

SUKUK RATING METHODOLOGY

Rating approach

The rating of a sukuk (debt instrument under sharia principles) will act as a measure of the instrument's creditworthiness, reflecting the ability and willingness of the sukuk issuer to meet financial obligations in a full and timely manner. When rating a sukuk, PEFINDO does not express an opinion on the transaction's compliance with sharia, and primarily focuses on credit aspects of the instrument. Rating a sukuk is the same as a company rating when the sukuk is ranked *paripassu* with other senior unsecured financial obligations of the company.

Here we apply the same approach as the conventional debt rating, by looking at the business and financial aspects, with detailing factors varying with the characteristics of the business/industry the company is in, or the asset pool it is created from. We provide the rating approach of these industries in our website. We will also put into consideration the capability and willingness of the parent company to provide extraordinary financial support when needed.

We also take note of several variations that may result in the sukuk not having the same rating as the company. For asset-backed sukuk, the rating is delinked from the issuer rating and we apply a similar rating assessment to the securitization rating, where the underlying asset pool is separated from the issuer and credit enhancement can be applied. Given the isolated asset being pledged to the sukuk, the asset claim should also be more superior than other *paripassu* lenders.

If the instrument is being structured in a way similar or takes form of securitization, we look at the strength of available credit enhancements, which come in several forms, such as guarantees (cash collateral, bank or corporate guarantee), overcollateralization (by posting more collateral or reducing proceeds), or tranching (structuring cash waterfall, with varying cash protection to different tranches). Lastly, we conclude the analysis by assessing the adequacy and robustness of structural protection and the impact of any key legal issues of the sukuk structure.

Types of sukuk

Out of many contracts/*uqood* that sukuk could have, there are three that are commonly used because of the familiarity of investors and also type of assets that are readily available and can be used by the issuers to accompany the sukuk. Those three are *mudharabah* (investor as fund provider and issuer as operator), *ijarah* (issuer as lessor that leases the rights to use of a particular asset to customer with lease income being shared to investor), and *wakalah* (the issuer acts as an investment manager on behalf of investors, and plows the issue proceeds to profit making activities).

The choice of these *uqood* will depend on the purpose of the issuance, which type of asset on issuer's balance sheet that is most suitable.

- For real sector, *ijarah* is the most used contract, since the issuer typically has a real productive asset such as communication tower, oil tanker, and so on.
- For financial institutions, *mudharabah* is the most commonly used *aqd* because the issuer provides the expertise in financing activities.
- Lately, *wakalah* scheme gained momentum because of its flexibility because it could be based by a mix of assets.

In addition to scheme or *aqd*, there are two ways to put asset in relation to sukuk. First and the most common way is as asset based sukuk, where the assets only act as the underlying of the sukuk transaction, but there is no specific structure to secure the cash flow from that particular assets as the source of repayment for the sukuk issuance.

The second way is asset-backed sukuk, similar to other securitization products where the asset is being pooled and sold to a special purpose entity, and the legal right of the cash inflow produced by that asset is transferred to the investor.

DISCLAIMER

The rating contained in this report or publication is the opinion of PT Pemeringkat Efek Indonesia (PEFINDO) given based on the rating result on the date the rating was made. The rating is a forward-looking opinion regarding the rated party's capability to meet its financial obligations fully and on time, based on assumptions made at the time of rating. The rating is not a recommendation for investors to make investment decisions (whether the decision is to buy, sell, or hold any debt securities based on or related to the rating or other investment decisions) and/or an opinion on the fairness value of debt securities and/or the value of the entity assigned a rating by PEFINDO. All the data and information needed in the rating process are obtained from the party requesting the rating, which are considered reliable in conveying the accuracy and correctness of the data and information, as well as from other sources deemed reliable. PEFINDO does not conduct audits, due diligence, or independent verifications of every information and data received and used as basis in the rating process. PEFINDO does not take any responsibility for the truth, completeness, timeliness, and accuracy of the information and data referred to. The accuracy and correctness of the information and data are fully the responsibility of the parties providing them. PEFINDO and every of its member of the Board of Directors, Commissioners, Shareholders and Employees are not responsible to any party for losses, costs and expenses suffered or that arise as a result of the use of the contents and/or information in this rating report or publication, either directly or indirectly. PEFINDO generally receives fees for its rating services from parties who request the ratings, and PEFINDO discloses its rating fees prior to the rating assignment. PEFINDO has a commitment in the form of policies and procedures to maintain objectivity, integrity, and independence in the rating process. PEFINDO also has a "Code of Conduct" to avoid conflicts of interest in the rating process. Ratings may change in the future due to events that were not anticipated at the time they were first assigned. PEFINDO has the right to withdraw ratings if the data and information received are determined to be inadequate and/or the rated company does not fulfill its obligations to PEFINDO. For ratings that received approval for publication from the rated party, PEFINDO has the right to publish the ratings and analysis in its reports or publication, and publish the results of the review of the published ratings, both periodically and specifically in case there are material facts or important events that could affect the previous ratings. Reproduction of the contents of this publication, in full or in part, requires written approval from PEFINDO. PEFINDO is not responsible for publications by other parties of contents related to the ratings given by PEFINDO.