



Government of Pakistan

Asset Light Sukuk Framework

September 2021

CONTENTS

1. Preamble.....	3
2. Purpose of this document.....	3
3. Scope of ALS Framework.....	3
4. Key roles	3
5. Pool of Assets	3
6. Shariah Compliance.....	4
7. Applicable Rules	4
8. Miscellaneous.....	4
9. Sukuk Structures.....	5
Structure A – Wakala Sukuk.....	5
Structure B – Mudaraba Sukuk	7
Structure C – Salam Sukuk	9
Structure D – Musharaka Sukuk	11
Structure E – Murabaha Sukuk	13
Structure F – Istisna’ Sukuk.....	15
Structure G – Hybrid Sukuk (Istisna’ and Ijara)	17
Structure H – Hybrid Sukuk (Musharaka and Ijara)	19

1. Preamble

The Federal Government of Pakistan (“GoP”) has set out a target of increasing the share of Sharia Compliant instrument in Government Securities to at-least 10% by end of 2022-23, in accordance with MTDS FY20-FY23¹. The GoP aims to achieve this target by issuing Asset Light Sukuk (“ALS”). ALS refers to any Shariah compliant arrangements (including Hybrid² structures) that may be used in Sukuk structuring, that do not require property or land as 100% of the underlying asset and do not contravene the rulings of the Shariah Advisory Committee of State Bank of Pakistan.

The “**ALS Framework**” provides general guidelines on raising Shariah compliant funding through a varied portfolio of underlying structures where the GoP can leverage the assets and projects in an efficient way to create a wider portfolio of sovereign Sukuk whilst being able to increase the value and regularity of issuances.

2. Purpose of this document

This document defines the key components of ALS Framework and provides an indicative list of generic Sukuk structures using a variety of Islamic financial arrangements that could be applied to future Sukuk issuances whether in the form of single Sukuk issuance or a Sukuk programme.

The document also provides high-level process flows, and potential applications and sample use cases for each structure. However, it shall be noted that the list of structures provided in this document is indicative and non-exhaustive. It does not restrict the GoP from issuing Sukuk using these or any other structure the GoP deems necessary/appropriate.

3. Scope of ALS Framework

ALS Framework is limited and applicable to the sovereign Sukuk issued by the GoP. Sukuk issued by any other government, public or private entity are not subject to ALS Framework.

4. Key roles

- a) **Originator:** The Ministry of Finance (“**MoF**”) acting as Originator of Sukuk on behalf of the Federal Government of Pakistan.
- b) **Issuance Agent:** State Bank of Pakistan (the “**Bank**”) acting on behalf of the MoF.
- c) **Committee:** Shariah Advisory Committee of the Bank approving the structure and documentation of each Sukuk or Sukuk programme issued in accordance with ALS Framework.
- d) **Issuer:** A company owned hundred per cent by the GoP (or any other company incorporated by the GoP for the purposes of issuing Sukuk) acting as the Special Purpose Vehicle (“**SPV**”) in the Sukuk issuance process and holding the Sukuk assets on fiduciary basis for and on behalf of the Sukuk holders.

5. Pool of Assets

- The MoF shall create and manage a Pool of Assets consisting of state-owned projects and assets³ that are Shariah compliant, unencumbered, suitable for use, and are made available for the Sukuk issuance process.

¹ Medium-Term Debt Management Strategy FY20–FY23

² Hybrid Sukuk combine two or more forms of Islamic financing in their structure such as Istisna’ and Ijara, Murabaha and Ijara etc. (International Islamic Financial Market)

³ Tangible (movable or fixed) assets, intangible assets, services, projects or receivables of particular projects, rights or claims as may be approved (from time to time) by the Committee.

- The MoF shall have the power to add new assets or remove an asset, amend, and update the Pool of Assets to achieve the Government's financial targets.
- The MoF shall assume the responsibility of actively managing the Pool of Assets in accordance with the framework that will be approved by the Committee.
- The MoF shall put adequate procedures in place to ensure the management of the Pool of Assets remains in compliance with the rulings of the Committee.

6. Shariah Compliance

- All ALS issuances shall be subject to approval by the Committee where a Certificate of Approval shall be provided for each Sukuk defining its tradability and Shariah audit requirements.
- The framework for the formation, management and liquidation of the Pool of Assets shall be subject to approval issued by the Committee.
- The structures included in this document and any other structures used in ALS issuance and implementation, remain strictly subject to the approval of the Committee.
- International Shariah and Governance standards⁴ shall be observed in ALS lifecycle (structuring, issuance, implementation, and redemption etc) however the Committee's interpretation, opinion, approval, and definition of Shariah requirements shall prevail.

7. Applicable Rules

The issuance of the ALS structures by the Government of Pakistan shall be as per the applicable laws and rules.

8. Miscellaneous

- The MoF shall have the discretion of deciding the maturity periods, denomination, expected returns or rates of return, early redemption etc. for the ALS issuances.
- Investors may be institutional, retail or others, domestic or international, based on the requirements and preferences of the MoF.
- The diagrams provided in this document provide a broad overview of the indicative Sukuk structures using common Shariah compliant financial arrangements. Specific and detailed components of the Sukuk structures shall be defined as and when required, subject to the approval of the Committee.

9. Sukuk Structures

Structure A – Wakala Sukuk

Definition

Wakala is an agency contract where one party or more (principal) delegates to another party (agent) the responsibility to undertake a defined action on their behalf (usually for an agreed fee/remuneration).

Investment Wakala is a form of Wakala where the subject matter of the agency is “investment of funds”.

Key conditions and particulars

- The principal must be the owner or has the right to make decisions in relation to the subject matter of the agency arrangement.
- The subject matter of the agency arrangement (e.g., actions/services/activities) should be Shariah compliant.
- The agent has a fiduciary responsibility and hence acts as trustee in executing the underlying agency activities.

Sukuk indicative application

Wakala Sukuk is structured as an investment agency arrangement where the investors⁵ (being the principals and acting through the PDSCCL) would appoint the MoF as their investment agent. The MoF may charge a Wakala fee⁶ to invest the funds in the Pool of Assets⁷ with the aim of generating an Expected Profit Rate (“EPR”)⁸ for the investors. Any profit generated by the Pool of Assets over the expected profit may be retained by the MoF as a reward for its good performance and achieving the EPR.

The MoF in its capacity as investment agent shall perform its obligations under the Wakala Sukuk dutifully and look after the interests of the investors in good faith. The MoF shall have an obligation to closely monitor the performance of the Pool of Assets and ensure that the EPR remains achievable during the Sukuk tenure. However, under a Wakala agreement, the investment agent cannot provide a guarantee to return the invested capital save for instances of negligence, gross misconduct and/or fraud of the investment agent.

At maturity, the shares of the investors in the Pool of Assets would be allocated back to the MoF and the investment amount subject to adjustments (i.e. profit/loss) will be paid to the investors (Sukuk redemption)⁹.

Tradability

Wakala Sukuk are generally tradable. However, each issuance will be subject to the tradability requirements defined by the Committee.

⁵ Under all Sukuk structures mentioned in this document, PDSCCL (or its nominee(s)) would sign the relevant Sukuk legal agreements/documents and exercise all rights and obligations on behalf of the investors (Sukuk holders)

⁶ In practice in other countries, this fee is usually nominal (e.g., US\$100)

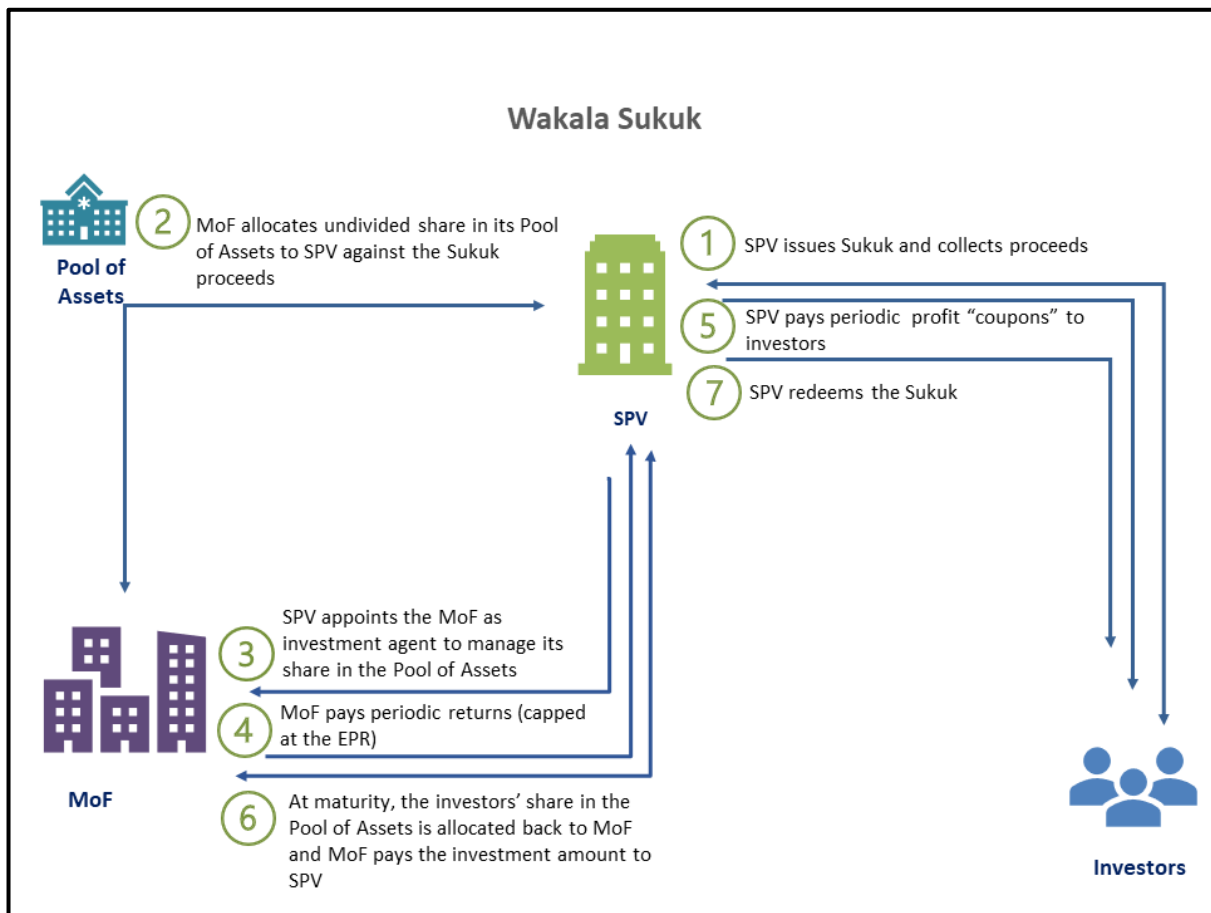
⁷ Undivided share of the Pool of Assets would be allocated to the PDSCCL against the payment of Sukuk proceeds to the MoF. The legal form of such allocation to be decided by the MoF’s legal advisers and in accordance with Shariah as per approval of the Committee

⁸ The EPR is the return expected to be generated from the investment of the Sukuk proceeds, expressed as annual percentage

⁹ Subject to the performance of the Pool of Assets and no losses being incurred

Process flow

The diagram below shows a generic process flow for a Wakala Sukuk that could be issued by the MoF.



Structure B – Mudaraba Sukuk

Definition

Mudaraba is a type of partnership arrangement where one party (managing partner) provides the work/expertise while the other partner(s) provide(s) the capital.

Key conditions and particulars

- The underlying Mudaraba project/assets should be Shariah compliant.
- The partners will share any profit generated from the Mudaraba project/assets according to an agreed profit-sharing ratio.
- Losses, if any, will be borne by the capital provider(s), except in cases of the managing partner's negligence, misconduct, wilful default, fraud, or non-compliance with the agreed Mudaraba contractual terms.
- The managing partner has a fiduciary responsibility and hence acts as trustee in managing the Mudaraba project/assets on behalf of all partners.

Sukuk indicative application

Under Mudaraba Sukuk, the MoF would be appointed as the managing partner while the investors will be the capital providers. The MoF in its capacity as the managing partner shall invest the funds in the Mudaraba project¹⁰. The MoF shall perform its obligations dutifully under the Mudaraba Sukuk and look after the interests of the investors in good faith. The MoF will also have an obligation to closely monitor the performance of the Mudaraba project and ensure that the EPR is achievable during the Sukuk tenure¹¹. However, under a Mudaraba agreement, the managing partner cannot provide a guarantee to return the invested capital, save for instances of negligence, gross misconduct and/or fraud of the managing partner.

During the Sukuk tenor, the MoF would make advance profit payments¹² to the SPV for distribution to the investors. On the maturity date, the MoF purchases the share of the investors in the Mudaraba project and pays the investment amount¹³ to the investors (Sukuk redemption)¹⁴. Any profit amount exceeding the expected profit is retained by the MoF as a reward for good performance, whilst any shortfall in the principal or between the advance profit payment and the actual profit achieved is reflected in the final pay-out.

Mudaraba Sukuk have been used in the issuance of perpetual Sukuk by some sovereign/quasi-sovereign issuers.

Tradability

¹⁰ Mudaraba Sukuk are suitable for long-term development and infrastructure projects (e.g., constructing a port, bridge, or highway). Mudaraba Sukuk may also help in BOT (Build-Operate-Transfer) projects

¹¹ The MoF may create reserves to stabilise profit payments over Sukuk tenure and cover any potential losses for the investors

¹² Advance profit payments are to be made on account assuming that the project will achieve the expected profit rate and they will be calculated and shared according to the profit-sharing ratio agreed at the outset of the agreement and they remain subject to final adjustments. In case the actual profit achieved is less than the total amount already paid as advance profit, a reverse adjustment will be required

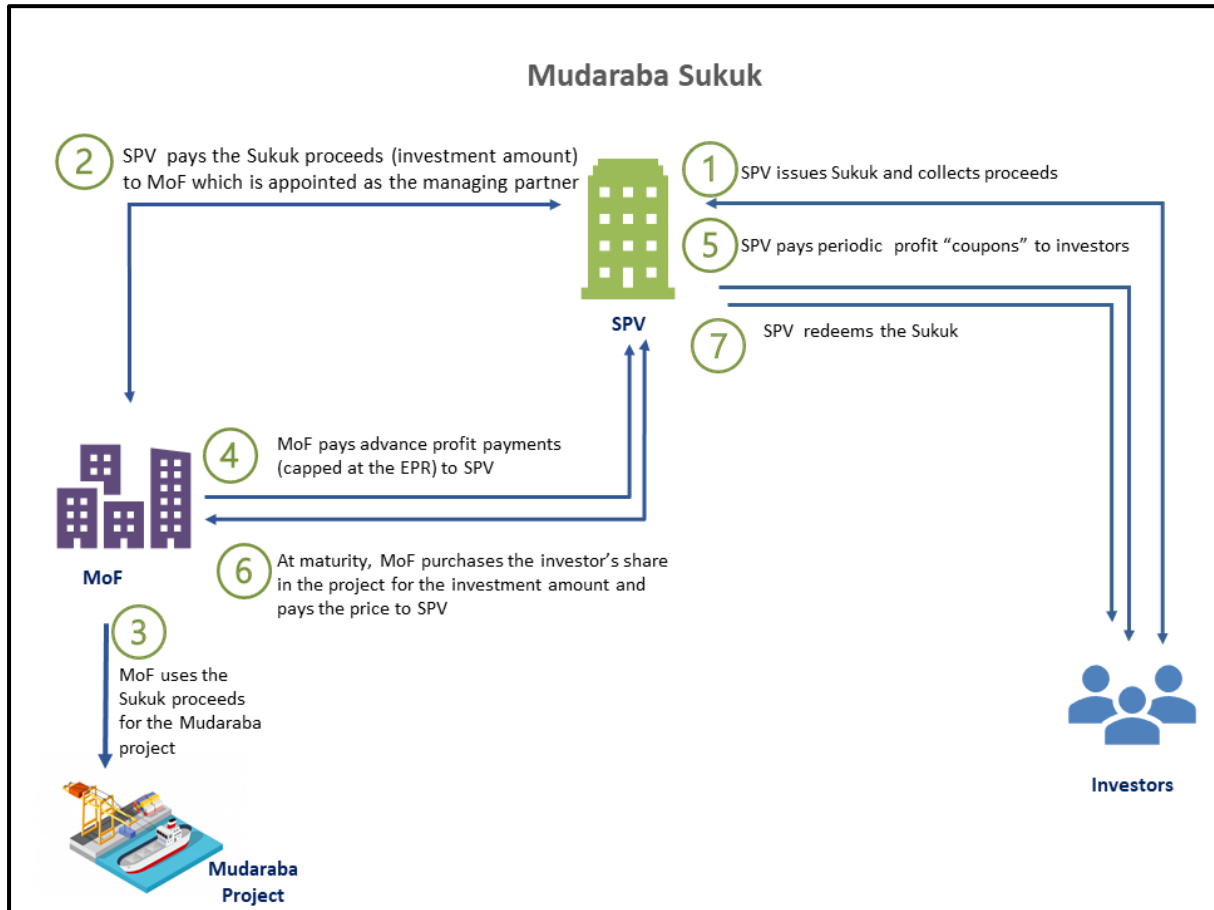
¹³ Subject to Mudaraba project performance

¹⁴ The MoF may request the assistance of other ministries/divisions/departments, and/or other institutions/contractors (depending on the nature of the Mudaraba project) to fulfil its duties as a managing partner and acquire/dispose the Mudaraba assets in a Shariah compliant manner as per the agreed requirements of the Sukuk documents

Mudaraba Sukuk are generally tradable. However, each issuance will be subject to the tradability requirements defined by the Committee.

Process flow

The diagram below shows a generic process flow for a Mudaraba Sukuk that could be issued by the MoF.



Structure C – Salam Sukuk

Definition

Salam is a sale contract involving spot payment of the full sale price and deferred delivery of the subject matter (Salam assets).

Salam is typically used in the Islamic finance industry to facilitate financing agricultural produce and production of other raw materials.

Key conditions and particulars

- Salam assets should be Shariah compliant items to be delivered in the future on an agreed date and place, measurable, replaceable, and described thoroughly to minimise the uncertainty.
- Sale price should be agreed at the outset and paid in full by the buyer upon signing the Salam contract.

Sukuk indicative application

The MoF, acting as seller, and the investors, acting as buyers, would enter a Salam arrangement. Accordingly, the investors make an immediate full payment to purchase the Salam assets on a deferred delivery basis from the MoF. The investors would also appoint the MoF as their agent to liquidate the Salam assets where the MoF undertakes to sell the same at a price that will provide the investors with the agreed profit rate. The Salam assets could be a certain volume, weight, and quality of crude oil to be delivered on a specific date.

Upon maturity of the Sukuk, the MoF delivers the Salam assets and then sells the same (as an agent of the investors) to an end buyer to liquidate the Salam assets and generate the agreed profit for the investors. The MoF may request the assistance of the related ministries/divisions/department, and/or other institutions/suppliers (depending on the nature of the Salam assets) to acquire and dispose the Salam assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documents.

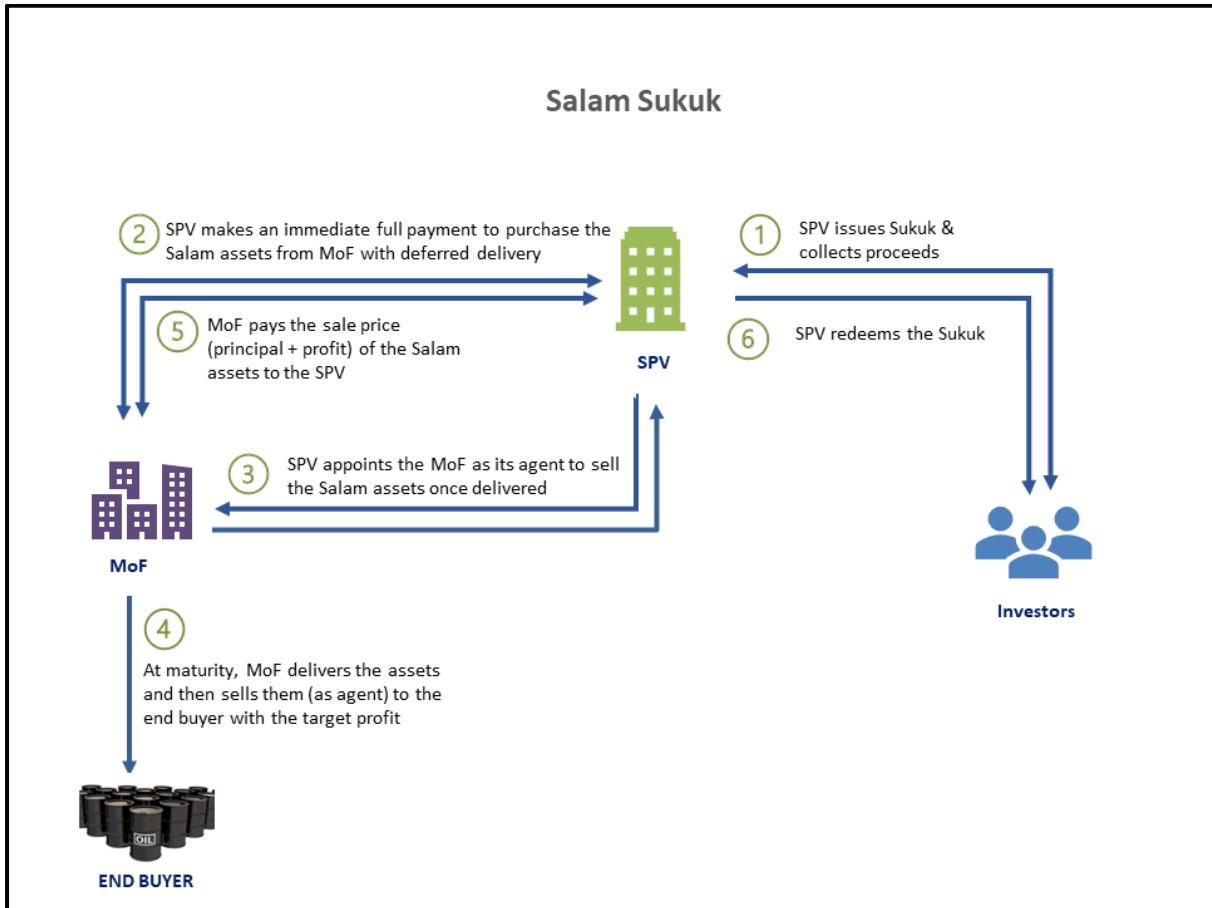
It is important to note that Salam Sukuk are comparable with short-term zero-coupon bonds where the Sukuk are sold to investors with a discount and the full face-value (principal + profit) is paid at maturity.

Tradability

Salam Sukuk are generally not tradable. However, each issuance will be subject to the tradability requirements defined by the Committee.

Process flow

The diagram below shows a generic process flow for a Salam Sukuk that could be issued by the MoF:



Structure D – Musharaka Sukuk

Definition

Musharaka is a partnership arrangement where two or more partners contribute capital to set up a project with the goal of generating profit.

Key conditions and particulars

- The underlying Musharaka project/assets should be Shariah compliant.
- Capital contributions of each partner could be provided in cash or in kind (valued at agreed market price).
- The partners can run the Musharaka project together, delegate to one partner (managing partner) the full responsibility of the business management or hire a third party to assume the responsibility of business management.
- The partners will share any generated profit from the Musharaka project/assets according to an agreed profit-sharing ratio. Advance profit payments can also be made, assuming that the Musharaka project/assets will achieve the expected profit rate and they will be calculated and shared according to the profit-sharing ratio agreed at the outset of the agreement and they remain subject to final adjustments, where any shortfall between the advance profit payment and the actual profit achieved is reflected in the final pay-out.
- Losses, if any, will be borne by all partners according to each partner's capital contribution. However, the managing partner should bear all losses incurred due to their proven negligence, misconduct, fraud, or non-compliance with the agreed Musharaka contractual terms and conditions.

Sukuk indicative application

The MoF and the investors would enter a Musharaka arrangement where the MoF is appointed as the managing partner. The investors' capital contribution would be provided in cash (Sukuk proceeds) and the MoF could provide its capital contribution in kind (e.g., land for building a solar power plant, where the land shall be valued at agreed market price).

The MoF would then use Sukuk proceeds to create the Musharaka project¹⁵ and any profit generated will be shared according to the agreed profit-sharing ratio. However, the investors' share of the Musharaka profit is typically capped at an agreed EPR, and any profit exceeding the expected profit would be retained by the MoF as a reward for achieving the EPR.

The MoF in its capacity as the managing partner shall perform its obligations under the Musharaka Sukuk and always look after the interests of the investors by acting dutifully and in good faith¹⁶. The MoF will also have an obligation to closely monitor the performance of the Musharaka project and ensure the EPR is achievable during the Sukuk tenure¹⁷. This responsibility to actively monitor the performance of the Musharaka project is a Shariah compliant capital-protection arrangement. However, under a Musharaka agreement, the managing partner cannot provide a guarantee to return the invested capital save for instances of negligence, gross misconduct and/or fraud of the managing partner.

¹⁵ Musharaka Sukuk are suitable for long-term development projects (e.g., building a solar power plant). Musharaka Sukuk may also help in BOT (Build-Operate-Transfer) projects

¹⁶ The MoF may request the assistance of the related ministries/divisions/department, and/or other institutions/contractors (depending on the nature of the Musharaka project) to fulfil their duties as a managing partner and acquire/dispose the Musharaka assets in a Shariah compliant manner as per the agreed requirements of Sukuk documents

¹⁷ The MoF may create reserves to stabilise profit payments over Sukuk tenure and cover any potential losses for the investors

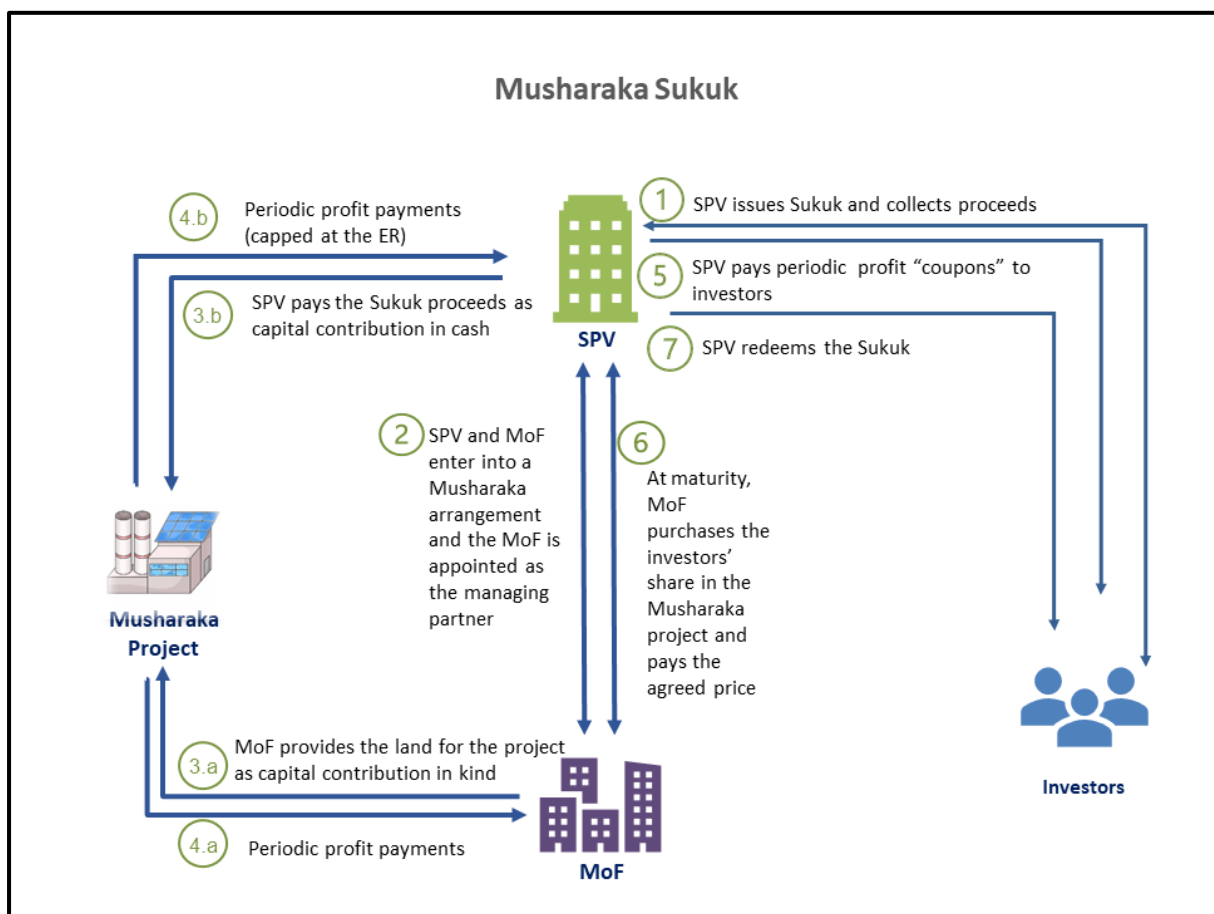
On the maturity date of the Sukuk, the investors will sell their shares in the Musharaka project and the MoF pays the market value, or any other price agreed between the parties at that time, except where the subject matter of the Musharaka project is a property (Sharikat-ul-Milk), where a pre-defined price may be agreed between the parties at the time of issuing the Sukuk.

Tradability

Musharaka Sukuk are generally tradable. However, each issuance will be subject to the tradability requirements defined by the Committee.

Process flow

The diagram below shows a generic process flow for a Musharaka Sukuk that could be issued by the MoF.



Structure E – Murabaha Sukuk

Definition

Murabaha is a sale contract where the cost of the subject matter (Murabaha assets) and the profit realised by the seller are disclosed to the buyer.

Murabaha is mostly used in the Islamic finance industry in combination with a deferred payment facility.

Key conditions and particulars

- Murabaha assets should be Shariah compliant, existent and owned (physical and/or constructive ownership) by the seller at time of sale, valuable, deliverable, described, quantified, and clearly priced.
- Cost price and profit margin should be declared to the buyer and agreed at the outset.
- The buyer becomes the owner of Murabaha assets and assumes full responsibility for them after concluding the Murabaha arrangement.

Sukuk indicative application

Under Murabaha Sukuk, the funds provided by the investors are used to purchase the Murabaha assets from a supplier upon the request of the MoF¹⁸. Subsequently, the MoF, acting as buyer, and the investors, acting as sellers, would enter a Murabaha arrangement with immediate delivery of the Murabaha assets and deferred payment for the sale price. The Murabaha assets could be a specified quantity and quality of construction materials to be allocated by the MoF to the related ministries/divisions/department in line with the government's development objectives.

The profit margin on the sale will be calculated based on the applicable profit rate. The profit rate is a rate of return set by the MoF.

The sale price of the Murabaha assets (principal + profit) is typically paid by the MoF to the investors as follows:

- Profit is paid as equal periodic Sukuk coupons.
- Principal is paid upon redemption of the Sukuk on the maturity date.

The MoF may request the assistance of the related ministries/divisions/department and/or other institutions/suppliers (depending on the nature of the Murabaha assets) to acquire and/or dispose the Murabaha assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documents.

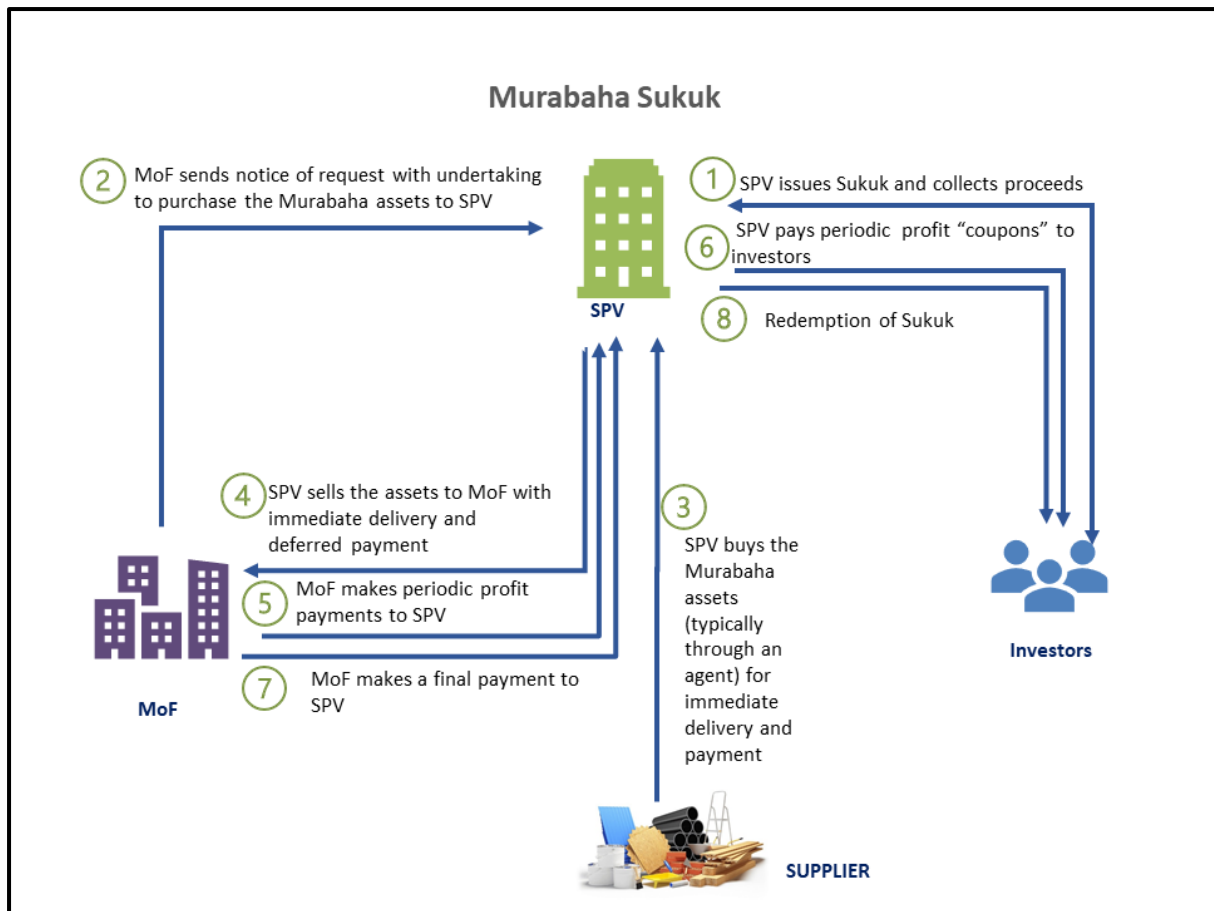
Tradability

Murabaha Sukuk are generally not tradable. However, each issuance will be subject to the tradability requirements defined by the Committee.

¹⁸ The MoF may provide a binding undertaking at the outset to purchase the Murabaha assets from the investors

Process flow

The diagram below shows a generic process flow for a Murabaha Sukuk that could be issued by the MoF.



Structure F – Istisna’ Sukuk

Definition

Istisna’ is a sale contract where the seller, based on the request of the buyer, manufactures or constructs a specific subject matter (Istisna’ assets) to be delivered on an agreed future date.

Istisna’ is typically used in the Islamic finance industry to finance manufacturing/developing assets e.g., properties, airplanes, machines etc.

Key conditions and particulars

- Istisna’ assets should be Shariah compliant and described thoroughly with all the relevant specifications to minimise the uncertainty.
- Sale price and payment terms should be agreed at the outset upon signing the Istisna’ contract (payment terms are often structured as progress payments against clearly defined development milestones for the Istisna’ assets).

Sukuk indicative application

The MoF, acting as seller¹⁹, and the investors, acting as buyers, would enter into an Istisna’ contract. During the Sukuk tenure, the funds raised under Istisna’ Sukuk would be used²⁰ to make periodic progress payments to the MoF against specific development milestones for the Istisna’ assets.

The investors would also appoint the MoF as their agent to sell or lease the Istisna’ assets, once completed. Istisna’ could be suitable for long-term development projects and the Istisna’ assets could be a school or university that would be developed according to agreed specifications and completed on a specific date.

Upon maturity of the Sukuk, the MoF delivers the developed Istisna’ assets and then sells the same (as an agent of the investors) to an end buyer and generates the agreed profit for the investors. The MoF may request the assistance of the related ministries/divisions/departments and/or other institutions/contractors (depending on the nature of the Istisna’ assets) to develop, acquire and dispose the Istisna’ assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documents.

Tradability

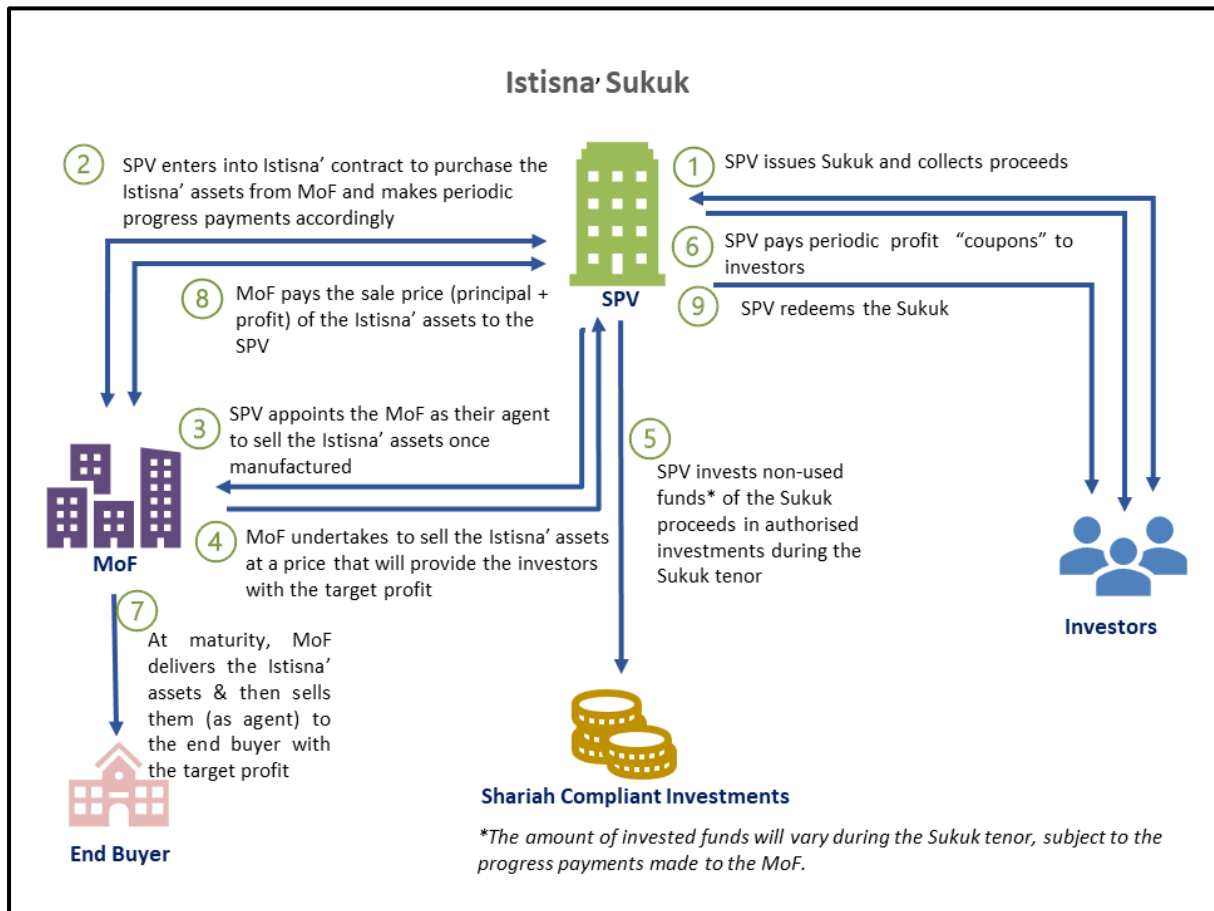
The Istisna’ Sukuk are generally not tradable however their tradability status may change depending on the level of completion of construction/manufacturing hence specific advice and approval from the Committee will be required. Each issuance will be subject to the tradability requirements defined by the Committee.

¹⁹ The MoF may appoint a contractor to do the construction in accordance with the specifications of the Istisna’ contract. However, such appointment will be independent of the Istisna’ contract and it will not relieve the MoF of its obligations under the Istisna’ contract with the investors

²⁰ Any non-used funds of the Sukuk proceeds may be placed in investments approved by the Committee to generate some returns for the investors until completing the development of the Istisna’ assets

Process flow

The diagram below shows a generic process flow for an Istisna' Sukuk that could be issued by the MoF.



Structure G – Hybrid Sukuk (Istisna’ and Ijara)

Definition

Ijara is a lease contract where the usufruct of a certain subject matter (Ijara assets) is let from the lessor to the lessee against payment of rent.

Istisna’ was defined in this document under structure F with the relevant key conditions and particulars.

Key conditions and particulars of Ijara

- The underlying Ijara assets should be Shariah compliant and used according to Shariah principles.
- The underlying Ijara assets and/or their usufruct must be owned by the lessor and remains the property of the lessor throughout the lease term.
- The rent amount and payment terms/dates must be agreed at the outset by the contracting parties²¹.
- Lessor is responsible for major maintenance of the Ijara assets while ordinary maintenance remains the lessee’s responsibility.

Sukuk indicative application

Under this hybrid Sukuk structure, the MoF and the investors would enter the following arrangements:

- Istisna’ contract²² - the investors would request the development of the agreed Istisna’ assets (to be delivered during the Sukuk tenure) and a down payment would be advanced to the MoF immediately. Further progress payments would be made to the MoF, subject to meeting the agreed development milestones for the Istisna’ assets.
- Forward Ijara contract - during the construction period, the MoF enters a forward Ijara contract with the investors to provide the investors with returns during the construction period through the payment of advance rent. Such rent can be adjusted against the first rent payment when the construction of the asset is completed. Advance rent is subject to Shariah requirements that shall be defined and approved by the Committee. Service agency arrangement - the investors would appoint the MoF as a service agent to maintain the Ijara assets during the Sukuk tenure.

Upon maturity of the Sukuk, the Ijara and service agency arrangements would be terminated and the MoF would buy the Ijara assets and accordingly pay the agreed price to the investors.

This hybrid Sukuk structure is suitable for long-term development projects. The Istisna’ assets could be a set of medical equipment that would be manufactured and delivered in batches according to certain specifications. The MoF may request the assistance of the related ministries/divisions/department or other stakeholders (depending on the nature of the underlying assets) to manufacture, acquire and dispose the assets in a Shariah compliant manner as per the agreed terms and conditions of the Sukuk documents.

²¹ Rent could be fixed during the entire lease term or variable where it can be reviewed periodically and amended according to a set of criteria to meet Shariah requirements

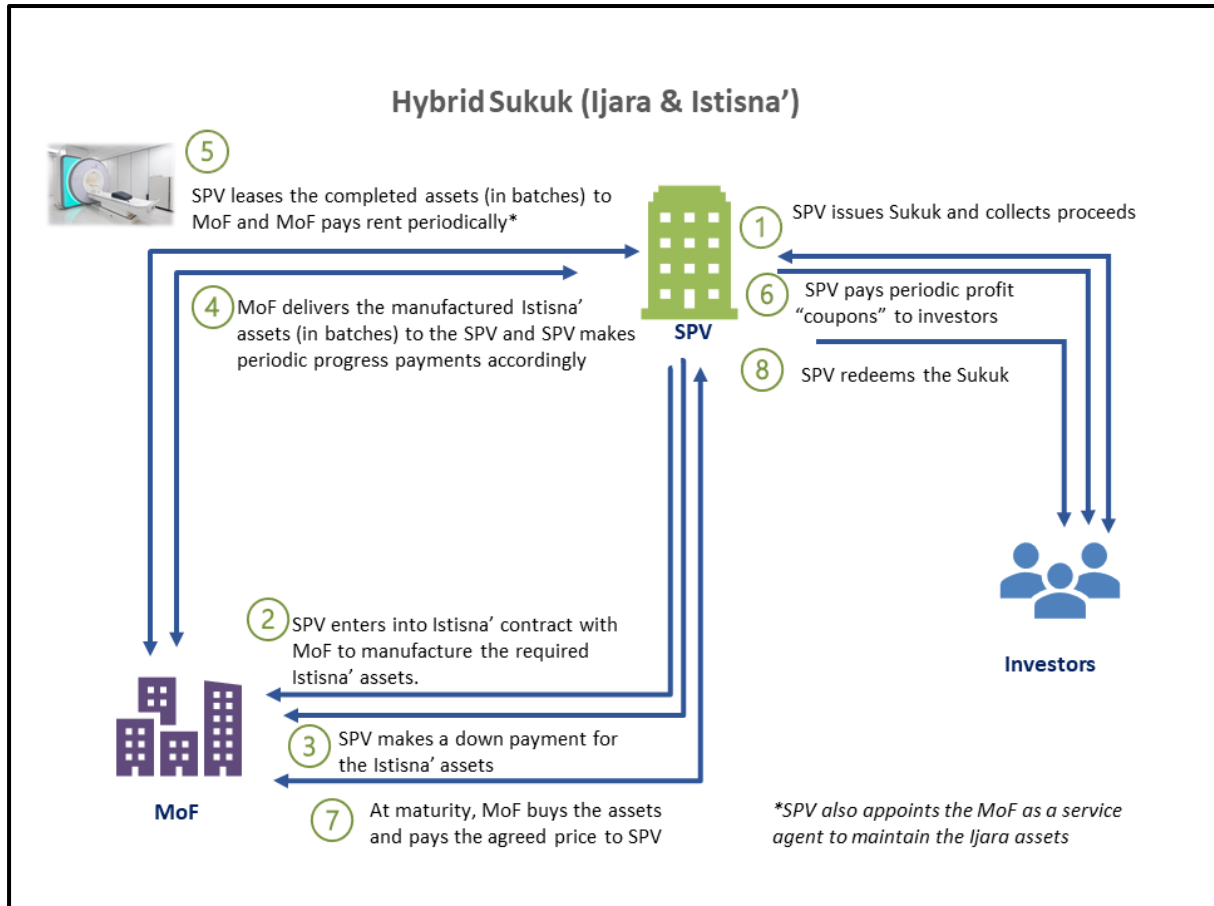
²² The MoF may appoint a third-party supplier/manufacturer to supply the Istisna’ assets in accordance with the specifications in the Istisna’ contract. However, this appointment will remain independent of the Istisna’ contract and will not relieve the MoF from its obligations under the Istisna’ contract with the investors

Tradability

This hybrid Sukuk would be generally tradable subject to the underlying assets fulfilling the specific tradability requirements defined by the Committee for each issuance.

Process flow

The diagram below shows a generic process flow of this hybrid Sukuk.



Structure H – Hybrid Sukuk (Musharaka and Ijara)

Definition

Musharaka and Ijara were defined in this document under structures D & G respectively with their relevant key conditions and particulars.

Sukuk indicative application

This hybrid structure can be used to undertake specific development projects (e.g., building hospitals, schools, universities, etc) where the MoF and the investors would enter the following contracts:

- Musharaka contract - the MoF and the investors would enter a Musharaka contract where the MoF will provide the land required for the project (contribution in kind) and the investors provide the capital (Sukuk proceeds – contribution in cash) needed to build the hospital.
- Forward Ijara contract - during the construction period, the MoF enters a forward Ijara contract with the investors to provide the investors with return during the construction period through the payment of advance rent. Such rent can be adjusted against the first rent payment when the construction of the hospital is completed. Advance rent is subject to Shariah requirements that shall be defined and approved by the Committee.
- Service agency contract - the investors would appoint the MoF as a service agent to maintain the Ijara assets during the Sukuk tenure.

Upon Sukuk maturity, the Ijara and service agency contracts would be terminated and the MoF would buy the investors' share in the project assets and accordingly pay the agreed price to the investors.

In addition to using this hybrid Sukuk structure for long-term development projects, the MoF can use this structure to fund different types of government's projects. Under this structure the risk is minimised for the investors as their income will be linked directly to the Ijara contract with no direct exposure to the performance of the project itself.

Tradability

This hybrid Sukuk would be generally tradable subject to meeting the specific tradability requirements defined by the Committee for each issuance.

Process flow

The diagram below shows a generic process flow for a hybrid Sukuk that could be issued by the MoF.

