
DRAFT

**REPORT ON DEVELOPING A CORPORATE BOND AND *SUKUK* MARKET IN THE
MALDIVES**

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1. Introduction

Taylor Wessing LLP has been retained as consultants by the Commonwealth Secretariat, which is assisting the Government of Maldives in preparing a report on the proposed development of the corporate Bond and *Sukuk* market in Maldives, including, developing an appropriate legal and regulatory framework to facilitate such a market.

In this regard a Commonwealth Secretariat mission including Makbul Rahim of the Commonwealth Secretariat and Rabel Akhund of Taylor Wessing LLP visited Maldives in May 2008 to carry out their investigations and meetings with the Capital Markets Development Authority ("**CMDA**"), Maldives Monetary Authority ("**MMA**"), various industry operatives and other stakeholders to assess the feasibility of developing a Corporate Bond and *Sukuk* market in Maldives.

Taylor Wessing LLP had also prepared a questionnaire for the CMDA on Corporate Bonds and *Sukuks* and another questionnaire for industry operatives and stakeholders. The questionnaires and the answers received are set out as Appendices to this report.

Our report includes a brief introduction to Bonds and *Sukuks* and the relevant markets for these instruments and considers the necessary regulatory and trading regime for these instruments. It then specifically covers the Maldivian case before where we make specific recommendations.

The terms of reference provided to us by the Commonwealth Secretariat were to:

- (a) assess the feasibility of developing traditional corporate bond market in Maldives and identify and examine current market constraints and impediments;
- (b) advise and make recommendations on developing appropriate legal and regulatory framework and measures to facilitate corporate bond markets;
- (c) examine feasibility of and options for introducing Shariah compliant corporate bond market and debt securities instruments in Maldives;
- (d) advise and make recommendations on the rating system for the corporate bond market and debt securities instruments in Maldives; and
- (e) examine and consider the insolvency regime of Maldives and advise on improvements necessary for the development of the corporate bond market.

This report has been prepared for the Commonwealth Secretariat and the Maldivian Government.

2. Corporate Bonds

2.1 Understanding Corporate Bonds

Bonds are debt instruments that denote the obligation of an issuer to satisfy a bondholder's claim to capital repayment and interest until the repayment occurs. Bonds can be structured in simple ways or in highly complex ways to satisfy the individual needs of the issuers and the objectives of the relevant investors.

Bond markets form the core of any capital market and are an important form of medium- to long-term financing for governments, corporates and financial institutions.

Issuers use bonds for both general purposes and finance or refinance specific projects and assets. Investors, on the other hand, use bonds as saving products. Bonds usually offer the investors an investment with a higher rate return than a cash deposit but with lower risk than equity investments.

There can be different types of bonds with mainly three basic features:

- bonds can be issued at par value, which will also normally be the redemption value of the bonds.
- coupon or interest rate; and
- the length of time to maturity.

Bonds can provide a fixed rate of interest or a floating rate of interest and, in some cases, bonds provide for zero coupons which make no interest payments at all. Instead, the investor buys such bonds at a deep discount to the par value and obtains the equivalent of an interest as the discount to par narrows over the life of the bond.

Maturities can also vary. Government bonds usually have a maturity of up to thirty years, however, bonds with an original maturity of less than five years are often issued as medium term notes by corporates.

The presence of covenants may change the risk or payment profile of a bond. Restrictive or negative covenants employed to limit the future actions of the issuer, for example, placing a contractual requirement on the issuer to limit future debt issuance or dividend payments.

SOME KEY DIFFERENCES BETWEEN BONDS AND EQUITIES

There are significant differences in the characteristics of different assets that may influence the way in which they are traded and the transparency levels that support the market's efficiency. In the case of bonds compared with equities, it can be observed that bonds:

- normally provide a much more predictable (nominal) return to the investor, but are much less likely to be bought for the purpose of capital growth;
- can be priced more easily, using fair value techniques (although this ability may be eroding);
- are less influenced by changes in an issuer's profits (unless this threatens the issuer's credit rating)

- can be priced relative to a benchmark;
- are more varied in their structures, even across bonds issued by a single issuer;
- probably have a wider variance in liquidity from the most liquid to the least, with a much 'longer tail' of less liquid issues which trade infrequently;
- are more likely to be 'buy and hold' assets, with most trading occurring within the first few days of issue;
- are traded in far larger transaction sizes and tend to have much larger denominations;
- have a lower direct participation by retail investors, at least in the UK;
- are often more likely than equity to be traded off-exchange;
- are more likely to have a listing outside the jurisdiction in which the issuer is located.

Some bonds can be asset-backed in the sense that they are backed by a pool of securities which provide income streams out of which bondholders are paid. Mortgage-backed securities do the same for the real estate market.

2.2 The Corporate Bond Market

While it may be perceived that bonds are long-term buy-and-hold investments, it is not always the case. Government bond markets are considerably more liquid and active than corporate bond markets. This is probably because of the ongoing investment interest in top credit quality and also the role that the government plays in managing liquidity in any economic or financial system. Government bonds can also be used as collateral by financial institutions and this increases the demand for government bonds. Although some corporate bonds are traded actively, such bonds are not traded to the same extent in volume or scale as government issues.

In terms of their size, government bonds tend to be much larger than corporate bonds, however, there are some super-national organisations such as European Investment Bank, which make foreign denominated issues of several billion pounds, but corporate sector issues are usually smaller than government bond issues. However, with the emergence of sovereign wealth funds and large multi-national companies, it is possible to see an emergence of larger corporate bond issues as well.

Another characteristic of the bond market is that, not only is there a high concentration of liquidity among a relatively small number of issues, but the liquidity profile of many issues changes far more dramatically over time than that of most equities.

BROAD CONCLUSIONS FOR BOND MARKET

A number of broad conclusions emerge about the markets for bonds:

- The level of outstanding debt is huge, and has continued to grow in recent years.

- The profile of trading across the lifetime of a bond can also differ substantially from issue to issue.
- Trading takes place in much larger average size and with less frequency than in equities. Dealer liquidity plays an important role in the trading process.
- Trading is fragmented. Over-The-Counter trading continues to dominate in most bond issues, although multilateral trading venues have made some progress in recent years to gain volumes in the very most liquid issues.

The profile of investors differs between countries, with retail participation in some jurisdiction being considerably higher than in others.

2.3 Market, Legal and Regulatory Requirements for Corporate Bonds

The macroeconomic environment can affect the development of a bond market in a number of ways. Rising economic activity can lead to a greater need for fund raising while rising income can breed greater demand for assets, including bonds, as savings increase. When inflation is stable, the fixed income structure of bonds can be particularly attractive to certain investors whose risk profiles demand a steady real rate of return.

Economic growth can also encourage firms to turn to the capital market for debt financing or for capital restructuring, given the right fiscal incentives and favourable monetary conditions.

The sources of financing in a particular economy provide an indicator for both the stage of financial development in the respective jurisdictions and the subsequent need for developing bond markets. Economies that have a high reliance on the banking sector as a source of finance are likely to face a more pressing need to develop their bond markets. This is due to the maturity mismatch involved in bank loan financing, wherein short-term bank loans are used to finance long-term investment projects that make an economy especially prone to the adverse effects of a banking crisis. In addition, where a particular surveyed jurisdiction is dependent on a single source of financing, there may be a need to review the financial structure and develop alternative sources of financing, such as bond markets. This is to ensure that borrowers are provided with financing alternatives best suited to their needs.

A high rate of savings, and therefore an increase in the availability of portfolio funds, could contribute towards supporting bond market development by driving greater demand for these securities.

Countries where a domestic bond market is already in existence, but where corporates rely heavily on issuance of bonds offshore typically reflect relatively high domestic cost of funds, and may thus imply greater potential scope for bond market development.

However, too heavy a reliance on international bond financing may pose a host of risks comparable to those arising from an over-concentration of sources of financing in the domestic financial system – especially if the ability to manage those risks is constrained or unavailable. These include foreign-exchange risk in cases where the bond issuer's cash inflows (e.g. sales revenue) and outflows (coupon and principal repayments) are in different currencies.

Market size can be an important and dominating factor in the potential growth of a bond market. There needs to be a sufficient number of investors willing to seek the bond market as an alternative to investment opportunity. Such investors can be

financial institutions, large corporations or high net worth individuals. The number of issuers is also important. There needs to be a sufficient number of investors wishing to raise debt finance by issuing bonds. Such issuers need to belong to a diverse set of industries to give the investors a chance to diversify their risk portfolio.

Where government bond markets are sizeable and work efficiently, market participants often use the yields on certain "benchmark" issues to construct a term structure of risk-free returns. These risk-free rates are used in the pricing of a wide range of financial instruments, including and especially corporate bonds. Investors and issuers are thus more likely to participate in the bond market, knowing that they can price instruments efficiently. Jurisdictions with larger and more active government bond markets may therefore be expected to have more developed corporate bond market as well.

Liquidity is a hallmark of an efficient and active market, and hence a useful indicator of market development. It is normally reflected in a high level of turnover relative to market size, and general price stability. The more liquid a market is, the more information-efficient are secondary-market prices likely to be.

Liquidity is usually considered paramount in the government bond market, if the ensuing yield curve derived from benchmark issues is to be reflective of an efficient risk-free rate of return. However, given the diversity and lack of uniformity in corporate bond issues, liquidity of the entire market is thought to be less of an issue for corporate bond markets as a whole. Instead, liquidity may only be important for certain classes of bonds or specific issues, depending on the needs of investors in those particular market segments.

The presence of reputable credit rating agencies are recognised as an important factor in the success of a bond market. The major benefits of an explicit credit rating system include the consistent measurement of relative risk of bond issues; incentives for bond issuers to improve their financial standing; the enhancement of information quality and quantity on issuers. The main purpose of credit ratings is to provide investors with objective and impartial opinions of relative credit risk of bond issues. A well-functioning credit rating system increases the transferability of corporate bonds, either in the primary or in the secondary market, and helps to foster growth of depth and liquidity in the corporate bond market.

Many domestic credit rating agencies in certain emerging markets began their operations with some form of technical arrangement or joint partnership with global credit rating providers. Links and co-operation between domestic and international credit rating service providers are expected to intensify as bond markets in emerging markets grow in size and become more liberalised. International networking may take the form of subsidiaries, franchising or joint-venture and can contribute towards achieving economies of scale in rating, accelerating transfer of technology and winning foreign investors' confidence and interest in the domestic bond market.

In some countries, domestic credit rating agencies are established under the initiative of the government, the stock exchange or the securities market regulator. Credit rating requirements are accompanied, at times, by a minimum investment grade requirement to ascertain the quality of public bond issues, though in developed markets, such minimum credit requirements are not mandated by securities market regulations in order to allow investors to choose from as wide a range of products as possible to cater for a variety of risk-return profiles.

Third-party credit enhancement, or the provision of credit guarantee by a third party for bond issues provides an important avenue for entities with non-investment grade credit ratings to access the corporate bond market. From the point of view of the issuer, credit guarantees would help lower funding costs as well as broaden market access

and the investor base. From the investors' perspective, credit guarantee provides additional comfort or protection against default risk and can also contribute towards enhancing liquidity in the secondary market. Credit guarantees basically play an important role in enhancing the efficiency of financial intermediation by bridging the gap between borrowers – especially those with inadequate credit ratings – and certain investors, who would only be allowed or interested in investing in bonds with higher credit ratings.

2.4 Clearing and Settlement

Robust clearing and settlement systems are a crucial element to bond market development because they help enhance the efficiency of bond trading and reduce their associated risks. In addition, bond market liquidity is closely linked to the reliability of bond clearing and settlement systems. Investors will only trade bonds if they are confident of the settlement of their trades.

The existence of a centralised depository is one of the key elements of a dependable clearing and settlement system by concentrating physical securities in one location. In most cases, central securities depositories operate an automated book-entry system of settlement. This increases the speed and efficiency of bond trading, reduces costs associated with settlement and custody arrangements and minimises errors and delays which may be seen in a manual system. Book-entry systems are also considered a precursor to shortening of settlement cycles and implementing delivery versus payment. Immobilisation of bond scrips within a central securities depository eliminates risk related to the destruction, loss or theft of physical certificates.

An automated linkage between the clearing and settlement system and the payment system ensures an added level of guarantee that payment will be made in the event of a transfer of securities and vice versa.

Euroclear is one of the most reputable equity and bond clearing system in Europe. Clients of Euroclear submit an instruction telling the depository when, how and with whom the clients want to settle their securities transaction. Usually this is done electronically through a fast and low cost form of processing known as Straight – Through Processing. The counterparty in the trade also submits an instruction.

Euroclear then matches the two instructions, and makes sure the seller has the securities and that the buyer can pay. Euroclear then completes the settlement process. If the settlement is taking place between two clients of the same Central Securities Depository (which operates as a sub entity under Euroclear), a simple book-entry transfer is made enabling a simultaneous exchange of cash and securities. Usually, account holders in a Central Securities Depository are dealers and brokers who operate on behalf of their clients who have the ultimate beneficial interest in the securities.

Securities in any given Central Securities Depository may either be immobilised or dematerialised. Immobilised securities are where a global certificate representing the interests of all the bond holders is held with the Central Securities Depository but the trading of individual trading is done electronically through the book entry system. Where dematerialised securities are concerned, no certificate representing the debt is issued at the outset and the original securities interests is created by means of electronic book entries in the Central Depository system.

In Malaysia, sovereign and unlisted corporate bonds are registered, cleared, and settled through Bank Negara Malaysia's ("**BNM**") real time gross settlement / Delivery-versus-Payment system: Real-time Electronic Transfer of Funds and Securities ("**RENTAS**"). RENTAS membership is restricted to financial institutions licensed under the Banking and Financial Institutions Act 1989. All unlisted corporate bonds are held

by BNM as custodian agent and are settled by fund exchange.

All listed corporate bonds under the Bursa Malaysia Bhd (formerly Kuala Lumpur Stock Exchange) are held in book-entry form and cleared and settled through the Bursa Malaysia Securities Clearing Sdn Bhd (formerly Securities Clearing Automated Network Services Sdn Bhd - SCANS). Bursa Malaysia also offers settlement services to institutional investors through the Institutional Settlement Service of Bursa Malaysia Securities Clearing Sdn Bhd.

The Bursa Malaysia Depository Sdn Bhd (formerly Malaysian Central Depository Sdn Bhd - MCD) operates a system for the central handling of securities that facilitates securities transactions without the physical delivery of scrip.

2.5 Over the Counter Trading or Listing

An advantage of over the counter trading for bonds is that even where the bonds are not listed on a formal exchange, they can be traded between dealers and market makers with ease. However, the disadvantage of allowing over the counter trading and not requiring listing is that it is possible that the issuer may choose not to go through the same rigorous disclosure requirements that are necessary for listing the bonds. However, this can be avoided by effective legislation that requires all issuers of bonds to go through the same disclosure requirements (to protect investors) whether the bonds are listed or traded over the counter.

2.6 Trading Transparency

The Role of Transparency in Secondary Bond Markets

- (a) Trading information has both a pre-trade and a post-trade dimension. Pre-trade information relates to current trading interest. Transparency of orders and/or dealer quotations provides the marketplace with information on the quantities in which market participants are willing to trade, and at what prices. Post-trade information relates to the prices and volumes of completed transactions. Transparency in this case informs market participants and investors about the most recent trading, helping them to assess both market trends if they are intending to trade and the quality of trade execution they have achieved once they have done so.
- (b) The extent to which market participants are willing to reveal their trading interest, and to whom, varies considerably. The same applies for trades they have completed. This can raise issues of the balance between individual participants' desire not to reveal this information and the wider demand for access to information in the interests of pricing efficiency and investor protection.
- (c) In most circumstances transparency facilitates market efficiency, fosters investor confidence and strengthens investor protection but that transparency is not an end in itself. Total transparency is not necessarily optimal, and appropriate transparency levels may differ from market to market. There can be trade-offs between transparency and liquidity, and that in some cases access to liquidity pools may be at least as important as what is published and when.
- (d) The importance of sufficient levels of market transparency is widely recognised by securities regulators internationally. For example, IOSCO states that 'regulation should promote transparency of trading' (Principle 27) and expands on this by stating that 'timely access to relevant information about secondary

trading allows investors to better look after their own interests and reduces the risks of manipulative or unfair trading practices'. IOSCO's work on bond market transparency is summarised in the following box.

BOND MARKET TRANSPARENCY

In considering the appropriate level of transparency, the following factors should be taken into account:

- size of the market;
- frequency of trading of particular bonds or groups of bonds;
- participants in the market;
- credit ratings of the issues;
- trading methodology;
- potential effects of disclosure on the liquidity of the market; and
- whether the bonds were Listed and subject to the existing exchange transparency standards.

- (e) On the negative side, transparency may in some cases reduce participation. This may occur if transparency excessively erodes the returns available to better informed market participants, or if the risk/reward ratio for some market makers becomes unacceptable. The latter could occur in several ways. For instance, any requirement for a firm to maintain a public quote (i.e. to commit capital) in significant size inevitably increases that firm's risk. This would also be the case if firms had to publish the full details of all larger risk trades before they had an opportunity to lay off the position. Without a delay, the market maker would be exposed to responsive action by other market participants, increasing the risk that the position could only be unwound at a loss. (These considerations become relatively more important when the market for a particular bond is thin, i.e. when there are few active dealers, infrequent trades and less scope for dealers to lay off their risk.)
- (f) Whether higher levels of transparency deter liquidity provision in practice depends on the balance of the above factors. Of particular importance to market makers is the extent to which any reduction in (traded) spreads is adequately compensated by an increase in clients' trading volumes.
- (g) Clearly, there are costs and benefits in all scenarios, and this implies that optimal transparency differs from maximum transparency. At the extreme, the degree of transparency that might seem optimal for gauging best execution will be counterproductive if it also reduces the opportunities to trade. In most cases, appropriate transparency levels need to be a function of the demand for liquidity and the microstructures by which it is delivered. This may mean, for instance, that in some markets pre-trade transparency has the more important role to play; in others, post-trade transparency may be more important.

3. **Sukuk Market**

3.1 *Introduction*

The growth of the global Islamic finance market and, in particular, a potential Islamic capital or secondary market, has been based to an extent upon the adoption by product developers, practitioners and investors, of conventional financing techniques and adapting these to meet Shariah compliance concerns.

This is particularly relevant to the development of the *sukuk* and the Islamic securitisation markets and indeed has been used as the basis behind existing *sukuk* issues within the sovereign, corporate and treasury markets.

3.2 *Sukuk - Definition*

It is helpful to first of all try to understand the definition of *sukuk* and how its components differ from conventional structures.

Sukuk (plural of **sakk**) is defined in Arabic as 'investment or participation certificates'. Continuing the analogy with terms used in the conventional markets, *sukuk* has also, perhaps simplistically, become known as the issue of "Islamic bonds".

There should, however, be an understanding of the relevant distinctions between the two.

At its simplest, a bond is a debt obligation based on a contract between two or more parties whereby the issuer is obliged by contract to pay the holders of the bonds or notes, on certain specified dates, with a repayment of, usually, interest and principal.

Under a *sukuk* structure, the *sukuk* holders each hold a "pooled" beneficial ownership in a set of underlying assets (the '*sukuk* assets'). *Sukuk* holders are technically entitled to share in the proceeds of performance and also in the realisation of the *sukuk* assets either on a disposition or perhaps an insolvency.

Additionally, and something we analyse further in this work, is that *Sukuk* certificates may be rated.

Under modern practice, investors in *sukuk*, may receive periodic payments under a *sukuk* issue that are compared or linked to an outside market rate, typically LIBOR (London Inter Bank Offered Rate) or the US Prime Rate. Accordingly, it has become increasingly apparent that the pricing and structuring of *sukuk* issues is using similar techniques as those used in the conventional markets.

3.3 *Main Eligible Asset Classes*

Given the fundamental requirements of the Shariah and in particular, the requirement for a defined class of assets which are identifiable and "tangible" in nature, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) published its accounting standard relating to investment *sukuk* and highlighted the different asset types.

Within a narrow field of exceptions, evidence of a debt, which represents a payment obligation alone, is ineligible for inclusion in a *sukuk* issue.

The main asset classes eligible for *sukuk* issues are the following.

- (a) ***Ijara assets.*** When a leased asset is held in a vehicle for securitisation or the issue of a *sukuk*, there is a right of ownership that must be documented in the **sakk**. This will qualify the holder with specific rights and obligations of ownership.
- (b) ***Mudaraba assets.*** A *mudaraba* is a partnership in profit between capital employed on one hand and work on the other, in which one partner, the investor (*rabb al-mal*) contributes money and the other, the manager (*mudarib*) invests time and effort. In this case, the issuer is the *mudarib* or, conventionally, the fund manager.
- (c) ***Musharaka assets.*** A *musharaka* is a form of partnership whereby each party contributes to the partnership capital in equal or varying degrees with a view to establishing a project or to share in an existing one. Each of the parties becomes an owner of the capital on a permanent or declining basis and indeed has a due proportion/ share of profits. Losses are shared in proportion to the contributed capital.

By comparison, a *mudaraba* is comparable to a fund or limited partnership. A *musharaka* on the other hand, is comparable to a corporate vehicle or an unincorporated association (with partnership shares). Similar requirements relating to ownership would also apply to any form of *musharaka*.

- (d) ***Full title assets.*** Any form of entity or any person owning absolute or unencumbered title to a Shariah permissible eligible asset may issue a **sakk**, complying with the required rules, based upon the relevant asset.
- (e) ***Variations on istisna'a and other assets.*** Assets used in an *istisna'a* transaction could be included into a *sukuk* issue.

Istisna'a is normally defined as a contract of sale for specified goods to be manufactured, with an obligation on the manufacturer to deliver them upon completion. It is normally an additional condition that the seller provides either the raw material or the costs of manufacturing the goods. Typically, *istisna'a* is used in project finance, infrastructure projects and for construction and development transactions.

- (f) ***Salam assets.*** *Salam* is defined as a contract for the purchase of a commodity for a deferred delivery in exchange for immediate payment according to specified conditions. It has similar characteristics, although not identical, to a conventional futures contract.

The issuer of the **sakk** is the seller of a commodity that is eligible for a *salam* sale. Investors are able to access the commodity, the selling price or the net price of a parallel *salam* sale.

- (g) ***Murabaha assets.*** *Murabaha* is the sale of goods with an agreed upon profit mark up on the cost.

There are essentially two modern interpretations of the type of *murabaha* sale. In the first, one party purchases the goods and then makes them available for sale without any prior promise for purchase and this is termed a spot *murabaha*. The second type typically involves the customer's promise to purchase the item from the original party.

- (h) ***Ownership of usufructs or financial benefits.*** The AAOIFI standards permit the purchase of a financial benefit as being an eligible asset claim for

investment *sukuk*. However, there must be a clear acquisition of financial benefits and importantly, the underlying risks.

Fatwas have approved the acquisition of benefits and risks related to an asset that will become available in the future. The purchase and sale of services and reselling of the same are permitted by the AAOIFI rules and this has the ultimate logical extension to the acquisition of certificates in investment agencies.

3.4 *Practical Application*

Having taken into account the definition of *sukuk* and its fundamental characteristics, and also considered the permissible and eligible asset classes, it is helpful to turn our attention to the practical method by which a *sukuk* (securitisation) transaction could be promoted and the various characteristics behind this.

3.5 *Issuer Vehicle selection*

One of the fundamental concerns will be the environment and characteristics by which the issuer vehicle is structured and incorporated. These concerns include the following:-

- (a) use of an appropriate vehicle structure that allows a trust type structure to be created on the basis of a declaration of trust;
- (b) selection of reputable organisations to form and manage the transaction (those having acceptability to investors);
- (c) having a tax effective and acceptable jurisdiction;
- (d) making sure all regulatory requirements governing the issuer are complied with;
- (e) all sensitive and confidentiality issues are preserved; and
- (f) appropriate levels of expertise exist in respect of any service provider and that their services are transparent and understood.

The special purpose vehicle, (SPV), is normally created to acquire the assets and issue the certificates to investors. This SPV is normally protected, in so far as possible, against insolvency. The issuer (or a manager appointed on its behalf) also usually acts as the trustee of the assets on behalf of the *sukuk* holders, although there are some variations to this.

Additional key issues for consideration include:

- (a) a differentiation of asset credit risk from the issuer's credit risk and the requirement, in effect, of a true sale. A true sale is necessarily subject to specific warranties and indemnities, which if proven to be wrong, would require termination or restitution;
- (b) possible novation of rights could achieve the same effect but is not always understood in some of the key markets where *sukuk* issues are flourishing;
- (c) assignment must be absolute and notice to the debtor. Equitable assignment, in which there is no notice and partial transfer, is common. However, these are not well established in emerging markets; and

- (d) in relation to the grant of security, there is a difference between floating and fixed charges; and charges which cover all assets and those which cover specific assets. However, if the sale is recharacterised as a loan or a fixed charge is recharacterised as floating, the nature of the transaction may be completely changed with the rights of the investors jeopardised.

3.6 *Trustee Issues*

The fundamental concept of trust is that ownership may be segregated into two classes: legal and beneficial. The former has title; the latter merely has some of the benefits that would normally be associated with legal ownership. The rights of a legal owner cannot be restricted by the general operation of law. The concept of legal and beneficial ownership is recognised in Shariah, and Islamic jurists have found that trust structures make *sukuk*-like bond issuances more efficient.

Additional to the trustee, there are a number of important parties who facilitate *sukuk* and bond issues:

- (a) paying agent or servicer: provides administrative support to the issuer to pay;
- (b) common depository: to hold relevant instrument or sakks;
- (c) custodian: holds the collateral on behalf of the investors; ensures settlement is executed correctly; maintains a clearing account; and provides corporate information and execution of corporate actions such as payments; collections and tax claims;
- (d) listing agent: applicable for exchange-listed transactions;
- (e) back-up servicer: supports primary in event of servicing failure or default; and
- (f) cash manager and bank account

3.7 Identification of Assets in an SPV

As mentioned earlier, one of the fundamental requirements of a Shariah compliant securitisation is the identity of the asset and the packaging of specific risks into a special purpose entity. That allows an identity to be created and also for those specific risks to be priced and mitigated, if required.

In the conventional capital markets, corporate vehicles, trusts with limited liability and with an accounting "off balance sheet" treatment from a parent or trading corporate, are the preferred methods for isolating assets.

This is replicated for *sukuk* and allows a very practical isolation of the assets for the purpose of issuing *sukuk* and usually allows insolvency remoteness. Accordingly in the event that a company owning or using the assets fails, its creditors will not be able to attach orders of enforcement against the assets in a manner disadvantageous to *sukuk* holders. This is also helpful to the *sukuk* holders in the event that the underlying asset is dealt with (through an act or omission) in a way that causes a diminution in value.

The SPV will either accumulate financial obligations or it will accumulate assets. It will then issue the investment certificate. The *sakk* might be viewed, under conventional jurisdictions, as a note, a participation certificate or another form of security. Each *sakk* is unique with respect to the underlying investment and its documentation.

3.8 *Transfer of Asset Ownership to the Issuer*

It is important to establish the ownership of any eligible assets within the issuer vehicle.

In general terms, it is recognised under the Shariah that the ownership of an asset is possible under a sale contract even if the title is not registered in the ultimate purchaser's name. It is recognised specifically by the Ijara standard and in transactions that have closed in this respect.

This principle has been used in most of the Ijara *sukuk* transactions executed so far but with an appropriate degree of certainty as to how that asset can be used within the issuer vehicle and indeed within the protections referred to earlier in this work. We comment further on these aspects later in this paper.

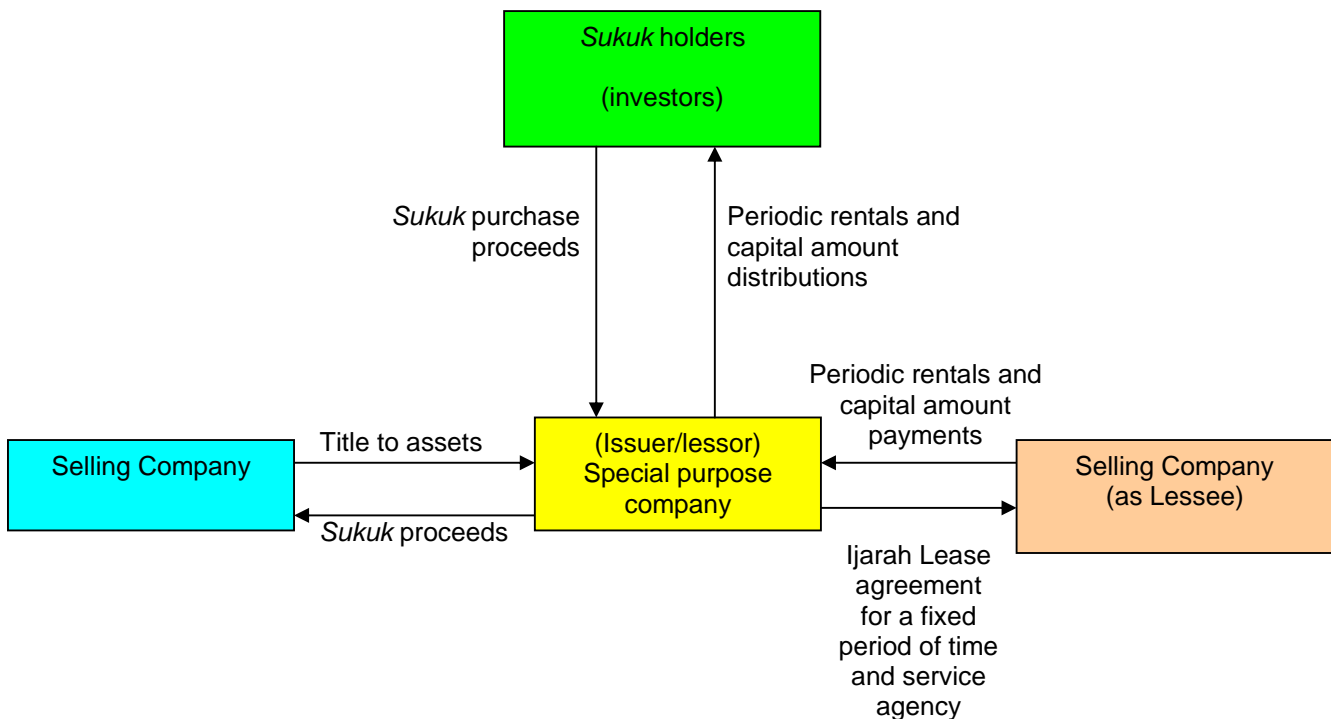
In this way, there is some certainty that the title to the asset has been transferred to the issuer free from all encumbrances and, of course, with any attached or accrued rights from the date of the original transaction.

The analysis above represents a conventional and relatively simple transaction but there are instances where title is not transferred. This is normally because of adverse jurisdictional concerns or indeed through an unfavourable tax treatment. Where beneficial ownership relates to "immovable" properties such as real estate and buildings, the use of an Ijarah mechanism allows the original seller to remain the registered proprietor of the assets. However, the original seller usually makes a legal declaration that it shall hold the assets as trustee for the buyer, which in a *sukuk* issue will be the issuer. Additionally, in a typical due diligence exercise, this requires close legal consideration by the advisers acting for the issuer.

3.9 *The Underlying Agreement in a Sukuk al-Ijarah*

As mentioned earlier, the most commonly used structure for *sukuk* issues to date has been the *sukuk al-ijarah*.

FIG 2: STRUCTURE OF A SUKUK AL-IJARAH (REAL ESTATE) TRANSACTION



The following normally applies:

- (a) the *ijarah* (lease or lease-back) agreement is executed independently of the initial **asset purchase agreement** and the two should not be conditional on the other. Any such conditionality is not acceptable to the majority of Islamic scholars, who view it as haraam from a Shari'a perspective. However, a way around this and normally found in some marketing materials is the entry into of a general non-contractual memorandum of understanding which may be signed prior to the agreements. Additionally, transfer of the ownership in the leased asset cannot be made by executing, along with the *Ijarah* agreement, a contract of sale that will be signed in advance and that will become effective at a future date.

However, given the nature of the transaction and the underlying comfort sought by investors, in effect, the same legal basis can be achieved, in line with the Shari'a requirements, by an initial **purchase undertaking** entered into by the lessee to ultimately buy the assets from the lessor and a similar initial **sale undertaking** made by the lessor for the ultimate sale of the assets to the lessee. It should also be noted that the undertakings are separate from the *Ijarah* agreement and should not be referred to therein as integral parts;

- (b) the leased assets are primarily the responsibility of the issuer (as lessor) throughout the duration of the *Ijara*. If the leased assets are in fact in the possession of the lessee, they should be held by the lessee in a fiduciary capacity on behalf of the lessor. In this way, the lessee is not to be held liable for any damage of the leased assets other than due to the misconduct or negligence on the part of the lessee;
- (c) confirmation is agreed between the parties that all major maintenance and repairs relating to the assets are the responsibility of the lessor, while the lessee will be responsible for ordinary maintenance and repair. This requires clear definition to avoid any dispute at a later stage.

Typically the issuer may, delegate to the lessee (as agent) this responsibility. The costs of this arrangement are invariably taken into account in fixing the lease rentals. Appointment of the lessee as agent for the lessor is practically achieved through the use of a **service agency agreement**. A similar structural apportionment is used for taking out insurance;

- (d) the type of lease document to be signed will be determined by whether the issue is of a fixed or variable rate nature;
- (e) notwithstanding the transfer of the assets at final maturity of the transaction, the purchase and sale undertakings are also critical in attending to contingencies during the course of the lease such as firefighting, standstills, default and acceleration scenarios; and
- (f) It has also been suggested that a reasonable period of time must elapse between signing the lease contract and the final sale-back agreement. No specific time frame has been suggested in this regard but there appears to be a general consensus among Shari'a jurists that the period between the two contracts has to be long enough so that the circumstances of the leased property or its value could have changed. Typically, a six month period has been used between the date of the original and positive further transactions as the "hiatus period".

3.10 *Means of transfer*

The *sakk*, representing an asset, may be fully transferable or indeed restrictions can be imposed. In either case, it must carry with it specific, identifiable attributes of ownership that may be divided into rights and obligations for the holder of the *sakk*.

The *sakk* can be a single certificate or instrument, however, some issuers have developed *sukuk* that carry multiple elements together, including a promise to pay, a security interest in property and possibly other aspects, in compliance with the Shariah.

3.11 *Rating of sukuk*

Rating agencies do not, in the main, apply a different ratings criteria to a transaction just because the transaction is structured as Shariah compliant.

However, the rating agencies recognising the growth in the market for Islamic products, have started to develop the analysis of *sukuk* into their analytical framework.

The main approach to determining the strength of an issue is the same as for traditional transactions and indeed from an investor perspective that has got to be the right way to look at it.

This includes the following:-

1. the financial position of the issuer;
2. the liquidity position of the issuer or the underlying assets;
3. whether or not any hedging of specific underlying risks has been put into place;
4. if the issuer is a financial institution, its capital adequacy;
5. the response of the assets or issuer to risks and hazards, including tolerance thresholds tests; and
6. the portfolio's uniformity, measurements, characteristics.

There is also a substantial matrix of potential risks which could be applied for any transaction and take into account such matters as currency, political and trading risks.

Additionally, in order to appeal to global investor bases and not just those based in certain geographical areas and indeed to secure a diverse range of investors within distinct jurisdictions and broad asset types, rating is essential. Such interaction is critical for the long term evolution of the *sukuk* markets and indeed any derivative instruments created from there.

3.12 *Regulation of Sukuk market*

All the observations made in section 2 (Corporate Bonds) of this report also apply to the *sukuk* market.

4. **Developing Corporate Bond and Sukuk Markets in Maldives**

4.1 Current Regulatory Regime

The Maldives Monetary Authority Act 1981 created the Maldives Monetary Authority ("**MMA**") to:

- issue currency and regulate the availability and international value of the Maldivian Rufiyaa;
- Provide advisory services to the Government on banking and monetary matters;
- To supervise and regulate banking so as to promote a sound financial structure; and
- To promote in the country and outside the country the stability of Maldivian currency and foster financial conditions conducive to the orderly and balanced economic development of Maldives.

The Maldives Securities Act of 2006 established the Capital Market Development Authority ("**CMDA**") to:

- develop a market in which securities (including debentures) can be issued and traded in a fair and orderly manner;
- protect and promote the interests of investors and potential investors in securities;
- regulate and supervise the securities market; and
- take measures to prevent unconscionable conduct in relation to dealings in securities and loss of confidence in the securities market.

The CMDA has already established a Stock Exchange to provide for a market for dealing in shares listed on the Maldivian Stock Exchange [and has also put in place a code of good governance for listed companies.]

In our opinion, Maldives has the necessary regulatory framework in place to be able to develop a bond and sukuk market in line with the principles of bond market regulation set out under section 2 (**Corporate Bonds**) and sukuk market regulation under section 3 (**Sukuk Market**) of this report. However, without the necessary legislative and legal framework it will not be possible to encourage bond and sukuk market development and this is considered below. Also, we believe that there are certain factors present in Maldives that might hamper the speed of development of these markets and these are also discussed below.

4.2 Existing Laws

We have reviewed, among other things, the following legislations:

- (a) The Companies Act of the Republic of Maldives;
- (b) The Law on Foreign Investments in the Republic of Maldives;
- (c) The Enforcement of Money Judgments Act;

- (d) An Explanatory Note on the Maldives Trust Law;
- (e) Maldives Contract Law; and
- (f) [any others].

[Insert discussion of law on Mortgages- not provided]

In our opinion, while the Companies Act enables Maldivian companies to issue debentures, including bonds, and provides for the winding up of companies in the event of the insolvency of a company, it does not distinguish between secured and unsecured creditors in section 91 (*Order of settling company's debts*) of the Act. It is important that the Companies Act makes this distinction so that holders of bonds which have been secured by security over the assets of an issuer, have priority in any claims against a corporate issuer ahead of the unsecured creditors of the company.

The Maldives Contract Law needs to be clearer that it recognises a contract where one party has incurred debt obligations to the other. As currently drafted it is not clear that this would be the case and as such could affect the validity of bonds issued by Maldivian issuers in Maldives.

We understand that there is a requirement that an application by an intended resort developer for a lease of an island to include a bank guarantee in relation to 50% of the cost of the development. This requirement makes it impracticable for any developer to raise funds in the bond market as no bank will provide the required guarantee unless all the development funds are assured in advance from committed parties. It is possible that funding requirements be changed so as to provide that an application for a lease may be made subject to the condition that a stated percentage of the costs will be successfully raised within a prescribed period from the bond market.

Section 9(b) of the Maldives Tourism Act provides that:

"Where the lessee of an island or land for development of a tourist resort is a public company that meets all of the conditions specified below, such island or land may be leased for a period of 50 years:

- (a) the [public] company is registered in the Maldives;*
- (b) the development and operation of tourist resorts is included as an object in the memorandum of association of the [public] company;*
- (c) the.... shareholders are all Maldivian citizens and at least 50% of the company's shares are sold to the public;*
- (d) no more than 1% of the publicly held shares are held by a single shareholder except where the shareholder is an investment company, in which case no more than 5% of the publicly held shares should be held by that investment company...."*

As a result of the above, it will be difficult for an issuer to grant security over the shares of a company that holds a 50 year lease of a tourist resort island without risking the loss of the licence as upon an enforcement, such shares could vest in a foreign bondholder. One option is that such share security is granted to a Maldivian trustee who holds the shares on trust for the foreign bondholders. Nevertheless, the provision of the above law severely restricts the persons to whom the trustee may transfer the shares to in an attempt to realise the security of the bondholders in the event of a default. This would prejudice foreign investors from investing in Maldivian bonds.

A crucial aspect of a well-functioning corporate bond market is the provision of a set of laws that clearly define the limit of public investors' legal ability to force bankrupt issuers to repay their obligations and the procedures for doing so. In essence these laws should not only define creditors' rights but also provide a mechanism for fair and efficient reorganisation in the case of default or bankruptcy. Such a mechanism, similar to Chapter XI of the Bankruptcy Code in the U.S., gives a company that is in financial distress protection from its creditors while it works out a plan for rehabilitation or liquidation, either under court supervision or through a voluntary reorganisation. As a result, investors are able to rationally assess the risk of investing in bonds and the likelihood of a partial restoration in cash or securities with little delay. The rationale is that the value of a business is greater if sold or reorganised as a going concern than the sum of its parts if sold individually.

At present the Companies Act of Maldives does not provide for such a court ordered moratorium to be imposed on the ability of the creditors to take action against an insolvent company, giving the company breathing space to make the necessary reorganisation. Therefore, we would recommend that the Companies Act is amended to provide for a Company to take advantage of such a procedure.

4.3 Industry Sectors

From our survey of industry operatives and stakeholders which is attached as Appendix [] the general consensus was that the Tourism, Fisheries, Manufacturing and Telecommunications industry sectors would be interested in issuing bonds.

4.4 Stakeholder Concerns

During our meetings with stakeholders, we identified three primary concerns.

First, it was believed that the relative size of the local market in Maldives would restrict the pace of growth and indeed the development of a viable bond and sukuk market in Maldives. It was believed that local and foreign banks operating in Maldives would have to take an active part in creating an investor base that could sweep up bond and sukuk issues in the first instance and then create a secondary market by encouraging their customers to invest in these products.

Secondly, it was believed that restrictions on foreign investments would hamper the development of a bond market due to the size of the local investor base.

Finally, the general impression was that the judicial system in the Maldives may be incapable of dealing with complex financial arrangements and give adequate protection to creditor rights even if the relevant laws exist that give bond or sukuk holders such rights. It was also believed that given recent examples, the inability of Maldivian courts to follow a precedent system created a lack of trust amongst the stakeholders in the Maldivian judicial system as they could not predict with any certainty the outcomes of legal disputes even where precedents supporting their legal position existed.

4.5 Recommendations

(a) Developing the Market

There needs to be established in Maldives a domestic credit rating agency that can develop domestic rating scales for corporate credit risk. This results in a system that provides sharper differentiation of credit risks within the domestic market, which in turn offers greater information value for investors. A domestic rating agency is also essential to help bridge the information asymmetry between investors and issuers, especially in the context of bond and *sukuk* markets that are not sufficiently large to support the entry and viable operation of an international credit rating agency. Furthermore, a domestic credit rating agency should also assume the additional responsibility of promoting the bond market via education, information dissemination and research undertakings.

A clearing and settlement system needs to be developed for bonds and *sukuks*. Indeed, it would be efficient if any clearing and settlement system that is developed for bonds and *sukuks* is regulated by CMDA which also regulates the settlement of share transactions. See paragraph 2.4 (Clearing and Settlement) above to understand how the clearing and settlement system would work for bonds and *sukuks*. To this end, we would recommend the adoption of laws and regulations for the development of a central depository system in Maldives.

There needs to be greater access to information, both pre-trade and post-trade. We understand that so far not many Maldivian companies have listed their shares on the Stock Exchange in Maldives due to a lack of willingness to subject their companies to public scrutiny. From our assessment there appears to be a culture of secrecy at the very basic corporate level which, unless changed, will also impede the development of the bond and *sukuk* market in Maldives. Concrete steps need to be taken by the regulators to encourage more companies to list their shares on the stock exchange, subject themselves to the good governance code and the listing rules of the Maldivian stock exchange and be more forthcoming about their financial health and performance.

In our opinion, the Maldivian regulators have been working on changing this culture by encouraging greater market awareness, greater dissemination of information to the public about their own activities and efforts, seeking expert overseas help to develop the laws and regulations and these measures need to continue. However, a definite targets and milestones need to be set and an anticipated timeline needs to be determined to establish greater market openness and information dissemination by some of the largest companies in Maldives.

While there are varying approaches to regulation of the bond market globally, in relation to whether the regulatory approach for bond market regulations should be centralised or fragmented, we believe that the regulatory approach in Maldives should be tailored to existing institutional regulatory arrangements in place in Maldives taking into consideration market sentiments.

We would also recommend that a credit rating agency is set up in Maldives preferably with the help of an international rating agency to provide rating services in order to develop the bond and *sukuks*.

We would also recommend that over the counter trading of bonds and *sukuks* be allowed for bonds and *sukuks*. It is possible that issuers may not be willing to list the bonds due to the costs involved but providing over the counter trading facilities for bonds and *sukuks* ensures that investors in unlisted bonds and *sukuks* have an avenue to trade their bonds and *sukuks*.

(b) Removing Legislative and Regulatory Hurdles

A significant impediment to the development of the bond and *sukuk* market in Maldives is the potential size of the market. At present there are approximately [300,000] Maldivian citizens and [] companies with market value in excess of [\$xx]. We understand that there are two insurance companies and a handful of local and international banks operating in the Maldives.

Given the size of the investor base and the issuer base, any potential bond or *sukuk* market will struggle, at least initially, to become a viable, vibrant and active market. One way to speed up the development process is to allow foreign subscribers (non Maldivian companies and individuals) to be able to subscribe for Maldivian *sukuks* and bonds.

At present, there are a number of laws that prevent this from happening. *The Law on Foreign Direct Investments* stipulates that a foreign national or a body corporate may invest in Maldives in accordance with the terms of this law. It appears that a foreign investment in bonds would also be covered by this law. The law also provides that the nature and the areas of any foreign investment that could so be made in the Maldives shall be decided by the Ministry of Tourism, where the investment is in tourism, and by the Ministry of Trade and Industries in all other investments. The said investments shall have a capital acceptable to the Maldivian government. Also, agreements need to be signed with the relevant Ministries to regulate the investment scheme and programme. Given the size of the local population of Maldives and the local investor base, we believe that for the development of a viable bond market in Maldives, the Maldivian government should also allow foreigners to invest in Maldivian bonds and relax the restrictions in the Law on Foreign Direct Investments. Currently, only a foreign bank or a person or body whose status is guaranteed by a bank or is acceptable to the Maldivian government may invest in Maldivian bonds. This is an onerous restriction and may impede the inflow of foreign investment in a Maldivian bond market.

Furthermore, a foreign person or company cannot own any property in the Maldives. So, for example, if a Maldivian company were to issue a *sukuk* or a bond and the security for the holder of the bonds or *sukuks* was over real estate in Maldives, it would not be possible for that bond or *sukuk* holder to enforce its security over such real estate ("secured asset"). It would be possible for a trustee (a Maldivian company or citizen) to enforce the security and take possession of the secured asset on behalf of the foreign bond or *sukuk* holder but in order to realise the secured asset the potential pool of purchasers would be very limited, as they too would have to be Maldivian residents or Maldivian companies. Again it is possible to set up a trust mechanism for a foreign purchaser of the assets subject to the enforcement but we believe that such a method would discourage foreign investors.

This situation is further complicated if the secured assets are shares. We understand that there are unrealistic incentives in the Maldives Tourism Act for the availability of a long leasehold interest in a Maldivian tourist resort. There is a requirement that no more than 1% of the shares in the case of individuals and 5% of the shares in the case of investment companies (the shares in each case being held by Maldivian citizens) be held by any one of the public shareholders of a tourist resort company. Therefore, upon an enforcement of security over shares, the foreign bond or *sukuk* holders would potentially reduce the value of their security if they were to take possession of the shares as the incentives under the Maldivian Tourism Act would be lost by the company in whom the shares are held.

Therefore, we would recommend that the legal and regulatory regime in the Maldives should be liberalised to allow foreign direct investment to take place without government consents and for foreigners to be allowed to own property (real estate, shares and other types of property) without any adverse consequences for the bond and *sukuk* holders or the companies and other entities in which they are interested.

Any adverse concerns that the authorities might have allowing a liberal foreign direct investment strategy should be protected by anti-competition legislation.

We would also recommend that foreign entities should be allowed to hold shares in Maldivian companies.

(c) Stakeholder concerns

The key stakeholder concern about the lack of an effective judicial system that understands modern commerce and finance and the concept of precedent should be addressed urgently.

We understand that there is a provision in the [Maldivian constitution] that allows judges to be non Maldivian nationals. This provision should be utilised to seek the appointment of a non Maldivian national on the bench in Maldives as someone who can bring with him/her the expertise of modern commerce finance and also train the next generation of judges in Maldives.

We would recommend that the courts in Maldives strictly adhere to the system of precedents in order to ensure certainty and encourage trust by the commercial community in Maldives in their judicial system. Lower courts should not overturn the decision of a more superior court on the same point of law and should not reopen or retry cases or issues that have already been determined by the Maldivian courts before.

APPENDIX 1

DEVELOPING A CORPORATE BOND MARKET IN THE MALDIVES - LAWS, REGULATIONS AND PLATFORM

**Preliminary questionnaire relating to questions and issues to be considered by the
Capital Markets Development Authority (“CMDA”)**

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Introduction

Taylor Wessing LLP, has been retained as consultants by the Commonwealth Secretariat, which is assisting the Government of Maldives in preparing a report on the proposed development of the corporate Bond market in Maldives, including, developing an appropriate legal and regulatory framework to facilitate such a market.

We have also been asked to consider the requirements for introducing Shariah compliant Bonds in the Maldives.

In this regard and to assist in our investigation, we have prepared the following preliminary questionnaire, the answers to which will enable us to report our findings. Where necessary, we have provided an explanation for the questions. Please note that references to Bonds in this questionnaire are references to corporate Bonds unless otherwise mentioned.

Question	Explanation	Answer
1. <i>Enabling Environment</i>		
<p>Please explain the status of trading and other entities that exist in Maldives and which you believe would like to issue corporate Bonds? Are they:</p> <ul style="list-style-type: none"> • Limited liability companies; • incorporated partnerships; or • others (please specify)? 		<p>Mainly limited liability companies and partnerships</p> <p>Partnerships unlikely to issue bonds</p>
<p>Please explain what you understand Bonds to be.</p>	<p>Do you understand them to be debt instruments denoting the obligation of the issuer to satisfy a holder's claim to capital repayment at a future date and to interest until repayment occurs?</p>	<p>Yes</p>
<p>Please explain the type of Bonds you anticipate will be issued in the Maldivian market. Will they be:</p> <ul style="list-style-type: none"> • Zero Coupon Bonds (please also see reference to Shariah-compliant); • Fixed Interest Bonds; or • Step-up Bonds with variable rates of interest 	<p>Zero Coupon Bonds make no interest payments at all. Instead, the investor buys the Bond at a deep discount to the Bond's par value and obtains the equivalent of an interest payment as the discount to par narrows over the life of the Bond. Step-up Bonds give a coupon during the initial specified period and a higher coupon in following periods.</p>	<p>Yes</p> <p>Yes</p> <p>Yes</p>
<p>Are there any current laws that govern the issue of Bonds, issuers or potential issuers?</p>	<p>This would cover corporate, insolvency and property laws.</p>	<p>Only financial institutions can take security</p> <p>There are a number of laws relating to financial institutions</p>
<p>What is considered to be the average maturity of potential Bonds in the Maldivian market?</p>	<p>Bonds with an original maturity of less than five years are often issued as medium term notes. Governments usually issue long term debt.</p>	<p>Experience is that difficult to get people to invest for more than one year</p>
<p>Will the issuers issue any Asset Back Securities?</p>	<p>Asset backed securities make use of a pool of loans, leases and other assets to provide the income streams out of which</p>	<p>Probably only for tourist resorts</p>

Question	Explanation	Answer
	Bondholders are paid.	
What is the anticipated size of the Bond market in Maldives and how will this be segregated between Government and non Government Corporate Bonds?		Treasury bills issued by MMA Not sure what size of bond market
Who are the potential investors into the Bonds? Will the investors be corporate entities or retail investors?		Banks, corporate investors, retail
Will foreigners and foreign entities be allowed to invest in the Bonds?	This is relevant in relation to the Law of Foreign Investments.	Yes
What will be the anticipated trading volumes for the Bonds?	Government Bond markets are usually more liquid and active than corporate Bond markets.	Don't know
What will be the regime governing trades by dealers in the Bond market and who will be the dealers in the Bond market? Will they be entities or persons authorised by the CMDA?		Investment advisors, Maldivian citizens, Maldivian companies Yes (Securities Bill) MMA will have primary market dealers, which are the banks CMDA will have investment advisors and dealers
What is the current role of the CMDA in relation to regulation of financial markets generally. Specifically: <ul style="list-style-type: none"> • Is there a Maldivian stock exchange and does the CMDA regulate the Maldivian stock market. If not, how is the Maldivian stock exchange regulated, including the trading activities carried out there? • Does the CMDA 		Yes - Maldivian Stock Exchange CMDA regulates it

Question	Explanation	Answer
<p>regulate the insurance industry?</p> <ul style="list-style-type: none"> • Does the CMDA regulate the banking industry? • Does the CMDA regulate the Asset Management industry, if there is one? • Is there a commodity trading exchange and does the CMDA regulate such a trading exchange or any other trading exchange? 		<p>No - MMA does</p> <p>No - MMA does</p> <p>Yes - see Securities Bill</p> <p>No</p>

Question	Explanation	Answer
4.6 <i>Implementation and conditions for operation of the Market</i>		
What is the nature of the existing corporate governance regime in Maldives for shares and can this be adapted for Bonds?		Yes - CMDA has a code of corporate governance for listed companies
What practical steps does the CMDA consider appropriate to increase transparency in the Bond market? Should this include sufficient pre-trading transparency and post trading transparency?		Would depend on how the bond market develops
What market failure safeguards does the CMDA operate in relation to the equities market?	Market failure can be caused by inefficiency in the price formation process or a failure in best execution practices.	Code of Governance, independent Stock Exchange, Listing Rules
Should market failure safeguards be built into the Bond market?		Yes
Are there any existing trading, clearing and settlement platforms that can be used for Bond markets?		Stock Exchange and Central Depository system
Please explain the nature of the platforms and the identity and nature of the market participants who operate them.		Stock Exchange is an independent body regulated by CMDA

Question	Explanation	Answer
4.7 <i>Conditions for Access to the Market</i>		
Will the CMDA provide a framework enabling issuers to list their Bonds?		Yes - HFDC bonds already listed and delisted
Will issuers have to comply with financial and legal thresholds in order to be able to have their Bonds listed?		Similar to listing rules Incorporate London listing rules in the listing rules
Will there be a separate index for Bonds to help increase liquidity and help in price transparency?		Yes - separate index
Will issuers need to be of good standing and will they be required to meet certain financial net worth tests in order to list their Bonds on the market?		Yes
What are the current criteria for membership of any trading exchange regulated by the CMDA, for example the Maldivian stock exchange?		Licence by CMDA as a dealing company Minimum capital requirements Fit and proper persons Liquidity margins
How well served is the Maldivian market by ancillary service providers relevant to a properly functioning Corporate Bond market, i.e. what will be the role of professional advisers, for example, lawyers and accountants in the issuing and listing process?		Up-and-coming Knowledge base limited Lack of practical experience Recognised accountants and investment professionals available but limited

Question	Explanation	Answer
4.8 <i>Valuation and Pricing</i>		
	<p>Are there any rating agencies in Maldives or institutions that can perform the role of rating agencies?</p>	<p>Valuing corporate Bonds is complex. Credit risk is a significant factor in the pricing of the Bond. Factors that may affect the credit risk include the priority ranking of the Bonds and the nature of the security package supporting the Bonds. Many investors rely on rating agencies for the ratings that they provide to the issuer.</p> <p>CMDA wants to bring a rating agency to Maldives</p>
	<p>Does the financial sector in Maldives provide for underwriting services to enable issuers to underwrite their prospective Bond issues?</p>	<p>Does the financial sector in Maldives provide for insurance and re-insurance services?</p> <p>Regulatory framework provides for licensed underwriters</p> <p>Banks can provide underwriting arrangements</p>
	<p>What access is there to market information for such rating agencies to properly rate corporate issuers, i.e., newspapers, listings, online information, trading information or information provided directly by the issuer?</p>	<p>The more information that is available to the rating agencies the more accurate the rating and the more efficient the market.</p> <p>Not that developed - contact the issuer</p> <p>Issuers have published accounts</p>

Question	Explanation	Answer
4.9 <i>Investor Protection</i>		
<p>Does the CMDA have investor protection regulation in place to protect market abuse, insider dealing and to protect investors investing in Bonds?</p>		<p>Yes - Securities Act, Investor/Fidelity Compensation Fund</p>

Question	Explanation	Answer
4.10 <i>Shariah Compliance</i>		
	To what extent does the CMDA wish the Bonds to be Shariah compliant, i.e. Sukuks?	The Shariah categorisation of Sukuks is that they are fundamentally asset-based securities, that represent an undivided share in the underlying assets of the issuer.
	Is the concept of trust recognised under Maldivian law?	<p>Both should exist</p> <p>Developing trust law</p> <p>Trust concept recognised</p> <p>Banks, e.g. HSBC, can act as trustees</p> <p>One of the fundamental concerns will be the environment and characteristics by which the issuer vehicle is structured and incorporated. These concerns include the following:</p> <ul style="list-style-type: none"> • use of an appropriate vehicle structure that allows a trust type structure to be created on the basis of a declaration of trust; • selection of reputable organisations to form and manage the transaction (those having acceptability to investors); • making sure all regulatory requirements governing the issuer are complied with; • all sensitive and confidentiality issues are preserved; and • appropriate levels of expertise exist in respect of any service provider and that their services are transparent and understood.
	What will be the status of the issuers of the Sukuks. Is it anticipated that they will be:	Limited liability company
	<ul style="list-style-type: none"> • Limited liability companies; • incorporated partnerships; or • others (please specify)? 	
	Are there reputable financial institutions	Banks and other investment

Question	Explanation	Answer
present in the Maldives that will form and manage the Sukuk transaction?		advisors
What will be the anticipated underlying assets and what will be the source of the income streams from such assets?	The underlying assets for Sukuks have to be ethical and Shariah compliant. None of the underlying assets should be “haram” (unlawful under Shariah) and such assets should also be put to Shariah compliant use so that the proceeds from such use are also Shariah compliant. For example, if the underlying asset is a hotel, the revenues from the hotel to service the debt payable to Sukuk holders cannot be derived from the sale of alcohol. In such instances, ring-fencing mechanisms can be used to ring fence the non Shariah compliant income stream from the Shariah compliant income streams.	Resorts, housing, manufacturing
Does the CMDA expect individual issuers to seek Shariah compliance certification from their own Shariah Scholars?	This will be important as the Sukuk issuers will require certification that their Sukuks are Shariah compliant.	Yes

APPENDIX 2

DEVELOPING A CORPORATE BOND MARKET IN THE MALDIVES - LAWS, REGULATIONS AND PLATFORM

Questions and issues to be considered by industry operatives and issuers

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Introduction

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Question	Explanation	Answer
A. <i>Identity, Asset Class and Information</i>		
1. What is your status of incorporation? Are you: <ul style="list-style-type: none"> • a limited liability company (public or private) • an incorporated partnership; or • other (please specify)? 		Corporates (limited liability)
2. What will be the nature of the underlying assets which will back the Bonds?	Please also explain the revenue streams from these assets. This will be relevant for Sukuk issues. The underlying assets for Sukuks have to be ethical and Shariah compliant. None of the underlying assets should be "haram" (unlawful under Shariah) and such assets should also be put to Shariah compliant use so that the proceeds from such use are also Shariah compliant. For example, if the underlying asset is a hotel, the revenues from the hotel to service the debt payable to Sukuk holders cannot be derived from the sale of alcohol. In such instances, ring-fencing mechanisms can be used to ring fence the non Shariah compliant income stream from the Shariah compliant income streams.	Real estate Fisheries Aviation (internal) Transportation Boat-building
3. Are you willing to grant security over these assets in favour of the Bondholders?		Yes
4. Please explain the type of Bonds you anticipate will be issued in the Maldivian market. Will they be: <ul style="list-style-type: none"> • Zero Coupon Bonds (please also see reference to Shariah-compliant); • Fixed Interest Bonds; or 	Zero Coupon Bonds make no interest payments at all. Instead, the investor buys the Bond at a deep discount to the Bond's par value and obtains the equivalent of an interest payment as the discount to par narrows over the life of the Bond. Step-up Bonds give a coupon during the initial specified period and a higher coupon in following periods.	Benchmarked, fixed or floating

Question		Explanation	Answer
	<ul style="list-style-type: none"> • Step-up Bonds with variable rates of interest 		
5.	Will you consider listing the Bonds to increase marketability?		Yes
6.	Will you issue any asset backed Bonds?	Asset backed Bonds/securities make use of a pool of loans, leases and other assets to provide the income streams out of which Bondholders are paid.	More likely to be project-specific, e.g. developing an island
7.	Will you be willing to grant full disclosure of your business activities?		Yes/not necessarily. Mixed response: (a) compulsory for listed companies (b) many companies not listed and might be reluctant to make full disclosure
8.	Will you be willing to provide details of your financial performance and market prospects?		Yes/not necessarily. Mixed response: (a) compulsory for listed companies (b) many companies not listed and might be reluctant to make full disclosure

Question	Explanation	Answer
B. Investors and Shariah Compliance		
1.	Will you consent to the Bonds being held by foreign persons?	
		Yes, subject to changes in regulatory requirements
2.	Will you prefer the Bonds to be Shariah-compliant, i.e. Sukuks?	
	The Shariah categorisation of Sukuks is that they are fundamentally asset-based securities, that represent an undivided share in the underlying assets of the issuer.	Sukuks preferred