Investing in Sukuk Negara (Indonesian Sovereign Sukuk)

What you need to know?

Sukuk Negara (Indonesian Sovereign Sukuk)

Sukuk Negara, in Indonesian Sovereign Sukuk Law terminology called SBSN, is sovereign securities based on sharia principles issued by Indonesian government either Indonesian Rupiah or foreign currencies denominated. The objective of such issuances is to issue sharia compliant securities in order to finance Indonesian State Budget. Several issues need to be clear beforehand for the investors attempting to buy Sukuk Negara such as the sukuk structure (aqad), underlying assets, the SPV, and any other things relevant toward investors’ investment decision. In response to that, the purpose of this article is to briefly explain the relevant issues needed by someone willing to invest in Sukuk Negara.

In 2008, Republic of Indonesia (RoI) started its tremendous debut in Islamic finance industry by enactment of Sovereign Sukuk Law Number 19 of 2008 (Sovereign Sukuk Law) followed by its first domestic sovereign sukuk issuance. To date, RoI has been issuing sukuk with various structures and variety of underlying assets. In issuing sukuk, RoI uses Special Purpose Vehicle (SPV), called Perusahaan Penerbit SBSN (PP SBSN), legally acting as issuer as well as trustee.

Total outstanding Sukuk Negara issuance as of May 6th, 2013 is IDR 138.14 trillion equals USD 14.35 billion with the following details:

<table>
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<tr>
<th>Domestic Sukuk</th>
<th>Amounts</th>
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<tr>
<td>IFR (Islamic Fixed Rate)</td>
<td>IDR 17.13 trillion</td>
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<tr>
<td>SR (Retail Sukuk)</td>
<td>IDR 35.92 trillion</td>
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<tr>
<td>SDHI* (Hajj Fund Sukuk)</td>
<td>IDR 35.78 trillion</td>
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<td>SPN-S (Islamic T-Bills)</td>
<td>IDR 1.82 trillion</td>
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<td>PBS (Project Based Sukuk)</td>
<td>IDR 21.97 trillion</td>
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*) non tradable sukuk

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<tr>
<th>International Sukuk</th>
<th>Amounts</th>
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<tbody>
<tr>
<td>SNI (Global Sukuk)</td>
<td>IDR 25.50 trillion</td>
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<td></td>
<td>USD 2.65 billion</td>
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Different from common practice in international market which uses one dedicated SPV for every single issuance, RoI uses single SPV named Perusahaan Penerbit SBSN Indonesia (PP SBSN Indonesia) for all its domestic issuances. Under this single SPV concept, PP SBSN Indonesia is allowed to issue multiple series and types of sukuk. Up to now, it has been issuing sukuk with various structures: ijarah sale and lease back, asset to be leased, and ijarah al-khadamat. Each structure utilizes different underlying asset for the transaction.

Figure below shows types of Sukuk Negara has been issued by PP SBSN Indonesia for the interest of Indonesian government:

- **Ijarah Sale and Leased Back**
  - regular issuances through auction and retail
  - underlying asset: state owned assets

- **Ijarah Al Khadamat**
  - issuance of Sukuk Negara on Hajj Fund
  - underlying asset: Hajj services including transportation, accommodations, and foods

- **Ijarah Asset to be Leased**
  - regular issuances through auction and retail
  - underlying assets: government projects

The role of PP SBSN Indonesia in the sukuk issuance is important in enabling specific transaction path to meet sharia principles. It is a separate legal entity and 100% owned by RoI. Therefore, it is fully controlled by the government. In issuance process, PP SBSN will act as issuer while RoI is the obligor of the sukuk. That means RoI will responsible to both coupon and principle of the sukuk.

The objective of the PP SBSN Indonesia as issuer is to issue sharia compliant securities in order to finance Indonesian State Budget in accordance the prevailing laws and regulations. To satisfy such purposes, the Issuer might issue one or more series of sharia compliant securities and enter into the transaction documents and other agreements necessary for the performance of its obligations pursuant to the issuance of such sharia compliant securities.
Despite using single SPV in its domestic issuances, no problems will appear to the investors. This is due to all obligations of the issuer is definitely guaranteed by Sovereign Sukuk Law which is stated in Article 9 Paragraph 2:

“The Government has the obligation to pay the Coupon and the Principle Value for each SBSN issued by the SBSN Issuing Company in compliance with the provisions as specified in the Akad of SBSN issuance.”

and Article 9 Paragraph 3:

“The funds for the payment of Coupon and Principle Value as specified in paragraph (2) herein shall be allocated from the State Budget every fiscal year up to the expiry of the period of such obligation.”

From those two articles, it can be concluded that even though Perusahaan Penerbit SBSN Indonesia acting as the issuer of Sukuk Negara, payment of coupon and principle value for each series of Sukuk Negara is the obligation of the government and allocated in State Budget for every fiscal year up to maturity date.

Counterparty risk is one of the most important things to be considered by investors before conducting business transaction with other party. It includes assessment on credibility and ability of the counterparty to fulfill its obligation. In this case, PP SBSN Indonesia is the counterparty of investors in the issuance of Sukuk Negara which act as issuer and trustee concurrently. Thus, understanding the credit risk of PP SBSN is extremely needed by investors.

Principally we can say that counterparty risk in this particular transaction is the sovereign risk. This is due to Investors will have the cash flows pattern similar to sovereign bond issuance. Practically, it will be only between RoI and investors. For instance in the issuance stage, when PP SBSN acts as issuer, the proceeds will be transferred directly from investors to RoI through paying agent. Similarly, in generating the coupon payment for ijarah sale and lease back structure, PP SBSN acting as trustee representing investors, will lease the trust asset back to the RoI (as lessee) and suppose to receive the lease payment periodically from the lessee. When the periodic lease fee is due, the RoI will pay the lease fee direct to the investors through paying agent as has been set in transaction documents, where PP SBSN Indonesia give full power to RoI to directly transfer to sukuk holders the lease fee on behalf of the issuer. Similar procedure applied in the redemption phase on the maturity date.