

Challenges of Sukuk Issuance in Nigeria: A Case Study of Osun State Sukuk

Muhammad Duku
Department of Islamic Studies,
Faculty of Arts, Management and Social Sciences,
Federal University Gashua,
Yobe State, Nigeria

Dr. Aliyu Dahiru Muhammad
International Institute of Islamic
Banking and Finance (IIIBF)
Bayero University Kano.
Kano, Nigeria.

Abstract:- Infrastructure challenge has been at the top of the priority of any nation. Problem of funding is the major constraint of education sector in Osun state which causes detrimental effect on the sector. The study examines the challenges faced in issuing Sukuk Ijarah in Osun State, Nigeria. The study uses qualitative method of data collection and the study use thematic analysis techniques to analyze the data collected through the use of interview. The study concludes that there is high level of challenges faced during the process of issuing and structuring of Sukuk in Osun state, the main challenges faced during the process of issuing Sukuk in Osun state are the implementation of central Shari'ah governance system, the preparation of suitable regulatory framework and the licensing processes. Therefore, the study recommends that there is highly need to have Shari'ah scholars who will satisfy the compliance of Sukuk issuance and provide legal rulings concerning a certain matter that may arise and the existing legal framework should always be complied with and improve to remain consistent with time and space.

Keywords:- Challenges, Sukuk, Issuance, Osun, Nigeria.

I. INTRODUCTION

For almost two decades *Sukuk* market is gaining popularity globally and the market is growing rapidly. Among the Islamic capital market products *Sukuk* serve as an alternative and viable tool for financing infrastructure development. Therefore, *Sukuk* emerged as an alternative financing instrument for companies and an investment asset-class, for investors as a source of funding and investment portfolio diversification purposes. *Sukuk* are back by tangible or intangible collateral and give undivided ownership of the underlying assets for an agreed period for investors. *Sukuk* is an important financing instrument unlike bank loans. Managers or companies can raise funds with favorable tenure via issuing *Sukuk* for longer term. For investors, *Sukuk* are favored as liquid and low-risk investment instrument which are flexible because they can be securitized and become tradable.

However, infrastructural problem is drawing back Africa's economic growth per capital by 2% each year, and reducing firm productivity as much as 40% (Ali, 2016). In Nigeria, for example, infrastructure in education sector

remains inadequate, which as a result the schools environment is not conducive for learning to take place and the state of arts infrastructural resources, also, remains a factor. In this regard, Osun state is one among south-western states in Nigeria created by the military administrator Gen. Sani Abatcha in 1996 and is a rural state educationally and economically disadvantaged and is a state with infrastructure deficit almost in all sectors. Thus, underfunding of infrastructure in education makes it difficult for the sectors to meet its expectation as the required infrastructural facilities for effective and efficient learning cannot be adequately provided with current trend of funding. Equally, investors in Nigeria have limited investment channels and most of their life savings they invest in the high-risk equity market or illiquid real estate markets. Institutional investors such as banks and insurance companies and government agencies greatly need to invest long-term and liquid instruments in order to meet their long-term liabilities. Hence, developing liquid and low-risk debt market will help individual and institutional investors in assets allocation and provide portfolio diversification. However the need to provide an alternative way for providing infrastructure deficit in education sector for sustainable development in the state arise.

In Africa, *Sukuk* market capacity is low, the year 2014 paved way for some African countries to tap in to the *Sukuk* market. Senegal issued its 4 year *Sukuk Ijarah* valued at US \$208 million to finance energy projects and South Africa followed by issuing US \$500 million *Sukuk Ijarah* with 5.75 years tenure in international market. Therefore, Osun state is the first sub-Sahara state to issue *Sukuk*. The Osun *Sukuk* which is up to 14.75% secure return *Sukuk Ijarah* due in 2020 funding the construction of 11 mega high schools across various local governments in the state. The issuance includes state of arts infrastructural facilities such as instructional materials, science and computer laboratories, and resourceful libraries, among others.

The overall objective of the paper is to examine or find out the challenges faced during *Sukuk* issuance in Osun state.

II. LITERATURE REVIEW

The Concept of *Sukuk*

Though, *Sukuk* structures have been in existence and utilized in Muslim societies as early as the middle-ages - where paper representing financial commitments originating from trade and other marketable activities are issued. The word "*Sukuk*" can also be traced back to traditional profitable Islamic literature used in place of certificate for goods or foodstuffs ("*Sakk al-bada'I*") as the system of paying the wages of government officers who would later exchange such certificates in line with their day-to-day consumption of such goods or foodstuffs (Amundi, 2012). The word *Sukuk* is defined by different bodies, according to the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) defines *Sukuk* as; 'Certificate of equal value representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the asset of a particular projects or special investment activity' (AAOIFI, 2004). While the Securities Commission of Malaysia (SC) briefly defines *Sukuk* as; 'A document or certificate which represents the value of an assets' (Security Commission, 2004).

An Overview of Global *Sukuk* Market

Sukuk market is a new development in Islamic financial system (Isra, 2012). According to Islamic finance information services (IFIS), cited in Islamic financial system: principles and operations, in 1990 Malaysia issued its first *Sukuk*, but since then there was no issuance by other market players or countries until 2001, where some institutions participated. The institutions including, *Majlis Ugama Islam Singapura (MUIS)* and the government of Bahrain issued *Sukuk*. Gutherie Malaysia was the first to issue global corporate *Sukuk*. In 2006 *Sukuk* issuance grew up to 145%, compared to 2005, to reach US\$27 billion, the market rose to US\$47 billion in 2007 and dropped by 55% to US\$21 billion in 2008. In 2009 the market started recovering with total issuance of US\$31 billion, higher than the issuance in 2006. In April, 2010 the issuance stood about US\$9.4 billion.

The global *Sukuk* market witnesses tangible growth, the annual *Sukuk* issuance almost tripled from US\$ 45 billion in 2011 to US\$ 118.8 billion in 2014. The growth of the markets was driven by the Malaysia, Saudi Arabian, and the United Arab Emirates (UAE) as well as emerging front line such as Turkey and Indonesia. Recently a landmark issuances were recorded from the UK, Hong Kong, Senegal, South Africa, Luxembourg states which shows that the *Sukuk* market is a viable and competitive source of funding (MWIFM, 2015).

Global *Sukuk* issuances in the first quarter of 2015 turn down to US\$18.7 billion from US\$24.2 billion in fourth quarter of 2014. Where the *Sukuk* market is intimately attached to reaction due to the down fall in the oil price and global economic and financial recession, as most *Sukuk* issuing countries are among the world's leading oil producers, and also the issue of exchange rate volatility in

emerging market is another key market driver in the first quarter of 2015 (MWIFM, 2015).

The total global *Sukuk* issuance amounted to USD\$116.7 billion in 2017. The global issuance increased from USD\$87.9 billion in 2016 to USD\$116.7 billion in 2017 an impressive increase of around 32% in volume. The increase was mainly due to sovereign *Sukuk* issuance by Saudi Arabia coupled with steady issuance from Asia, GCC, Africa, and other jurisdictions, while still Malaysia has dominated the *Sukuk* market (IIFM, 2018). Connectedly, the total global issuance reaches USD\$123.15 billion in 2018, the issuance of *Sukuk* in 2018 shows a modest increase of +5% from USD\$116.7 billion in 2017 to USD\$123.15 billion in 2018. The huge volume of *Sukuk* issuance was mainly due to sovereign *Sukuk* issuance from Africa, Asia, GCC and other jurisdictions, while still Malaysia has dominated the *Sukuk* market with other countries such as Indonesia, UAE, and to some extent from Turkey (IIFM, 2019).

The boost of the *Sukuk* market is as a result of its capability to offer long-term financing. Majority of *Sukuk* have the maturity of three to five years. In April, 2013, Saudi Electricity Company (SEC) issued the first international 30 years *Sukuk* and in April, 2014, Dubai government issued its first ever 15 years *Sukuk* (Latham and Watkins, 2016).

The Role of Nigerian Securities and Exchange Commission (SEC) on *Sukuk* Issuance

SEC plays a vital role in providing the basic requirements for *Sukuk* issuance in Nigeria, the following are the requirements (SEC, 2015):

1. Any public company (including SPV), state government, local government, government agency, multilateral agency is qualified to issue, offer or make an invitation for *Sukuk* with the consent of the SEC.
2. Any issuer of *Sukuk* must fulfill with the same registration requirements in the SEC rules and regulation that are pertinent to other conventional securities issued or offered for sale in Nigeria.
3. If the issuer is a public company and the *Sukuk* is competent of being renewed or exchanged in to equity with the intention of being listed, the issuer must also comply with the listing requirement of the relevant securities exchange in Nigeria.
4. The issuer must appoint *Shari'ah* adviser that is registered and recognized by the SEC. the *Shari'ah* adviser will be responsible for (i) advising on all aspects of the *Sukuk* issuance (including documentation and structuring), (ii) issuing *Shari'ah* certificate that outlines the basis and rationale of the structure and the *Shari'ah* principles used and (iii) ensuring that all aspect relating to *Sukuk* issuance comply with *Shari'ah* principles.
5. The SEC will recognize as a *Shari'ah* adviser any Islamic bank, a bank licensed by the CBN to operate as a non-interest bank or fund manager licensed by SEC to managed a *Shari'ah* compliant fund. *Shari'ah* principle must be observed for all *Sukuk*.

6. The principles in the *Sukuk* rules are the same general principles that support all other Islamic finance structure.
 7. Accordingly in relation to the assets that will support a *Sukuk*, such assets must comply the requirement of *Shari'ah* (for example prohibits dealings or business involving alcohol, pork or pornography) and must be established and certain.
 8. In terms of consideration to be paid by an issuer to acquire the underlying assets from the originator, the *Sukuk* rules go on in specify that the purchase price must not exceed 1.51 times the market value of the assets.
 9. All *Sukuk* must be rated and the rating made available throughout the tenure of the issue.
 10. *Sukuk* program must meet specified additional criteria, including with the respect to the disclosure materials and the tenure for the program (not to exceed two years).
 11. If approval is granted by SEC for a *Sukuk*, the approval must be implemented within three months of the date of approval, except if it is a *Sukuk* program or *Sukuk* under a shelf registration, in which case the initial issuance must be made within two years of the date of approval.
 12. All issuers must appoint a *Sukuk* trustee that is registered with SEC and the disclosure and other documents to be submitted with any application.
7. Any issue, offer or invitation of *Sukuk* by public company intended to be listed on the exchange shall be subject to the listing requirements of the NSE.
 8. Any issuer which is a foreign government, a national of any foreign country, or a company or other organization incorporated under the law of any foreign country shall appoint an agent or representative in Nigeria to be responsible for communication with NSE, on behalf of the issuer.
 9. A foreign issuer shall prepare financial statements in accordance with International Financial Reporting Standards (IFRS), but shall also provide certified English translations of such financial statements for holders of its securities that are listed on NSE.
 10. If the issuer is the SPV, the obligor shall comply with the requirements imposed on the issuer under the rules of the commission and of the NSE as if it were the issuer.

The Role of Nigerian Stock Exchange (NSE) on *Sukuk* Issuance

NSE plays a vital role in providing rules governing the listing of *Sukuk*. The following are some of the requirements that must be complied with by an issuer seeking a listing of its *Sukuk* on the official list of the Nigerian Stock Exchange (NSE);

1. An issuer of *Sukuk* must have a *Shari'ah* adviser registered with SEC who will carry the responsibilities of (a) advising on all aspect of *Sukuk* documentation and structuring, (b) issuing *Shari'ah* certification of the arrangement and method of the *Sukuk* issue, the appropriate *Shari'ah* principles used for the *Sukuk* issue and relevant *Shari'ah* matters relating to the documentation of the *Sukuk* issue, (c) ensuring that the appropriate *Shari'ah* principles and any relevant decisions and ruling certified are complied, (d) applying *Ijtihad* in all parts relating to ensure that *Sukuk* issuance are in conformity with *Shari'ah* principles, (e) must carry all function set out by SEC rules and regulations.
2. An issuer shall submit its listing application through a stockbroker.
3. The NSE shall exercise discretion over the admission and continued listing and quotation of *Sukuk* on its official list and may approve or reject the application for listing.
4. The NSE may approve applications for listing and quotation of *Sukuk* unconditionally or subject to such conditions, as it deems fit.
5. Where *Sukuk* are issued under a program, an issuer may list on NSE either all or a certain class or tranche of the *Sukuk* issued under the program.
6. No short-term *Sukuk* with maturity date of less than 1 year shall be listed.

A number of researches on *Sukuk* financing have been conducted to bridge the gap and support the system. Zein (2018), assesses the issues and challenges for developing corporate *Sukuk*: lesson from an Indonesian case study. The paper aims at mapping the issues and challenges of the development of corporate *Sukuk* in Indonesia and formulating a corporate *Sukuk* development strategy. Through the use of questionnaire and in-depth interview. Ahmet and Mehmet (2018), the study clarify secondary market of *Sukuk* and its problems and proposes some solutions to clear the hurdle of weak secondary market. Descriptive method of research was employed for the study. The study depict out that secondary market of *Sukuk* is weak because of the scarcity of *Sukuk* supply, hold-to-maturity culture, *Shari'ah* restriction, lack of standardization, inadequate trading platforms, low level of *Sukuk* rated and listed, lack of primary sales of *Sukuk* to retails investors and lack of large global Islamic banking institutions. Hosen (2016), provides insights in to the growth, contemporary issues in practice and challenges of *Sukuk* in Malaysia. Therefore, the study fin-point out some challenges such as *Shari'ah* compliance issues, prudential issues, regulatory plurality, *Shari'ah* opinions, Islamic security quality rating, liquidity of *Sukuk* instrument and public awareness of application.

Talahma (2015), proposes financing system, which combines merits of the capital system (the Anglo-American market-Based financial system) and Islamic financing system, while at the same time avoiding the flows of each. The study introduces new system based on Islamic jurisprudence of financial transactions as well as establishes principles of capital system. Therefore, the study suggested that a new financing system combining the pros of each of the capitalism system and Islamic financing system be created in order to eliminate all the potential flows and defect of each. Oladunjoye (2014), examines the potential of using *Sukuk* as a tool of capital raising and infrastructural development in Nigeria and discusses the recent *Sukuk* issuance in Nigeria by Osun state under their #60 billion debt issuance program. The study uses exploratory method to show Islamic finance as a means of financing based on the principle of Islamic law (*Shari'ah*) and has several

structures that can be used to suit various way of financing depending on the situation such as *Ijarah*, *Murabahah*, *Takaful*, *Wakalah* and so on.

Hanefah., Noguchi., & Muda (2013), the study discusses the importance of *Sukuk* as a financial instrument in a global financial markets and the study describe the difference between *Sukuk* and conventional bond and discusses the issue concerning accounting, recognition, measurement and disclosures in the financial statement. A comparative analysis between IFRSs and AAOIFI standards indicate that *Sukuk* or other Islamic financial instruments do not require separate accounting standards for recognition, measurement and disclosures. The study recommended that all IFRSs must at all-time consider the unique features of Islamic financial instruments in the development of new accounting standards. Zakaria., Isa., & Abidiu (2013), examines the effect of *Sukuk* rating as an additional risk in explaining the earning response coefficient based on a sample of 225 firms listed on the Bursa Malaysia from 2008-2011. The study tests whether *Sukuk* rating effect ERC after controlling the ERC determinant-beta, growth, earning persistence and size. The study finds that *Sukuk* rating is strongly correlated to default risk measure. Using reverse regression and the study also confirm that *Sukuk* rating is significant and negative to ERC.

III. METHODOLOGY

The study used primary source of data collection to gathered information from seven (7) respondents through interview. Based on the selected population of the study, the respondents were selected through their respected working places and they were selected based on their knowledge and experience about the issuance, also at the same time their active participation in *Sukuk* issuance in Osun state. This interview lasted for the period of three weeks that is from 28th March, - April 21st, 2016.

The administration of the interview is as follows; the interview conducted with respondents from Osun State Debt Management Office and Lotus Capital Limited was face-to-face interview individually. But for the Securities and Exchange Commission, the interview was conducted face-to-face except that the respondents were gathered in one place each respondent responding to the questions. Also assurance was made to ensure that all the information received from the respondents will be detained as confidential and for the purpose of research only and the interview was recorded and transcribed with the permission of the respondents.

The study use thematic analysis techniques to analyze the data collected through interviewed.

Data Presentation and Analysis

In an attempt to answer the research questions, different themes were identified within the framework and bringing together component of ideas or experience. Therefore, themes that are emerged formed the informant

stories together to form a comprehensive picture of their collective experience.

IV. THEME PRESENTATION AND ANALYSIS

Challenges faced by Osun State *Sukuk*

Sukuk offers a vast scope of innovation and a large potential for the growth of capital market, but at the same time development of the instrument faces some challenges. However, the issuance of *Sukuk* is regulated by the SEC through the framework provided under the guidelines on the offering of Islamic securities (guidelines). The main challenges facing *Sukuk* issuing process are the implementation of central *Shari'ah* governance system, the preparation of suitable regulatory framework and the licensing processes. It is known that for every new development there must be disadvantage likewise in process of issuing *Sukuk* in Osun state challenges has to expect. In this regard the interviewees agreed that they were faced with different challenges of (i) rules and regulations that give way for the issuance (ii) challenges of limited knowledge about the product and (iii) challenges of misconception of the people for relating *Sukuk* to religion practices. Interviewee SEC1 detailed:

"First when the application was file to the commission, virtually we have no rules, so we are face with that challenges of coming-up with the rules on Sukuk, the challenges earlier I have mention the knowledge gap is a challenge both on the operators side and regulatory side and awareness also there were no awareness in the entire market." SEC1

In relation to the challenges in the process of structuring the *Sukuk* in Osun state. One of the challenges of *Sukuk* is attributed to the nature of the *Sukuk* structure (Ali & Humayon, 2007). The challenges of *Sukuk* issues exist in the structure of the *Sukuk* must comply with *Shari'ah* or has to be *Shari'ah* compliant (Abdullahi, et al., 2014). Accordingly, the nature of Islamic financial products is derived from an interpretation of Islamic law through consensus, and analogical reasoning, creates the possibility for varying interpretations among scholars (Hidayah, 2014). One of the main challenges facing Islamic finance industry in Nigeria as depicted by LOTUS is that, there is scarcity of qualified *Shari'ah* scholars who will give approval on Islamic financial product (see appendix). Also another challenge noted by interviewees DMO1 & DMO2 that *Ijarah* as an asset-based there are requirement needed before the issuance. While SEC1 added that, they were faced with challenges of coming-up with amount to be charged as tax and challenges of amending their rules to make *Sukuk* to be part of investible instrument for Pension Funds Administrators (see appendix).

V. RESULT FROM THE FINDINGS

The result of the study shows that there is high level of challenges faced during the process of issuing *Sukuk* and structuring the *Sukuk* in Osun state, the main challenges facing *Sukuk* issuing process are the implementation of central *Shari'ah* governance system, the preparation of suitable regulatory framework and the licensing processes.

VI. CONCLUSION AND RECOMMENDATION

To conclude the findings of the study shows that there is high level of challenges faced during the process of issuing *Sukuk* and structuring the *Sukuk* in Osun state, the main challenges facing *Sukuk* issuing process are the implementation of central *Shari'ah* governance system, the preparation of suitable regulatory framework and the licensing processes.

The study also recommends that there is highly need to have *Shari'ah* scholars who will satisfy the compliance of a product and provide legal rulings concerning a certain matter that may arise and the existing legal framework should always be complied with and improve to remain consistent with time and space.

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APPENDIX

TRANSCRIPTION FOR THE INTERVIEW

Questions	Discuss Unit	Subthemes	Themes
What challenges do you encounter in the process of issuing the Sukuk?	<p>The only challenges I can speak to may be at the time we started there were no specific rules on Sukuk issuance in the SEC as we all know if you going to issue any instrument or undertaken transaction there must be rules on that. LOTUS</p> <p>Well the challenges are enormous been the first Sukuk in Nigeria and sub – Sahara Africa nobody for you to hear word Sukuk, you will ask what is the meaning of that. DMO1</p> <p>There are so many challenges and the challenges are associated with the fact that there is limited knowledge about the Sukuk product in the country. DMO2</p> <p>First when the application was file to the commission , virtually we have no rules, so we are face with that challenges of coming-up with the rules on Sukuk, the challenges earlier I have mention the knowledge gap is a challenge both on the operators side and regulatory side and awareness also there were no awareness in the entire market. SEC1</p>	<p>-no specific rules on Sukuk issuance in the SEC</p> <p>- first Sukuk in Nigeria and sub – Sahara Africa nobody for you to hear word Sukuk</p> <p>- limited knowledge about the Sukuk product</p> <p>- challenges of coming-up with the rules on Sukuk</p>	Challenges faced by Osun state <i>Sukuk</i>
People perception on Sukuk as an instrument attached to religious practice	<p>The one major challenge is the affiliation of the word Sukuk to Islam, people are thinking you want to Islamize the state, you want to make the state in to Islamic country, so is very difficult for the state to convince not even the citizens, even the potential investors about the advantages of Sukuk. DMO1</p> <p>So when we started we actually witness the challenges of misconception, once you mention Sukuk the impression is that Sukuk is a synonymous with Islamic faith. DMO2</p> <p>We have the challenges of not having shari’ah advisors, the entire market I think too you know the operators at least to have their own advisory council also total acceptance of the product you understand people see it as Islamic product. SEC1</p> <p>The only general challenges we may face now as we are looking for foreign you know investors in to buying in Sukuk, the issue of tax. So these are the issue that we need to raise to the government to look in to. SEC4</p>	<p>-want to Islamize the state</p> <p>- challenges of misconception</p> <p>- challenges of not having shari’ah advisors</p> <p>- foreign investors to buying in Sukuk</p>	
What are the challenges the agencies face in the process of Sukuk structuring in Osun state?			
Challenge come across in the process of structuring the Sukuk instrument	<p>We don’t have a scholar that will interpreted the law that is applicable to the issuance of Ijarah that was the confidential challenge, so we chose Ijarah because we want the structure that will be tradable. LOTUS</p>	<p>-Scholar that will interpreted the law.</p> <p>-challenge on Ijarah been an assets based</p> <p>- arranging the structure.</p>	

	<p>Exactly we have a challenge on Ijarah been an assets based, take for instance all the schools that we built with Sukuk we need to go round all the schools, we need to issue C of O i.e certificate of occupancy is part of the requirement from SEC for occupancy of the schools lands that we built because the structure of the Sukuk by the is not government property is for the Sukuk holders. DMO1</p> <p>In terms of you know arranging the structure, so it was a big top that time I remember even that time before we agree how to go about it, it involves as a state government, it now involve the use of structuring a special purpose vehicle company, we have to now register one company special purpose vehicle OsunSukuk plc. In terms of time taking actually we waste a lot of time before we get the structure right. While in terms of coming-up with structure getting shari’ah advisory board to even satisfy what we are going to do is in line with shari’ah. I can tell you that there is no any qualify personnel in the country to satisfy the issuance. DMO2</p> <p>So we have to look at even how are we coming with the fees that commission will charge, you understand and another challenge is looking at even the market, the agreement even that was file, the structure it has a multi-function structure I can say we have an Istisna’a aspect inside embedded in it. Another serious challenge that we face during such time was with Pension Funds Administrators Sukuk is not part of the investible instrument for Pension Funds Administrators, so we were face with that challenge. SEC1</p>	<p>-Fees charge, and looking at even the market and the agreement</p>	
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