6.345%
Nakheel Development 2 Limited	17 January 2008	2011	US\$750 million	Sukuk Al-Ijara	5.5%
Nakheel Development 3 Limited	14 May 2008	2010	AED3.6 billion (US\$980 million)	Sukuk Al-Ijara	N/A

Of particular interest is the Nakheel Development Limited issue, which is the largest sukuk issue to date in the history of Islamic banking and is the first of its kind in both Islamic and conventional capital markets (Islam Finance News, 2006). The sukuk was structured as per the rules of Sharia and was approved by the Sharia board of the Dubai Islamic Bank. The transaction

was structured as a three year Pre-QPO Equity Linked Sukuk al-Ijarah (Appendix 1-4). Under a purchase agreement, certain pre-identified assets were sold to Nakheel Development Limited, an offshore Special Purpose Vehicle (SPV). The underlying assets were comprised of the leasehold rights for a term of 50 years over certain land, buildings and other property at Dubai

Waterfront. This sukuk's structure was the first of its kind in Islamic capital markets. Originally planned at US\$2.5 billion, the issue was oversubscribed by more than 2.5 times and closed at US\$3.52 billion. The Qualifying Public Offering (QPO) yield does not reflect the actual coupon payments of the bond, as they float depending on the profit earned by Nakheel. The QPO yield is used for comparison to traditional bonds so that the sukuk can be priced competitively.

SUKUKS AND CONVENTIONAL WESTERN STYLE BONDS

At first glance, the details of the sukuk may appear as conventional bonds, as they pay semi-annual coupons. However, the sukuk al-ijara is compliant with Sharia, as the semi-annual payments are considered to be rent charges for the leasing of assets, in this case land. Nakheel technically sells the \$3.52 billion of sukuk assets to the SPV promising to buy it back at \$3.52 billion at the end of three years. The SPV will lease out the underlying assets to Nakheel and Nakheel will pay 'rent' every six months to the SPV. The SPV will collect the semi-annual rents and distribute them to sukuk holders. At maturity, the sukuk holder sells his sukuk back to the SPV at face value. In cases of default, the long lease would be repurchased by Nakheel and that deferred rental payment would be made.

In order to comprehend the role of Islamic Banking and Finance (IBF) in the Dubai World debt standstill, we must be able to distinguish between conventional and Islamic bonds. Conventional bonds do not represent ownership on the part of the bond holders in the commercial or industrial enterprises for which the bonds were issued. Rather, they document the interest-bearing debt owed to the bondholders by the

issuer, the owner of the enterprise. With the exception of zero-coupon bonds, regular interest payments are made to the bondholders. The amount of interest can be fixed or floating, but does not reflect a percentage of actual profits. Bonds guarantee the return of principal when redeemed at maturity, regardless of whether the enterprise was profitable or otherwise. Whatever profits may have been earned by the enterprise accrue entirely and exclusively to the issuer.

Generally, sukuk represent ownership shares in assets that bring revenues and produce profit, like leased assets. In reference to coupons, most of the sukuk that have been issued are identical to conventional bonds with regard to the distribution of profits from their enterprises at percentages based on interest rates (LIBOR or EIBOR). In order to justify this practice, the issuers include a paragraph in the contract which states that if the actual profits from the enterprise exceed the percentage based on interest rates, then that amount of excess shall be paid in its entirety to the enterprise manager as an incentive for the manager to manage effectively (Usmani, 2009). If the actual profits are less than the prescribed percentage, then the manager may take it upon himself to pay out the difference (between the actual profits and the prescribed percentage) to the sukuk holders, as an interest free loan to the sukuk holders. Then, that loan will be recovered by the lending manager either from the amounts in excess of the interest rate during subsequent periods, or from lowering the cost of repurchasing assets at the time the sukuk are redeemed. Virtually all of the sukuk issued today guarantee the return of principal to the sukuk holders at maturity, in exactly the same way as conventional bonds. This is accomplished by means of a binding promise from either the issuer or the manager to repurchase the

assets represented by the sukuk at the stated price at which these were originally purchased by the sukuk holders at the beginning of the process, regardless of their true or market value at maturity (Usmani, 2009). It should be noted that what is being called an 'incentive' in these sukuk may not truly be an incentive but rather a method for marketing sukuk on basis of interest rates. In order for sukuk to be purchased by investors around the world, they need to be comparable to traditional bonds. Providing a fixed numerical interest rate allows the bonds to be priced efficiently on the market.

In September 2009, Dubai World announced that they were in the process of rescheduling \$12 billion of debt. Dubai Ruler Sheikh Mohammed reassured Dubai investors, as he said during a press conference that he was 'not worried' about Dubai's ability to repay its debts (Al Maktoum, 2009a,b). In October 2009, Dubai World claimed that the organisational restructuring was nearly over and that it would be able to save \$800 million over the next three years. They also cut their global workforce by 15%. On 25 November, the government of Dubai announced that it had raised \$5 billion from two Abu Dhabi government owned banks, National Bank of Abu Dhabi and Al Hilal Bank, as part of its \$20 billion long term bond program. Hours later, the government of Dubai announced that Dubai World would be restructured to address its financial obligations. As a first step, Dubai World intended to ask creditors to Dubai World and its entity, Nakheel, for a standstill and extend maturities until at least 30 May 2010. The government also specified that the \$5 billion raised earlier in the day was not linked to this restructuring.

On the following day, 26 November Sheikh Ahmed bin Saeed Al Maktoum, Chairman of the Supreme Fiscal Committee

(SFC) of Dubai issued a statement explaining that the Dubai World restructuring was carefully planned and is needed to take decisive action to address Dubai World's debt burden. Two days later, the Abu Dhabi Central Bank announced that it 'stands behind' the banking system, including branches of foreign banks operating in the country, and launched a special liquidity facility to support local banks (Nazim, 2009). On 14 December, the Chairman of the SFC issued another statement on behalf of the government of Dubai, detailing a set of actions in relation to Dubai World. According to the Chairman, the government of Dubai had been working closely with the Abu Dhabi Government and the UAE Central Bank since the debt standstill was announced, to assess the impact of Dubai World on the UAE economy, banking system and investor confidence.

In his statement, the Chairman laid out a specific course of action to provide support to Dubai World. The government of Abu Dhabi would create the Dubai Financial Support Fund (DFSF) and had agreed to fund \$10 billion to satisfy a series of forthcoming debt obligations of Dubai World. The first step was the authorisation of \$4.1 billion from the government of Dubai to pay the sukuk obligations that were due on 14 December. The remaining \$5.9 billion would be used for interest expenses and working capital expenses through 30 April 2010. In his closing remarks, the Chairman twice stressed that his actions are to 'best serve the interests of all stakeholders' (Al Maktoum, 2009a,b).

THE SHORT TERM IMPACT OF A STANDSTILL

The repercussions of the Dubai World debt standstill were felt immediately in the financial markets and have had a lasting impact on the debt capital markets, particularly for

IBF. Throughout the months following the event, there was much speculation on how Nakheel and Dubai World would raise funds to pay their obligation, if the bonds would be discounted, and if Abu Dhabi would step in to help. On 25 March 2010, four months after the event, Dubai World and Nakheel announced proposals for the restructuring of their liabilities. The Sheikh spoke about the plans in a press conference, explaining how the plans “would ensure Dubai World and Nakheel are key contributors to the strong economic future of the Emirate of Dubai and the wider United Arab Emirates.” Nakheel’s comprehensive recapitalisation plan offered creditors 100% of agreed amounts owed and the fulfillment of its obligations to customers through the prompt completion of near term projects. Under the recapitalisation plan, the Government of Dubai, through the DFSF, committed to provide approximately \$8 billion of new money directly to Nakheel to fund operations and settle liabilities. In addition, the DFSF proposed to convert its existing \$1.2 billion debt claim in Nakheel into equity. The support from the Government of Dubai would be conditional upon the creditors agreeing to the plan. However, ahead of the agreement an initial \$1.5 billion of the new funds from the DFSF would be made available as required to Nakheel to fund contractors to continue building near-term development projects.

Dubai World presented a proposal to all of its creditors offering to recapitalise Dubai World. The Government of Dubai, acting through the DFSF, would convert \$8.9 billion of debt and claims into equity, representing 38% of the total amount of standalone debt and guarantees of the company. Additionally, the DFSF would commit to fund up to \$1.5 billion of cash into Dubai World to fund the company’s working capital and interest payment commitments that would arise from the new debt facilities. Non-DFSF

creditors would receive 100% principal repayment through the issuance of new debt with five and eight year maturities. Although both announcements were positive in terms of providing investors with clarity, the plan failed to reassure investors of a declining credit risk. In essence, Dubai World creditors would be relying upon asset sales and dividends for eventual principal repayment.

LONG TERM IMPACT OF A STANDSTILL AND THE ROLE OF IBF

While it is too early to assess the long-term consequences of the Dubai World debt standstill, it is possible to determine the role that IBF played in the event. In July 2006, East Cameron Partners LP became the first US company to issue sukuk. The company subsequently defaulted on their sukuk and declared bankruptcy in October 2008. The case still remains in the courts, as a bankruptcy judge in Louisiana is deciding the fate of sukuk holders, and whether they actually own a portion of the company’s oil and gas. A typical US investor would want to have the sukuk classified by the court as debt, not as equity, even though that goes against the Sharia characterisation, because in court, if it’s classified as debt, then the debtors receive preference before equity holders in terms of receiving funds.

While currently Dubai World is far from declaring bankruptcy, the concern over whether sukuk is actually debt or equity is a pressing matter. If the foundational principle of sukuk is profit and loss sharing, one may wonder if sukuk is closer to equity than debt. In order to evaluate if ‘debt standstill’ is the correct term for the incident of Dubai World, a further analysis of Nakheel’s sukuk al-ijara is needed.

It is often said that sukuk are comparable to conventional asset-backed securities

that provide investors with ownership in a specified underlying real asset found on the balance sheet of the issuing company. The sukuk of the debt standstill were of al-ijara structure, which are especially similar to ABS. In conventional finance, assets (credit card loans, auto loans), or mortgages, are pooled and put into a SPV. The ABS represent claims on the principal and payments on the loans in the pool, through securitization, in which the securities are usually sold as bonds. New issues of ABS carry higher estimated yields than US Treasury securities. Many corporate bonds, of comparable maturity and credit quality, also carry higher yields as investors demand a higher interest rate to compensate for prepayment risk and resulting uncertainty in the average life of an ABS.

According to Sharia, sukuk must be tied to actual assets. In sukuk al-ijara, the underlying assets are 'sold' to the SPV which issued the sukuk, who then 'rents' the asset back to the company. The company pays 'rent' to the sukuk holders. In Nakheel's sukuk contracts, it states that the issuer will buy back the underlying assets at full price at maturity. This is exactly why Dubai was forced to have a 'standstill'. They were unable to pay the Nakheel Development Limited sukuk that was maturing on 14 December 2009. Instead, they asked for creditors to defer payment for six months, a time Dubai World felt would be sufficient to raise the funds to pay back its creditors in full. In the US, however, this would not be the case. Many investors who owned ABS and MBS that defaulted received only a fraction of their initial investment.

Although the Federal Reserve intervened to fund the purchase of these securitised products, many investors around the world suffered significant losses. The investors in Dubai World and Nakheel however, may

not experience the same magnitude of loss if they hold their positions. If they decided to sell their sukuk on the secondary market, they will likely suffer losses. Nakheel sukuk were purchased at 110% on the dollar in the beginning of the issue; after the standstill announcement, they were trading at 60% on the dollar (Bryan-Low, 2009). However, while it is unknown if investors will receive their full principal in the short-term, it is likely that they will receive their full investment at some point in time due to contractual agreement outlined in the sukuk.

Although creditors and debtors have come to an agreement on both Nakheel and Dubai's recapitalisation plans, we might wonder what may have happened had this dilemma been brought to court. Islamic jurisprudence may have rejected the permissibility of principal protection of sukuk investors, but scholarly opinion may have permitted repayment of the original asset value at the time of issuance. According to Sharia, in general, issuers cannot guarantee principal through the repurchase of underlying assets for a fixed nominal value or offer a credit guarantee. Any repurchase can only occur at net value or fair market value. However, since the Nakheel transaction involved commercial leasehold properties, the legal action consistent with current AAOIFI recommendations on sukuk al-ijara would have permitted repayments up to the amount of remaining lease payments or original asset value, which would have resulted in a forbearance on interest.

Sharia law requires payoffs from time-contingent profit/loss sharing arrangements; this principle is tied to contractual certainty associated with direct ownership. However, the original terms and conditions of the Nakheel sukuk ruled out such direct asset linkage. Investor claims arising from the sukuk were considered only asset-

based, not secured asset-backed, handing investors ownership of the cash flows but not of the assets themselves. In terms of the risk/return profile, asset-backed sukuk are arguably closer to an equity position because sukuk holders own the underlying asset and have no recourse to the originator in the event of a payment shortfall. On the other hand, asset-based sukuk, like Nakheel's sukuk al-ijara, are closer to debt because sukuk holders have recourse to the originator if there is a shortfall in payments. The ijara sukuk with a repurchase agreement at par creates a stream of rental income from the underlying asset. However, Nakheel's contract had a repurchase clause where the issuer repurchases the asset at par in cases of default, making the instrument debt. The sukuk holders have no recourse to take possession of the asset; their claims are transformed into unsecured debt obligations against the issuer. Therefore, if sukuk holders keep their position, it is likely they will receive their investment back in full. Because the debt of the Dubai World standstill was a sukuk al-ijara, a debt instrument of IBF, investors are likely better off. The returns to investors of conventional bonds or ABS in default are likely less than those of sukuk holders.

THE LACK OF PRECEDENT

This better-off analysis is mainly hypothetical due to the lack of precedence in the issue. In May 2009, Investment Dar Company, the Kuwait owner of half of Aston Martin Lagonda Limited, missed a payment on \$100 million of debt, becoming the first Gulf company to default on Islamic bonds. In June 2009, the Saad Group, part of the struggling family-owned conglomerate based in Saudi Arabia, began restructuring due to its inability to make payments on \$650 million sukuk. Banks and investors are estimated to be owed more than \$20 billion

by the Saad Group and its subsidiaries, and lenders have taken legal action against the company in New York, the Cayman Islands and the Gulf. The legal proceedings against both of these companies, and for East Cameron Partners, are still currently underway. Therefore, accurately predicting the results of Dubai World's debt standstill is virtually impossible.

In the UAE, there is no precedent for a restructuring of the size of Dubai World and Nakheel, and its government ownership. As a result, investors will be watching events related to the Nakheel bonds for a road map for future restructurings in the region. How the underlying legal structures would fare in a court of law in comparison with conventional bonds is uncertain. Although sukuk must comply with Islamic law, they are governed as well by the secular law under which they are issued, like bonds. In the case of Dubai World, a bailout by Abu Dhabi has obviated the need to address this question directly. In addition, the role and efficacy of Sharia governance arrangements and due diligence for Sharia compliance have attracted attention. Given the relatively early stage of development of sukuk in particular and of IBF in general, sukuk are likely to continue to evolve.

In some ways, the Dubai World case is a typical example of what happens at the end stage of a real estate cycle. Commercial real estate always involves what economist Hyman Minsky calls Ponzi finance (Minsky, 1982). In the Ponzi finance stage, business cash flows are not sufficient to meet current debt payments nor does expected income meet future payment requirements. Therefore the company lacks the ability to pay either interest or principal payments and must depend on borrowing in order to finance debt commitments. For Dubai World, the collapsing real estate

market in Dubai, combined with diminishing tourism revenues, significantly decreased their income. They were unable to meet their debt obligations and were forced to call a standstill. Luckily for Dubai World, the government of Dubai and the government of UAE in Abu Dhabi stepped in to support them. Without the support of the government, it is likely the Dubai World debt standstill would have triggered a larger catastrophic event for Dubai World and the region.

CONCLUSIONS

It appears that the financial crisis in the Western world was fueled by government efforts to relax borrowing standards so that more citizens could purchase homes using 'sub-prime' mortgages. Ultimately these mortgages were packaged and used to back securities that would derive value from increased payments. When adjustable rate mortgage holders experienced large increase in payments and when the houses that collateralised the mortgages began to lose value, defaults increased. Lenders foreclosed on homes causing the mortgaged back securities to lose most of their value. This set off a chain of events that crippled credit markets and ultimately led to a world wide recession, as investors suffered large losses.

In countries that follow Islamic Banking, this financial meltdown essentially did not occur. The reason seems to be that investors will likely not suffer any losses. Even when a 'standstill' (the western equivalent of a default) occurs, the result is that investors will likely not lose any of their capital.

Our assessment is that Islamic banking minimises the risk to investors since they are not likely to ever suffer losses.

With Western banking, losses could occur, thereby increasing risk. The conclusion then, is that Islamic banking places virtually all of the risk on the borrower (the entrepreneur). This increased risk increases the cost to the entrepreneur so that fewer projects may be undertaken. It is possible, that while Islamic banking protects the investor, it places extra burdens on borrowers who may become reluctant to take on additional projects. This could result in slowing overall development. Admittedly more research is needed in this area.

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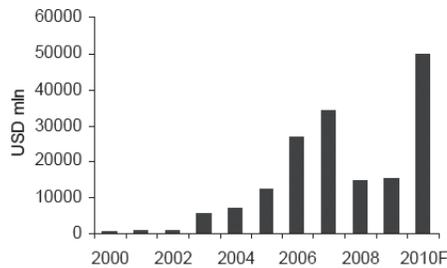
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APPENDIX 1

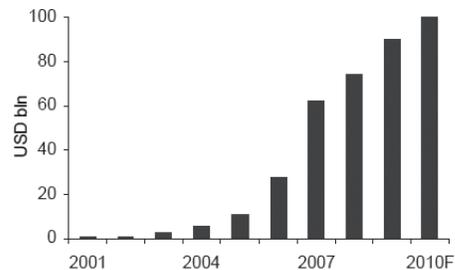
Global sukuk data

Global Sukuk Issuance Trend (2000-2010F)



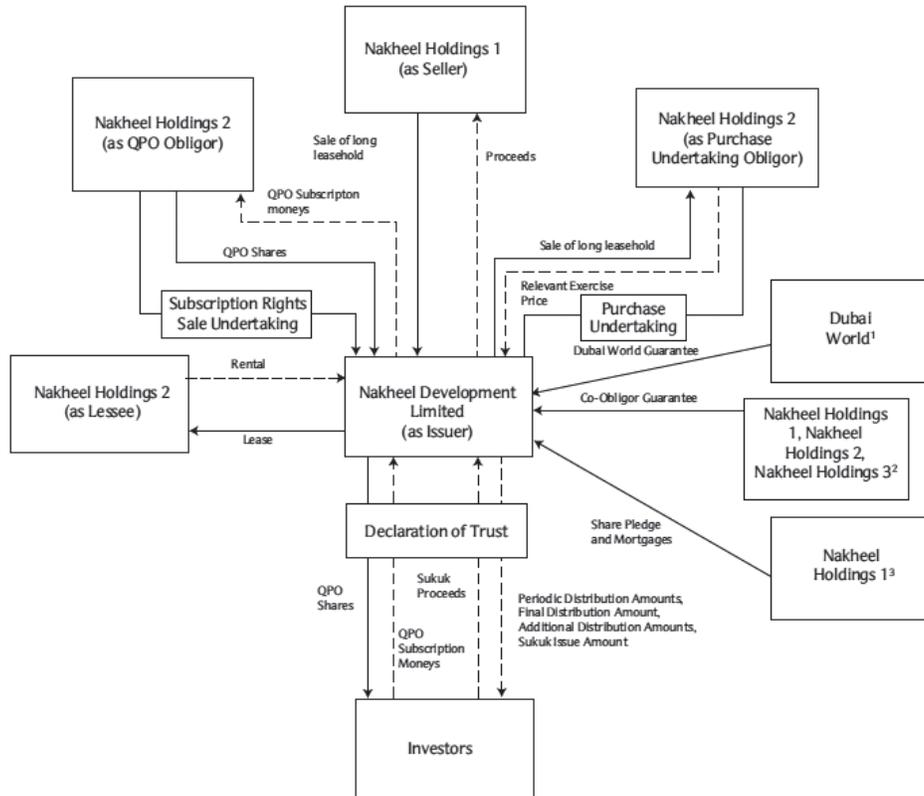
Source: Zawya, IFIS, Bloomberg, KFHR

Global Sukuk Outstanding (2001-2010F)



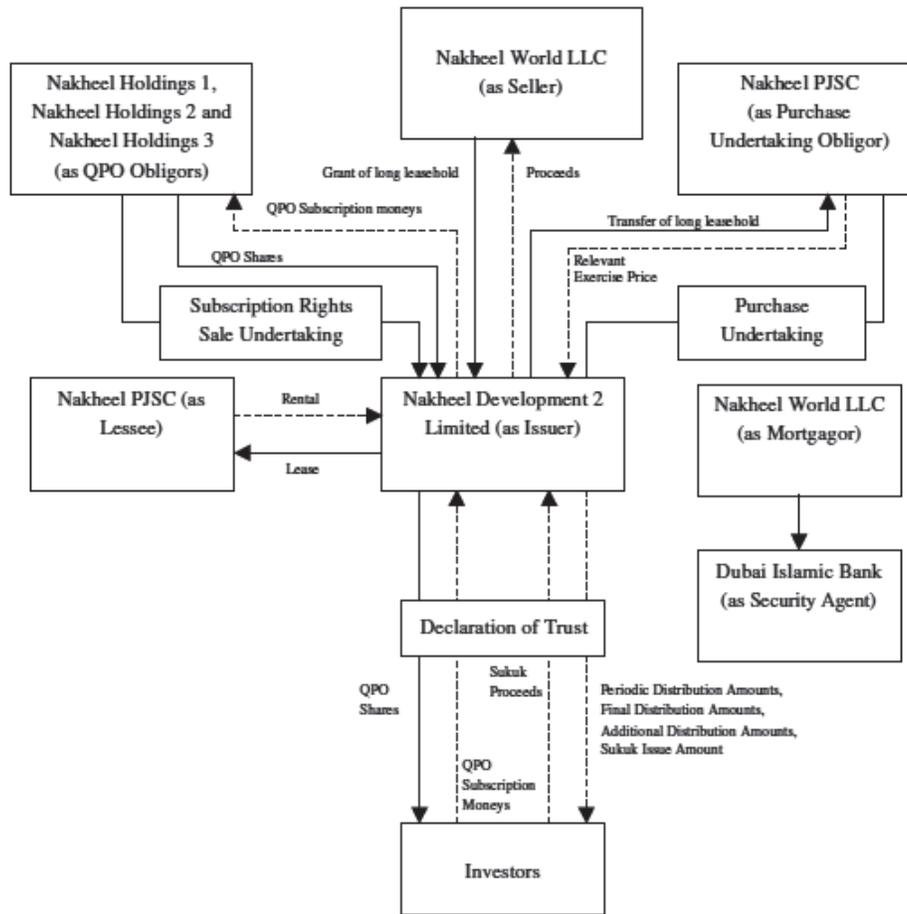
Source: Zawya, IFIS, Bloomberg, KFHR

APPENDIX 2
Nakheel development limited sukuk structure



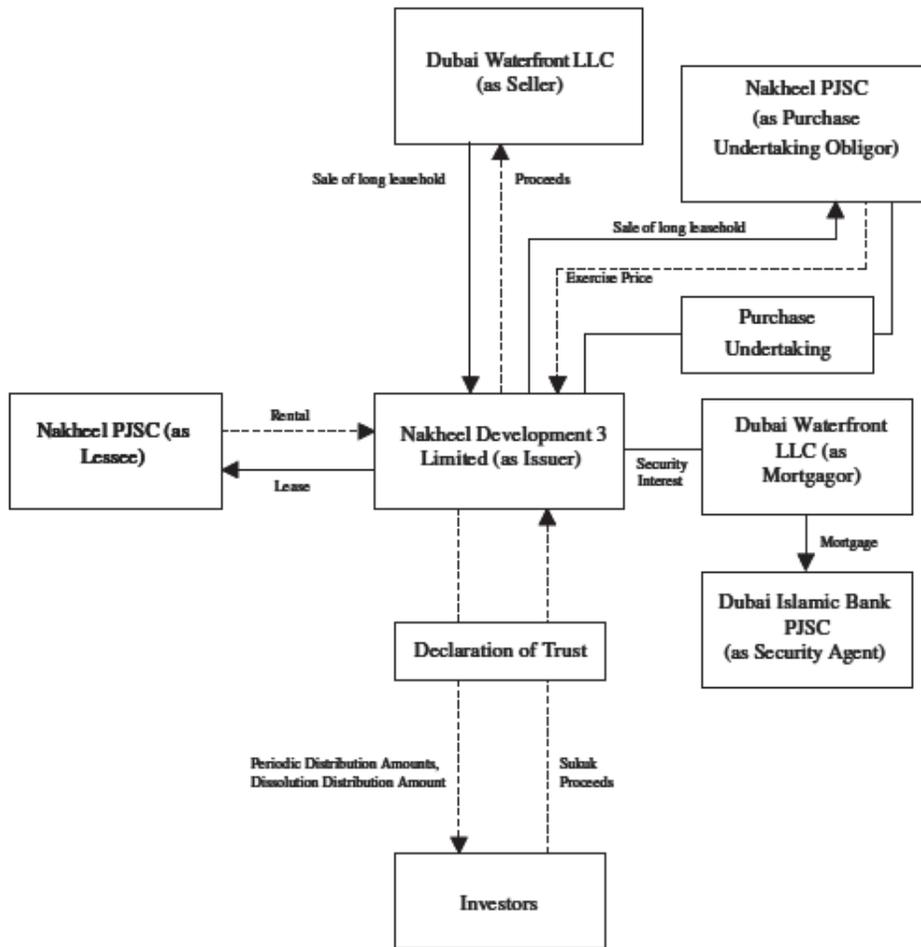
Source: Offering circular for Nakheel Development Limited Sukuk, 13 December 2006

APPENDIX 3
Nakheel development 2 limited sukuk structure



Source: Offering Circular for Nakheel Development 2 Limited Sukuk, 15 January 2008

APPENDIX 4
Nakheel development 3 limited sukuk structure



Key:
 -----> Cash Flow
 -----> Agreement

Source: Offering Circular for Nakheel Development 3 Limited Sukuk, 8 May 2008