

Article Title: General Criteria: Methodology For Rating Sukuk Data: (EDITOR'S NOTE: —On Jan. 12, 2023, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.)

1. This article presents S&P; Global Ratings' methodology for assigning issue credit ratings to sukuk (trust certificates). These criteria explain how we rate sukuk with contractual commitments from their respective sponsor. The main changes in the criteria provide further transparency on the conditions under which we rate sukuk at the same level as the sponsor's rating, as well as identify more clearly cases where additional risks can affect sukuk ratings.

2. Sukuk that S&P; Global Ratings rates under these criteria provide for contractual commitments by their sponsor to make certain payments that, together with cash flow derived from the underlying assets (if any), ultimately cover the instrument's periodic distribution and principal amounts. The terms and conditions of sukuk that S&P; Global Ratings rates generally provide for early dissolution and redemption in case the cash flows from the sponsor and the underlying assets do not fully cover the periodic distribution amounts and payment of one periodic distribution amount is missed. This is funded through the undertaking of the sponsor to repurchase the underlying assets or an indemnity from the sponsor, at least equal to the sum of the accrued periodic distribution amount and the principal. S&P; Global Ratings treats the sponsor's contractual payment obligations under a sukuk transaction toward the issuing special-purpose vehicle (the special-purpose vehicle (SPV) or the issuer) as financial obligations, the failure to meet any of which leads to a 'D' or 'SD' issuer credit rating on the sponsor, indicating default or selective default.

3. These criteria are consistent with "Principles Of Credit Ratings," published on Feb. 16, 2011. When rating sukuk, S&P; Global Ratings does not express an opinion on the transaction's compliance with Sharia. Sukuk Overview Sukuk are trust certificates usually issued by a special-purpose vehicle (SPV or the issuer), the proceeds of which are, generally, on-lent to a corporate, financial institution, insurance company, sovereign, or local or regional government (the sponsor), for the purpose of raising funding according to Islamic principles. Sukuk are issued on the basis of one or more Islamic contracts (ijara, murabaha, wakala, etc.), reflecting either investment or financing contracts (see the chart below for example of sukuk structure, and for definitions of the different kinds of Islamic contracts, see "Glossary Of Islamic Finance Terms: August 2015 Update," published Aug. 10, 2015). Sukuk usually involve the transfer of an asset or a pool of underlying assets or beneficial interests in these assets to an SPV, which issues the trust certificates. Generally, the return on these underlying assets serves as a basis for the payment of periodic profit distribution to sukuk holders. To delink the sukuk's credit quality from the performance of the underlying assets, sukuk sponsors have so far typically undertaken contractual payment obligations to the sukuk issuer to provide it with the necessary funds to fulfill its financial obligations toward investors. While this is the most common approach, we have seen cases where the repayment of the sukuk is solely based on the underlying assets, therefore mimicking the characteristics of a structured or project finance transaction. We note that under some sukuk structures, the sponsor's contractual payment obligations cover only the principal and last accrued periodic distribution under an early dissolution event, but not the ongoing periodic distribution. Under this type of structure, the sukuk will pay periodic distribution amounts as long as the underlying assets generate sufficient revenues or the sponsor decides to make equivalent payments to the issuing SPV. In case of shortfall, early dissolution is typically triggered, and the sponsor is obliged to make payments to the issuing SPV that enables it to pay any accrued periodic distribution amount and repay the sukuk principal. An early dissolution could require the consent of a certain minimal share of investors, to prevent the sponsor from deliberately triggering dissolution in case it desires to refinance its sukuk.

I. SCOPE OF THE CRITERIA

4. The criteria apply globally to sukuk that directly or indirectly contractually oblige the sponsor to make payments to the issuer that ensure full and timely payments of principal and of periodic distributions (all of them, or in case of early dissolution, the last one due before that event), as we define timeliness in "S&P; Global Ratings Definitions" (see "Payment Timeliness Standards" in appendix). The sponsor can be a sovereign, a local or regional government, a corporate, a financial institution, or an insurer. The criteria do not apply to sukuk with two or more sponsors. If not ratable under these criteria, we may potentially rate sukuk according to criteria that pertain to the type of underlying assets.

II. SUMMARY OF THE CRITERIA

5. For long-term sukuk: We rate sukuk with an issue credit rating at the same level as the sponsor's senior unsecured rating, if it meets the five conditions set out in paragraph 9. We rate the sukuk at the level of

the sponsor's financial obligations with the same level of seniority in accordance with paragraph 25 when the sponsor's contractual payment obligations do not rank pari passu with its senior unsecured financial obligations, but the sukuk meet the four conditions other than condition B in paragraph 9. For sukuk that we consider short-term in their relevant market, we would apply the sponsor's short-term issuer credit rating, if it meets the same four other conditions set out in paragraph 9. For both long-term and short-term sukuk, if we assess certain risks as non-remote, we may assign an issue credit rating on the sukuk that is different from the sponsor's rating, according to paragraphs 22 or 24. 6. The issue credit rating on the sukuk--whether foreign currency or local currency--depends on the denomination of the sukuk's periodic distributions and principal, and in turn, on the sponsor's foreign or local currency ratings. We assign a 'D' or 'SD' issuer credit rating (ICR) on a sponsor if the issuer fails to pay on the sukuk's periodic distributions and principal, and the sponsor has failed to fulfill, in amount or timeliness, one of its payment obligations toward the issuer under the sukuk's terms and conditions. 7. This paragraph has been deleted. 8. This paragraph has been deleted. III. METHODOLOGY 9. We rate a long-term sukuk (for short-term sukuk, see paragraph 10), and assign it an issue credit rating at the same level as the sponsor's senior unsecured rating, if the next five conditions (A-E) are met: A.) The contractual payment obligations of the sponsor to the issuer are sufficient for full and timely periodic distributions and final payments of principal (on the scheduled dissolution date or in case of early dissolution); B.) The sponsor's contractual payment obligations rank pari passu with the sponsor's other senior unsecured financial obligations (if they do not, but the other four conditions are met, see paragraphs 10 and 25). C.) The sponsor's contractual payment obligations are irrevocable; D.) The sponsor commits to fully and unconditionally pay all foreseeable costs of the issuer including taxes and costs related to the trustee, service agent, and investment manager through the life of the transaction, in a timely way, so as not to weaken the issuer's ability to meet all payments due in a timely way; E.) We assess as remote the risks that conditions, such as those mentioned in paragraphs 16 to 20, jeopardize full and timely payments (as defined by our criteria, see paragraph 12). If we believe these risks are non-remote, we may assign an issue credit rating on the sukuk that is different from the equivalent sponsor issue credit rating according to paragraphs 22 or 24. 10. We rate the sukuk at the level of the sponsor's financial obligations with the same level of seniority in accordance with paragraph 25 when the sponsor's contractual payment obligations do not rank pari passu with its senior unsecured financial obligations, and the four other conditions in paragraph 9 are met. We then adjust downward the rating caps in paragraph 22 by the difference in notches between the junior and senior unsecured ratings. For example, a bank sponsor's subordinated sukuk would be capped at 'BBB-', not 'BBB' under paragraph 22.B.1. We generally assign short-term ratings to sukuk that we consider short-term in their relevant market, if the same four other conditions in paragraph 9 are met. We apply the sponsor's short-term issuer credit rating regardless of whether the sponsor's contractual payment obligations rank pari passu with its senior unsecured financial obligations, since we do not distinguish between senior and subordinated debt on our short-term rating scale. 11. We treat the payment obligations of a sukuk's sponsor toward the issuer as financial obligations. Thus, we assign a 'D' or 'SD' issuer credit rating (ICR) on a sponsor if the issuer fails to pay on the sukuk's periodic distributions or principal, and the sponsor has failed to fulfill, in amount or timeliness, one of its payment obligations toward the SPV under the sukuk's terms and conditions. By contrast, under the provisions of paragraph 22 the rating on the sukuk may be different from the rating on the sponsor. 12. We define timeliness with respect to payments to sukuk holders in "S&P; Global Ratings Definitions" (see "Payment Timeliness Standards" in appendix). For a long-term sukuk that has no stated grace period, or a stated grace period of one to five business days, timely payment means no later than five business days after the due date for payment. For a long-term sukuk that has a stated grace period of more than five business days, timely payment means no later than the earlier of the stated grace period or 30 calendar days. For short-term sukuk, when there is no stated grace period, we do not impute any grace period; when there is a stated grace period, timely payment means no later than the earlier of the stated grace period or five business days after the due date for payment. 13. The sukuk that are within the scope of these criteria include two types of instruments: Under the first type, the sponsor's payment obligations to the issuer mirror in timing and amount the issuer's payment obligations to the sukuk holders. Thus, payments made by the sponsor, fully and in a timely fashion, cover payments by the issuer to sukuk holders. These sukuk

instruments are generally structured using murabaha or ijara contracts, where the sponsor contractually commits to timely and sufficient murabaha or ijara charges, so that the issuer can service timely periodic distribution amounts, and the sponsor commits to buy back the assets at a price at least equal to the sukuk's principal and any accrued periodic distribution amount at maturity or upon early dissolution. 14. In the second type of sukuk within the scope of these criteria, the sponsor's contractual obligations do not cover periodic distribution amounts. Such sukuk are ratable only if, under its terms and conditions, the sukuk holders (or their delegate) have the right to demand, in case of a non-full or non-timely payment of one periodic distribution amount, early payment of the principal and any accrued periodic distribution amount from the sponsor in a timely way, as our criteria define timeliness (see paragraph 12 above). In our understanding, to date rated sukuk of this type have all paid all periodic distributions on a timely basis. We have observed in the terms and conditions of certain sukuk that early payment is subject to the request of a certain minimal share of investors. In our view, such a requirement of a minimal share of investors doesn't impact our opinion on the creditworthiness of the sukuk. 15. We rate both types of sukuk referred to in paragraphs 13 and 14 at the level of the sponsor's senior unsecured rating, subject to potential rating differentiation for conditionality (as described in paragraph 17 and the section below, "Treatment Of Total/Partial Loss Events") or subordination (as described in the section below, "Treatment Of Contractual Or Structural Subordination"). We assign a foreign or local currency rating, depending on whether the currency in which the sukuk's periodic distributions and principal are denominated in foreign or local currency, respectively. 16. If, after publication of these criteria, conditionality or other types of limitations are applied to sponsor obligations in sukuk issuance, where we rate such sukuk we expect to explain how we apply the criteria to these specific circumstances. 17. We have observed in the terms and conditions of certain sukuk one type of conditionality that in our view could lead to situations where the sponsor may perform on its contractual obligations but where the sukuk's periodic distributions or principal repayment are not full and timely. For example, we think that such conditionality could occur in case the terms and conditions require that assets be insured, if a "total loss event" (TLE) or a "partial loss event" (PLE) occur, and an insurance payment is not made or, if made, is insufficient or late. For the definition of TLE/PLE, see the "Treatment Of Total/Partial Loss Events" section. 18. The sukuk is rated at the sponsor's senior unsecured rating level for a remote risk of TLE/PLE, or if we assess the risk of less than full or non-timely payment to sukuk holders because of TLE/PLE, as remote subject to potential subordination considerations, as described in the section below, "Treatment Of Contractual Or Structural Subordination." 19. In case of actual occurrence of a TLE/PLE, if we are of the view that under the sukuk's terms and conditions, the sponsor is obliged to pay shortfalls between the insurance proceeds--if any--and principal amount and accrued periodic distribution, and if such payment is deferred as per the terms and conditions of the instrument, we evaluate such a delay under "S&P; Global Ratings Definitions" (see "Issue Credit Ratings--Cumulative Deferral On Hybrid Capital And Similar Instruments" in appendix). According to these definitions, temporary deferrals, as the terms and conditions of the instrument define them, will not lead to a 'D' issue credit rating as long as we expect repayment of such deferred amounts within one year from the original payment date. 20. Consequently, in conjunction with the occurrence of a TLE/PLE, acceleration of principal and accrued periodic distribution for sukuk whose terms and conditions require repayment of such accelerated amounts within one year or less (for example, 41 days), and when we expect such payment according to these terms, do not lead to a 'D' issue credit rating on the sukuk.

#### IV.1. Treatment Of Total/Partial Loss Events

In determining the TLE/PLE remoteness, we examine the definition of the TLE/PLE in the sukuk terms and conditions and the nature of the underlying assets. In assessing TLE/PLE remoteness, we typically use the specific definition of the TLE/PLE, the nature of the assets, as well as analytical judgement. If the TLE/PLE definition involves the physical destruction of the underlying assets, we would typically assess the risk as remote, depending on the geographical dispersion or concentration of the assets, geopolitical risks such as war, terrorism, or risk of conflict, and natural catastrophe risks, both in the jurisdiction(s) where the assets are located and within the timeframe of the transaction. If the TLE/PLE definition involves nonphysical loss, such as nationalization or confiscation risks, we would typically assess the risk as remote, unless we assess that the government demonstrates a tendency to nationalize that could directly or indirectly affect the sukuk's underlying assets within the timeframe of

the transaction. The table below includes guidance on how we assess TLE/PLE remoteness depending on the definition of the TLE/PLE and the nature of asset(s).

Assessment Of TLE/PLE Remoteness And Definition	ASSET/TLE-PLE DEFINITION	PHYSICAL TLE-PLE	NONPHYSICAL TLE-PLE	Single asset
Generally remote, unless the asset is located in a war zone, an area at risk of conflict, or a zone subject to natural catastrophe risks that could affect the underlying asset within the timeframe of the transaction	Generally remote, unless we assess that the government demonstrates a tendency to nationalize that could apply to the asset within the timeframe of the transaction	Portfolio of assets in a single jurisdiction	Generally remote, unless the assets are located in a war zone, an area at risk of conflict, or a zone subject to natural catastrophe risks that could affect the underlying assets within the timeframe of the transaction	Generally remote, unless we assess that the government demonstrates a tendency to nationalize that could apply to the assets within the timeframe of the transaction
Portfolio of assets in multiple jurisdictions	Generally remote	Generally remote	TLE--Total loss event. PLE--Partial loss event.	

Physical TLE/PLE. We generally define a physical TLE as the destruction of, or damage to the whole of, the asset(s), or any event or occurrence that renders the whole of the asset(s) permanently unfit for any economic use, and the repair or remedial work in respect of the asset(s) is wholly uneconomical. We generally define a physical PLE as the destruction of one or more of the assets in a manner that substantially deprives the issuer from the benefits expected from the whole assets. Nonphysical TLE/PLE. We generally define a nonphysical TLE as the expropriation, nationalization, requisition, confiscation, attachment, or sequestration of the asset(s). We generally define a nonphysical PLE as the expropriation, nationalization, requisition, confiscation, attachment, or sequestration of one or more of the assets in a manner that substantially deprives the issuer from the benefits expected from the whole assets.

21. If we consider a TLE/PLE occurrence to be remote, we rate the sukuk at the same level as the sponsor's senior unsecured rating (subject to paragraph 25) even if we do not believe that the sponsor is obliged to make up shortfalls between the insurance proceeds--if any--and the principal amount and the accrued periodic distribution.

22. If, when rating a sukuk for the first time, we determine that a TLE/PLE is non-remote, or if our assessment of the TLE/PLE likelihood changes after having first rated a sukuk, and the sponsor's contractual obligations do not provide for the repayment of the principal and periodic distribution to sukuk holders in case of a TLE/PLE, there are three possible outcomes (subject to paragraph 25):

- A.) The sponsor's ICR incorporates the TLE/PLE and consequently the sukuk issue credit rating is at the same level as the sponsor's senior unsecured rating;
- B.) The sponsor's ICR doesn't incorporate the TLE/PLE, and the sukuk issue credit rating is:
  - 1.) Capped at 'BBB' if we consider that the TLE/PLE is non-remote but do not expect it to happen in the next three years.
  - 2.) Capped at 'BB' or 'B', depending on the likelihood and timing of the TLE/PLE, if we believe the risk of the TLE/PLE occurring is higher than in 22.B.1. We rate the sukuk no higher than 'BB' if we believe that the TLE/PLE, while remote over the next year, could occur in the following two years. 'B' would be the highest rating consistent with an event that we believe is remote over the next year, but we believe may be non-remote in the following year.
- C.) A combination of outcomes A and B whereby, perceiving a higher risk that the events corresponding to a TLE/PLE occur, we lower the sponsor's ICR and lower even further the sukuk issue credit rating as per 22.B. The sponsor's senior unsecured rating and the sukuk issue credit rating can differ.

23. We understand that typically the sponsor can substitute some of the underlying assets under certain conditions such as a PLE. Generally in our experience the terms and conditions of sukuk require that the total value of the new assets is at least equal to the value of the substituted assets. If this leads us to assess the likelihood of a TLE/PLE as non-remote that we previously assessed as remote, we derive the sukuk issue credit rating using the approach described in paragraph 22.

24. "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," published on Oct. 1, 2012, apply and prevail over these criteria. For example, if and when a TLE/PLE occurs and we believe that a sukuk instrument is currently vulnerable to non-payment and depends on favorable business, financial, and economic conditions to meet its financial commitments, we expect to rate the sukuk 'CCC+' or lower (minus any notching applicable under the next paragraph, floored at 'C').

IV.2. Treatment Of Contractual Or Structural Subordination

25. We equalize the issue credit rating of the sukuk with the ratings that we apply to the sponsor's financial obligations with the same level of seniority. To reflect contractual or structural subordination, we apply the criteria that are relevant to the sponsor's industry (for example, bank criteria if the sponsor is a

bank) in determining the notching of the sukuk issue credit rating relative to the sponsor's senior unsecured issue credit rating or to the sponsor's issuer credit rating, and floor the sukuk rating at 'C' unless 'D' applies. V. GLOSSARY 26. Sponsor: a legal entity that is directly or indirectly contractually obliged to make certain payments to the issuer. 27. Underlying assets: assets used for the purpose of structuring the sukuk. 28. This paragraph has been deleted. VI. REVISIONS AND UPDATES This article was originally published on Jan. 19, 2015. Changes introduced after original publication: Following our periodic review completed on Jan. 18, 2017, we updated the contact information and related research and clarified the chart. Following our periodic review completed on Jan. 17, 2018, we updated the related research. On May 2, 2019, we republished this criteria article to make nonmaterial changes reflecting the publication of "Guidance: Methodology For Rating Sukuk." We moved the definition of a total loss event (TLE) from paragraph 28 to the guidance. We also removed text describing the additional factors we may consider when assessing the risks related to a TLE from paragraph 21, as these factors are now detailed in the guidance, and we removed examples from paragraphs 22.B.1 and 22.B.2. Finally, we updated the contact information and criteria references. On March 9, 2020, we republished this criteria article to make nonmaterial changes to update criteria references. On July 27, 2020, we republished this criteria article to make nonmaterial changes to clarify the definition of short-term sukuk in paragraphs 5 and 10, and to align that with our general approach to short-term ratings. On March 4, 2021, we republished this criteria article to make nonmaterial changes to update criteria references. On March 7, 2022, we republished this criteria article to make nonmaterial changes by adding new content in the "IV.1. Treatment Of Total Loss Events" section. As announced in "Evolution Of The Methodologies Framework: Introducing Sector And Industry Variables Report," published Oct. 1, 2021, we are phasing out guidance documents over time. As part of that process, we have archived "Guidance: Methodology For Rating Sukuk," published on May 2, 2019, and included its content in the "IV.1. Treatment Of Total Loss Events" section of the criteria without any substantive changes. We also added a related research and updated contacts. On Jan. 12, 2023, we republished this criteria article to make nonmaterial changes in paragraph 15, paragraphs 17-20, and the "IV.1. Treatment Of Total/Partial Loss Events" section to add the definition of "partial loss event" and treatment of PLE, which is similar to the treatment of TLE given the current definition of PLE. This nonmaterial change reflects the changes in the legal documents post the adoption of the Accounting and Auditing Organization for the Islamic Financial Institutions Standard 59. We also updated related publications. VII. RELATED PUBLICATIONS Related Criteria Hybrid Capital: Methodology And Assumptions, March 2, 2022 Methodology For National And Regional Scale Credit Ratings, June 25, 2018 Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012 Principles Of Credit Ratings, Feb. 16, 2011 Related Guidance ARCHIVE: Guidance: Methodology For Rating Sukuk, May 2, 2019 Related Research S&P; Global Ratings Definitions, Nov. 10, 2021