

IICM

Certificate of Housing Loans Priority

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Preface

Development of capital market is at stake of designing new instruments as well as public acceptance. One of the most important characteristics of a vibrant capital market is its ability to introduce new ways to facilitate transactions; transactions with high levels of transparency and efficiency. In order to survive in global severe competition, Islamic Capital Markets should prove their capabilities in providing creative mechanisms to facilitate financial needs. As Islamic capital markets develop, the need for clear spheres of transactions sets to work to design new instruments. Today we see new progresses in this market all over the world

Islamic Capital Market in Iran, since its establishment, has developed increasingly during the current decade. We have designed and introduced new Islamic financial instruments to the market in order to meet domestic and foreign demands. One of our recently designed instruments is Certificate of Housing Loans Priority about which we want to discuss in this volume

Certificate of Housing Loans Priority is introduced into Iranian capital market in November 2010. The idea of designing this instrument backs to a demand in do-

mestic market. As a result of a boom in Iranian housing sector, there has been a great demand in the market for housing facilities and purchasing priority right of housing loans

Since housing and construction sector comprises some major part of households concerns, it is popular in most of economies to facilitate this sector through different policies including giving low-interest loans. However as the sources of such loans are limited, however, using some methods of rationing is inevitable. Furthermore, specialized banks have some regulations and bureaucratic processes meeting which is usually time-consuming; a reality which is not desirable for those who want to finance their housing projects. For example, in the case of Iran, using housing facilities of Maskan Bank requires to deposit a sum of money (depending to the amount of loan needed) for several months whereas a person who wants to purchase a house or is in emergent need to finance his housing project, cannot wait such a time

On the other hand, there may be some people who are qualified to use housing facilities and have the priority right to get housing loan but not actually need such facilities. These people may prefer to sell their priority right against some cash amount but they cannot find the needed person or they may not sure about the price of such right

In this situation, developing a centralized and clear sphere to perform such transactions is of high value. So, Iranian capital market officials and experts decided to design a mechanism to make these transactions possible in the Farabourse

market which is a subset of Iranian capital market

As Iranian Capital Market is a kind of Islamic market and it is necessary to meet Islamic regulations and constraints, the proposed mechanism was scrutinized by Shariah Board of Securities and Exchange Organization. During several sessions, the Board surveyed this mechanism from different jurisprudential aspects and finally approved it as compatible with Shariah. The final record of Shariah Board assessment of this instrument is in the following pages. Establishment of such mechanism in Farabourse requires a kind of securitization and standardization of housing loan priority rights. The regulatory and implementation details of this new instrument are discussed in this volume. Certificate of Housing Loans Priority, like any new instrument, initially did not welcomed by market actors and its price declined in first weeks. But as more and more people became familiar with this instrument, it became more acceptable by them and the market for this instrument experienced a moderate boom and its market size increased.

The current volume of IICM bulletin is devoted to give the readers some important and useful information about this instrument which includes its regulations and operational instructions, Shariah Board viewpoint, and some statistics and records of its operation in the market. By joining forces, all the participants in the Islamic financial industry will be able to pool their resources towards development of cooperation and promotion of this system across the globe. I hope sharing such experiments could help all of us

to have a more vibrant and efficient Islamic capital market

Dr. Ali Salehabadi

President and Chairman of the Board



Shariah Board

A Review on the Islamic Aspects of Certificates of Housing Loans Priority

- 1. Under what title the Bank gives these priority rights to the depositors?**
- 2. Under what title the certificate owner transfers them to others?**

Making sure an instrument is not Shariah incompatible, Shariah Board of Iranian Securities and Exchange Organization scrutinizes any new financial instruments from different Fiqh aspects. The Board which is consisting of some Shariah scholars as well as some finance experts approves new instruments only if they meet Shariah constraints.

Certificates of housing loans priority, as described in the minutes of Shariah Board, are given by Bank Maskan to those who invested their money in

premium account of Bank Maskan. These certificates are representatives of a priority right to use housing loan for either buying or constructing a dwelling; the loan can be in the form of credit sale or leasing according to Iranian Interest-free Banking Law. The owners of the Certificates may use the loan themselves or they may transfer it to others either freely or against something else such as money.

At first, in a special session for studying the certificates of housing loans priority, the Board asked finance experts and Bank Maskan representatives to explain about the advantages of exchanging these certificates in securities market. After that, the Board analyzed the certificates from Fiqh perspective. Two questions were asked by the Board about the certificates:

- First, under what title the Bank gives these priority rights to the depositors?
- Second, under what title the certificate owner transfers them to others?

Discussing about these issues, the Board achieved to these conclusions:

1. Giving priority right of using housing loan, in addition to profit, by Islamic Banks to the depositors through Wakalah contract is not prohibited by Shariah.

2. There is no Shariah constraint for depositors to use the loan themselves or transfer the priority right to others through either Bay', Sulh or Hibah contracts as well as against any other substitutes.

3. There is no Shariah restriction in transferring priority right through formal market in securities and exchange market

as well as informal market by a specific agreement.



Operational Mechanism of Certificates of Housing Loan Priority

As housing sector is an important part of economy and is directly related to the life of every body, investment in and facilitation of this sector is of high priority for governments. So the governments use different instruments and motivations in order to pool funds and provide them for housing sector. One of these policies in Iranian economy is to pay a specified amount of low rate housing loans to the demanders under certain circumstances. Though high levels of reception by public, these loans have some problems specially in the process of receiving them; many people who are in urgent need for financing their housing project cannot wait for several months in order to become qualified for receiving such loans. These groups may prefer to buy the priority right of housing loan from those who are currently qualified for receiving loan but not in emergent need or have no need for such loans at all. Before introducing the Certificates of Housing Loan Priority in Iranian capital market, there were high levels of price ambiguity as well as high transaction costs for finding suppliers and demanders. Designing a standard mechanism for issuing these certificates and setting the stage for their transactions in formal capital market have substantially reduced these problems and costs.

Definition

Certificates of Housing Loan Priority are securities representing a priority right of receiving housing loan in order to buy or construct a dwelling. These certificates are given to the owners of Premium Investment Accounts¹ in Bank Maskan under certain conditions. Bank Maskan², on a monthly basis, gathers information related to Premium Account balance in different branches and announces the list of eligible persons. In the next step, Treasury Bureau of Bank Maskan prepares the certificates and sends them to the eligible. The eligible may use the loan themselves or they may come to the market and sell their priority rights to others.

Secondary market for Certificates of Housing Loan Priority and their Issuance

Establishing a standard market for Certificates of Housing Loan Priority in Iranian Farabourse³ did not require

transforming the nature of these certificates but it was necessary to change operational procedures of their issuance and secondary transactions.

Before establishing “Farabourse market for these certificates, it was possible for the owners of such certificates to sell them in unofficial market and the final buyer who wanted to use housing loan himself, would go to a branch of Bank Maskan and after meeting required conditions in his housing project, he could use bank facilities.

Being exchanged in Farabourse, the Certificates of Housing Loan Priority should be deposited. So an agreement was signed between Bank Maskan and Central Securities Depository of Iran⁴ so that the process of depositing Certificates of Housing Loan Priority would be done in this company. According to this agreement, some changes have been made in operational procedures of issuance and secondary transactions of the certificates.

¹ Premium Investment Account designed by Bank Maskan for the purpose of investing in housing sector. The owner of Premium Investment Account after passing some specified time can use the Bank housing facilities as well as receiving the profit of his investment.

² Iranian Bank specialized in providing facilities for housing sector. The word “Maskan” in Persian language means “housing”.

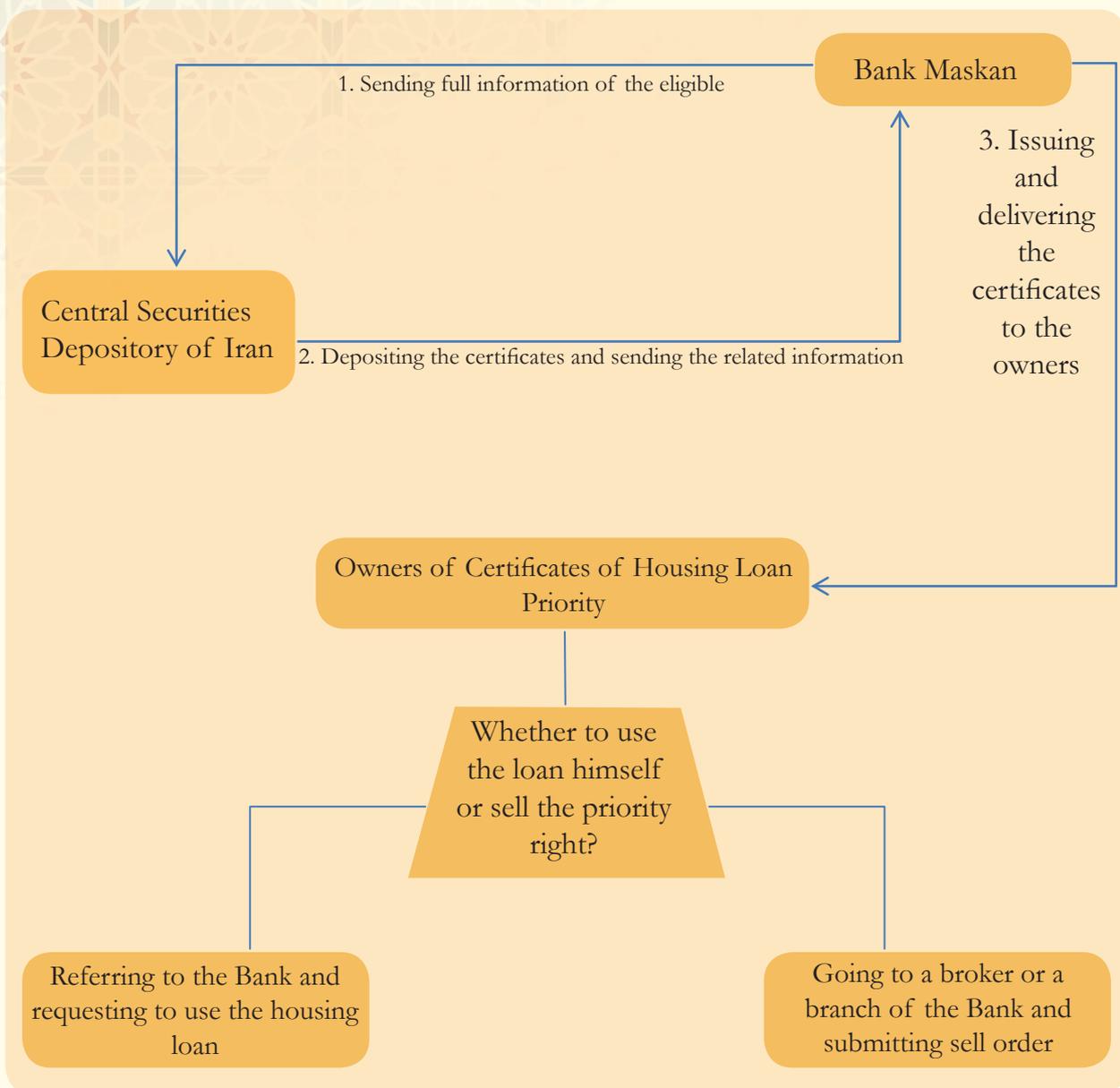
³ Since 2009, Iran has been developing an over-the-counter (OTC) market for sukuk and equities (aka Farabourse). Its shareholders include the Tehran Stock Exchange Corporation (%20), several banks, insurance companies and other financial institutions (%60), and private and institutional shareholders (%20). As of July 2011,

Farabourse has a total market capitalization of 20\$ billion and a monthly volume of 2\$ billion.

⁴ Central Securities Depository of Iran is a foundation which plays an important role in the efficiency of Securities Market through minimizing the cost of trades, risk of damage, loss, forgeries and increasing the efficiency of clearing and settlement of trades. Registration and custody of securities in a dematerialized form and transferring the ownership of securities based on DVP system are the main goals of Central Securities Depository of Iran. Accepting the role of CCP, performing corporate action economically and efficiently, finally establishing the settlement guarantee fund are also considered main goals of CSDI.

For depositing new certificates which will be issued by Bank Maskan during following months, Bank Maskan should provide full information of certificate holders for Central Securities Depository of Iran. This company will deposit the certificates based on the information provided by Bank Maskan. Then, within at most 5 working days, the company gives Bank Maskan the

related information for issuing certificate of premium account for housing loan. Each certificate represents 5 million Rials (about 400\$) housing loan and the number of certificates each person have is written on them. These certificates are indexed in first Farabourse market as “Certificates of Housing Loan Priority (month) (year)”; “Month” and “year” refer to issuance date of the certificates.



Validity period of Certificates of Housing Loan Priority is two years from their issuance date so the price of certificates may differ according to time remained to their expiration date. At the expiration date, the related index will be removed forever.

Going to any branch of Farabourse brokers, bank customers who have received their certificates can sell them. In order to do that, the customer should fill out the form of selling or buying order, just the same as selling or buying stocks. The supervisor broker is Bank Maskan by default.

According to usual procedure of stock exchange, deposit certificates will be issued for all buyers and delivered to them. The buyers can refer to any branch of Bank Maskan and receive the loan after meeting the Bank conditions for housing loan.

Donation of these certificates (for charity purposes) is possible through two-sided transaction by sending a letter form Bank Maskan to Farabourse at the end of the day. This can provide an option for those who want to transfer the certificates out of usual market pricing and formality.

According to secondary market procedure, price fluctuation limit for housing loan indices is 5 percent. In addition, the basic volume for these indices is not implemented so the certificates can experience a 5 percent price fluctuation every day.

Indices of Certificates of Housing Loan Priority can be stopped in only two situations:

1. Validity period of the index expires and the certificates lose their value.

2. by request of Bank Maskan as a result of important changes in conditions and criteria of housing loans which may have an influence in price of the certificates and after acceptance of Farabourse.

Being assured of printing and distributing among the eligible, each index of the certificates will be opened at the first day of preceding month. The initial price for the certificates will be determined by a selling and buying in the first day of transaction. The base price for reopening of the certificates in preceding months is the last price of the index in previous month considering fluctuation limit of 5 percent.

Clearing

Like stock transactions, the clearing process will be done in 3 days after transaction and through clearing and settlement system of Central Securities Depository of Iran and brokers of selling and buying. After clearing, new certificates will be issued for the buyers. The whole number of certificates one has is written on the certificates and the buyers can receive their certificates from broker companies. Sellers' funds are payable 3 days after the transaction day by brokers.

Competition and pricing conditions

The whole process of exchanging Certificates of Housing Loan Priority in Farabourse is similar to other kinds of securities: their price is determined in Farabourse transaction system based on auction method and as a result of transaction of suppliers and demanders. So the criteria for daily price are the

resultant of transaction volume and its supply and demand. According to current experiences, this is the most efficient method for price discovery of securities. Competition conditions and the method of transaction of these certificates is under the regulations of the first and second market of Farabourse so they can be exchange from Saturday to Wednesday (according to Iranian calendar). Other conditions are similar to stock transactions and clearing will be done in next 3 days.

It is necessary for the brokers to compare the prices carefully since there are 36 different indexes for these certificates which differ only in the time remaining to their maturity. So there should not be substantial differences between indices.

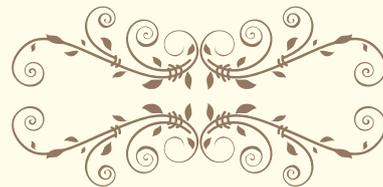
Costs and Fees

To perform Certificates of Housing Loan Priority transactions through Farabourse, there are some costs and fees that must be paid by sellers and buyers and also Bank Maskan to the brokers, Farabourse, Central Securities Depository of Iran and Securities and Exchange Organization. These costs and fees include: subscription costs, certificates depositing costs and transaction fees.

After the decision of subscription board of Farabourse for accepting these certificates in Farabourse market, Bank Maskan should pay the initial subscription costs to Farabourse Company. This payment is for all 36 indices. Based on the agreement between Bank Maskan and Central Securities Depository

of Iran, the Securities and Exchange Organization will determine the cost of depositing these certificates. Bank Maskan should pay the cost to Central Securities Depository of Iran.

In addition, there are some fees per each transaction that should be paid to Farabourse brokers, Central Securities Depository of Iran and Securities and Exchange Organization.



News

Tehran Stock Exchange at the Top of WFE Members July 2011 ,2

According to World Federation of Exchanges (WFE) report, the index of Tehran Stock Exchange stood at the top of WFE members. During May 2011-2010 Tehran Stock Exchange has experienced %79 growth while at the same time, Colombo Stock Exchange and Lima Pro with a growth of %75 and %48 respectively, stood in second and third position.

Based on this report, the current value of Tehran Stock Exchange has grown by %55 in the first half of 2011 and it has occupied the 4th rank in the world. In

addition, transaction volume of Tehran Stock Exchange in the same period with a growth of %25.4 has reached to the 10th rank of the world stock exchanges.

Recognizing Qard Sukuk as Shariah Compatible July 2011 ,8

Scrutinizing different aspects of operational issues and Shariah qualification, Shariah Board of Iranian Securities and Exchange Organization (SEO) has recognized Qard Sukuk as Shariah compatible. Qard Sukuk are issued based on interest-free Qard (lending and borrowing) contract. The issuer will be indebted the nominal value of the Sukuk to the Sukuk holders and he should repay it in the maturity.

The issuer of such Sukuk mobilizes surplus funds of benefactors and invests them in an investment project. He will repay the funds in the maturity from annual budget or by accumulating Qard installment or by issuing new Qard Sukuk. Through iterating this procedure, there is always huge amount of funds pooled from benefactors which can be devoted to the targeted groups.

First Participation of Online Traders in Capital Market July 2011 ,10

For the first time, online traders participated in the first supply of Zagros Petrochemical in Farabourse. In the present time the number of online traders in Farabourse is more than 400.

Iranian Securities and Exchange Organization aims to develop online transactions through minimizing restrictions. Currently there are four online-developer companies active in Iranian capital market and more than 70 brokers provide such services to their customers.

Iranian Oil Bourse Establishes July 2011 ,11

President of Iranian Securities and Exchange Organization declared that Iranian Oil Bourse is going to be established in four extends including physical transaction, Parallel Salam Contracts, futures contracts and options. Third phase of Iran Crude Oil Exchange has been launched and a shipment of 600,000 barrels of heavy crude oil was offered at the Kish International Trading Floor on July 2011 ,23 and was traded at USD 112.65 per barrel.

The Volume of Capital Increases is doubled Aug 2011 ,8

In the second quarter of 2011, the volume of increase in capitals has doubled with respect to the similar period of previous year. According to Iranian capital market officials, during the second period of 2011, the market has experienced more than 3.7\$ billion (46,000 billion Rials) increase in capital volume. In this **period**, four public companies raised their capital by more than 170\$ million (2,150 billion Rials). Iranian securities and

exchange Organization has submitted the permission for capital increase for 26 companies.

from 9.46\$ billion (116,000 billion Rials) to more than 15.41\$ billion (189,000 billion Rials).

Opening of Bourse Studio

Nov 2011 ,22

By cooperation of Securities and Exchange Organization, other pillars of Iranian capital market and radio network of Eqtesad (Economics), Bourse Studio started its broadcasting through Saturday till Wednesday (Iranian working days).

Covering evolutions of capital market, providing the latest news related to stock exchange and Farabourse, announcing the latest information and formal reports of companies, broadcasting the evolutions of global markets, educating public and introducing official brokers are from the most important programs of Bourse Studio.

More than %11 Growth in Capital Market Value

Nov 2011 ,28

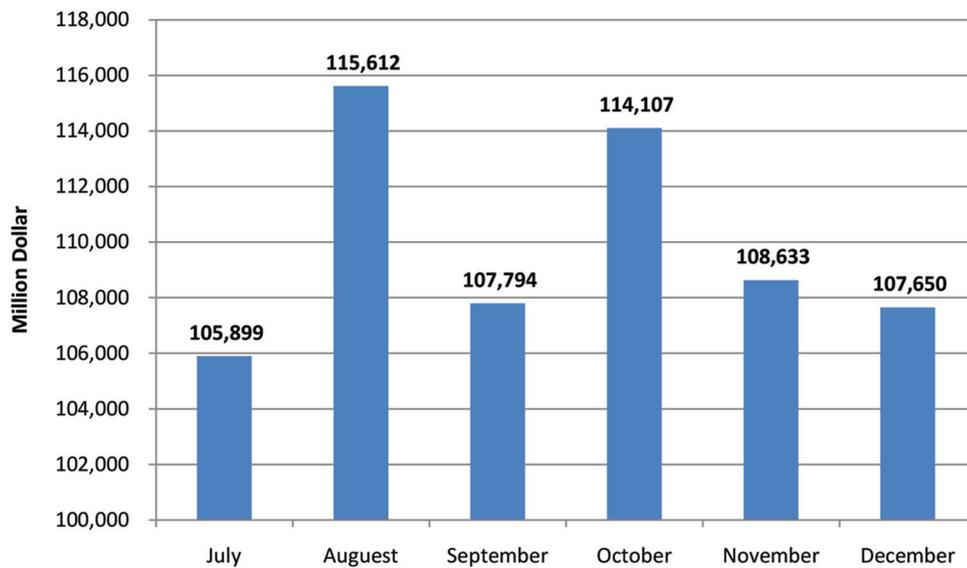
The current value of Iranian Capital Market is more than 113\$ million (1,394 billion Rials) and despite the global crisis and decline in the capital market value of different countries, the Iranian one has experienced %11.5 growth in the first three quarters of 2011.

The value of Tehran Stock Exchange in the same period with %6 growth has reached 100\$ million (1,205 billion Rials). The value of Iranian **Farabourse Market with %63 growth has reached**



Facts and Figures

Market Capitalization



Tehran Exchange Dividend and Price Index (TEDPIX)





Securities & Exchange Organization (SEO)

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