

Opportunities Related to Securitization and Sukuk Structure of Shariah Compliant Securitization

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Abstract: Variable annuities are in the spotlight in today's "Islamic bonds (coupons Sukuk)" market. The tax deferral feature and the absence of the investment risk for the insurer (while keeping the possibility of investment benefits) boosted their popularity. They represent the sensible way found by the "Islamic bonds (coupons Sukuk)" industry to compete with other stock market and Islamic financial intermediaries. A variable annuity is an investment wrapped with a life insurance contract. An insurer who sells variable annuities bears two different types of risk. On one hand, he deals with a financial risk on the investment. On the other hand there exists an actuarial (mortality) risk, given by the lifetime of the insured. I considered a simple market model with one riskless asset and one risky asset, whose price jumps in different proportions at some random times which correspond to the jump times of a Poisson process.

Key words: Securitization • Shariah Compliant • Shariah Compliant Securitization

INTRODUCTION

Sukuk (plural of sakk) is often referred to as "Islamic bonds (coupons)," but more accurately translate the Arabic word should be "Islamic investment certificates." The simplest explanation for the differences is that the bond - this is a debt obligation of the contract, according to which the subject, releasing them (the issuer) must pay to the holders of bonds under the contract, subject to certain specified dates, interest and capital cost. For comparison, according to the structure of the sukuk, each holder of a sukuk in the use of the undivided beneficial ownership in the underlying assets ('sukuk assets'). Consequently, the sukuk holders are entitled to participate in the revenue generated by the sukuk assets, as well as participate in the proceeds from the sale of assets of the sukuk. Legal structure and format of the certificate may be considered analogous to the sukuk trust certificates of the United States and sukuk certificates can be registered and installed at a price.

According to modern Islamic jurisprudence, investors may receive a periodic fee in the issuance of sukuk with an interest rate of Libor (London Interbank Offered Rate). Hence, indicates the price Sukuk certificates using the same installer technology prices, which is used for conventional Eurobonds [1].

At the moment, the issue of sukuk - solid structure initiators with recourse that are based on the concept of Sukuk Al Ijara.

Market trends for sukuk issues are very complex structure. As an example, you can bring Sukuk DMCC (Dubai Metals and Shopping Center) from 200 million U.S. dollars, organized in collaboration with Dubai Islamic Bank and Standard Bank. In this transaction, the holders of the sukuk could choose and receive periodic charge payable pursuant to the sukuk certificates or gold bullion.

This transaction was one of the first public offering of sukuk issued by the Middle East, built on the principles of Musharaka - a form of cooperation between the Islamic bank and its clients.

Sukuk Emirates Airlines, issued in 1995, were based on the same principles.

The structure of business operations Emirates is shown in the figure 10A. Musharaka simplest way can be described as the Islamic partnership. One party (the initiator) is contributing to the natural form (whether expert or other form of tangible asset) and the other side (investors) invest the funds required for the enterprise. Although no longer in its own name Musharaka involves some form of equity participation, in fact, the risk profile of these certificates is the same for fixed income investments.

- Emirates and issuers of sukuk certificates, Wings FZCO, joined in the Musharaka, in which, as the Emirates and the Wings had the undivided beneficial ownership of assets Musharaka (which to the date of completion of the bidding form a capital formed sukuk issuance and investment of the natural form of the relevant part of the real property Emirates [confirming letter usufruct].
- Each time after trading Musharaka assets were seized to determine all income and assets acquired by the application of Musharaka capital (ie rental income, formed by the growth of this part of the real estate).
- After starting in the Musharaka agreement, Emirates and Wings joined the agreement in detail describes the propagation of income.
- On the day of issue sukuk certificates, participation in the Emirates and Wings Musharaka is a special number of items. At the time of the transaction Emirates obliged to buy a unit with the issue, which reflects the amortization program sukuk certificates.
- Produce a list of conditions, briefly outlining the deal, describing the client, the legal structure, cash flow hedges and historic features, if present;
- Documentation of the transaction;
- Approval of the off-balance sheet accounting, this sale;
- Analysis of service;
- Assessment;
- Approval of the loan;
- Finalization of the signature;
- Marketing-to write a memorandum on the proposal and
- Completion of the transaction

Providing Asset and Liability: The basic principle of Islamic finance in the world-that's what financial arrangements should be provided assets. In the structure of a securitization of Shariah compliant, some degree of ownership of the underlying assets should be transferred to the issuer than a simple assignment cash flow allowed when conventional securitization.

From the point of view of the main reason for the introduction of Sharia Musharaka structure - is that sukuk issued certificates may be used freely in trade in the secondary market to the full development of the property and can be used in trading operations, which are not necessarily in the conventional structure of the real estate according to al istisna Ijara sukuk.

In the structures described above, the sukuk holders have a right of recourse against the founder. As financial infrastructure and education in the industry increased and mutual funds that are suitable for securitization developed (as consumer financial assets), market participants sought to structure the securitization transaction that is not secured by mortgage loans, without recourse, Shariah compliant [2].

Unlike conventional securitization markets-which can securitize all forms of accounts receivable, forward transactions and other non-business assets or all streams - Islamic securitization require high connectivity to the underlying assets and the current trading activities. This is true in part to the fact that when such transactions violate Islamic restrictions on *riba* - interest rate.

While the methods of the process are clear, the achievement of the Islamic securitization is actually similar to any conventional securitization, asset-backed:

- Give authority to the organizer and organize a team for the transaction;
- Analyze the portfolio securities; historical data, price and payment factors;

Transfer of the registered unconditional ownership of the underlying assets is not necessary, because it interferes with the securitization of assets in the Middle East. This is due to the fact that the laws of some countries in the Middle East prohibits non-residents have the right to buy or rent a certain, local domiciled assets and local economic entities issue debt securities. Transfer of the Issuer (the proponent) set of 'rights that are close to the right of possession, allowing the issuer to participate in the income generated by the underlying assets sufficient to meet the restrictions of Shariah, provided that the Shariah experts admit that the risks and rewards associated with the assets of the sukuk, assigned to the issuer of sukuk certificates. Alternatively, it may be established eligibility fatwa-a formal legal opinion based on Sharia - and indicated that the Sukuk certificates can not be included in the trade on the secondary market at a premium or a discount to their face value.

Given the Sharia mortgage securitization, unqualified fatwa, allowing sukuk certificates to the status of free participation in trade in the secondary market will be achieved only when the pool of mortgages is at least 51% of the mortgages Ijara (typical structure of Islamic mortgages) and a maximum of *istisna* 49% of mortgages (mortgage on the property, which are built). The main reason for the ban-this is something that experts in Sharia mortgages classified *istisna* receivables.

Securitization structure Shariah compliant may include techniques to improve credit, provided that the underlying assets are not overridden. Accounting first

loss, interest-free liquidity of the enterprise (although they can be structured as murabaha devices-sale of goods with the agreement arrived at higher prices-so that the financial service provider can make a profit in this business), pereobespechenie and probably perform tranche can also be included the structure of the securitization Shariah compliant. Given the fact that many issuers will try to enter the market, this area is likely to be developed.

By the end of 2005, appeared on the market a few decent system of securitization in the Islamic world, is rapidly expanding structure. Consumer financial markets, Shariah compliant (including residential mortgages), the whole region of the Cooperation Council of the Persian Gulf and Western Europe is growing rapidly. In addition, for some of the Arab countries of export-financing of oil and petrochemical securitization of receivables provide a common fund (pool) of assets for securitization. Case Study Global Oil, presented below, shows a good example of what has been said [3].

Structure, considered earlier as inappropriate Shariah, for example, deals with the future flow securitization, in this revised experts on Shariah. Usually they are rejected, as the guardians of Shariah seemed that there was a lack of certainty as to the regularity of payment and that the assets of providing these transactions were not 'real estate'. Market participants have donated time and resources trying to change the structure of ordinary transactions with the future flow securitization to conform to Sharia. If this reasoning would lead to a positive result, it will be a sector with huge growth potential-revenues tickets and toll roads may also be subject to the securitization in a manner corresponding to the Shariah.

Evaluation of Securitization, Sharia-Compliant:

Criteria: Rating agencies can not apply different rating criteria to the instrument corresponding to the Shariah. Since 2002, the rating agencies have started to introduce Sukuk analytical network. The main approach in determining the stability of the issue of securities similar to ordinary transactions, including:

- The financial position of the issuer;
- Liquidity position of the issuer or the underlying assets;
- Whether there are specific basic hedging risks;
- Whether the issuer is a financial institution, the adequacy of its capital;

- Reaction of the assets of the issuer or to the stress tests and
- Whether the portfolio of asset-backed securities: the homogeneity of the portfolio securities, measurement, characterization and reaction to stress tests.

In order to appeal to a global investor base and to ensure a variety of border services domicile investors with clear and comprehensive objectives of diversification of assets, Islamic investment banks need to employ the rating agencies. This interaction is important for long-term development of the sukuk market.

Analysis of the rating agencies should take into account the nuances of the legal regime in which the assets are placed sukuk, as well as legal precedents in some Muslim countries, such as Saudi Arabia.

Taking into account the fact that the Islamic markets are relatively new, the degree of risk assumed appearance above the average. Since sukuk, in the majority, are securities, asset-backed, it is important to use rankings in their present function as a means of analyzing credit risk. Securities backed by assets, clearly expressed in the usual market, as the maturity of bonds and the basic overall performance may vary depending on the proposals underwriters. This can cause a significant difference between the expected and the final maturity date. These precise differences also apply to Islamic associations (pools). Sukuk, in fact, provided the assets directly associated with the assets and are not just cash flow. In some cases, it may also be used by the excessive security as a risk management tool because of the re-investment of early repayment, as was the case with the Auto Leasing Hanco [4].

Rating agencies are turning to historical data relative to the action of the underlying assets. Analysis of non-payment of debt-a key element of historical analysis. The case of securitization Ijara MALTMM, described below, shows the issue of the securities received investment bankers and rating agencies in the study of new structures of Islamic assets. As the recent case of global sukuk in Qatar, the absence of special rules in some independent Islamic markets makes risk assessment difficult. Even in the case of Ijara MALTMM some investors were concerned about the structure of the SPV.

Ijara MALTMM and the case of Qatar showed problems in assessing risk: the risk of prepayment risk and reinvestment risk reassessment. At the moment, Islamic sukuk dropped in price relative to conventional

indices of profits. For example, the case of Ijara MALTTM deals with discounted deals U.S. Treasury bonds for 10 years. Qatari case-discounted Libor. In the capital markets ribavi-operation that riba is its integral part-collateralized mortgage obligations-about 25% of the total market securities, asset-backed (up to 15% in 2001). Since the Islamic alternative to conventional mortgages fell to the same indicators, there is a risk of convexity, as in securities secured by mortgages (MBS): if the market interest rate falls, the main debtors are replacing their existing obligations more attractive, putting pressure on investors, forcing replace mortgage instruments other than securities, reducing profits for proposals for the same securities, although the market as a whole may experience a period of growth in market interest rates. Lack of Islamic securities MALTTM, possibly reducing the risk for a short period of time.

Historical Information and Risk Assessment:

Study: Securitization Ijara Malttm: Taking into account the elements of the acquisition of the assets and estimates, a large amount of historical information or special association (pool) leads to a better, accurate pricing and appreciation. The lower story is an extensive network of comparable groups (pools) that affect the supply of Investment Bank Boutique (BIB) by the Bank of Michigan MALTTM.

Pool Bank of Michigan includes the average level of leverage of the portfolio securities, equal to 83%: 65% of the securities portfolio has been used for more than 80% and 35% were used less than 80%, deviating from the mean. The segment with the highest leveraged received 25% of the first loss insurance purchased by the Bank of Michigan at the General Insurer Risk (GRI). Consequently, the high use of leverage has been reduced externally introduced improvements.

U.S. mortgage market allows for minimal documentation and eliminates the approval of documents on the basis of the consumer credit score or initial payments. Pool Bank of Michigan was a pool with a complete document, means strict underwriting on each transaction with complete documentation to confirm the consumer's creditworthiness. Methods of consumer and property guarantee placement were standard and consistent technology market. The securities portfolio also documented the overall credit exposure of the Bank of Michigan for each consumer, maintaining the existing banking security of the overall availability of credit to consumers according to strict underwriting the full documentation [5].

BIB estimated pool of 93 instead of the nominal or par value of a surcharge, disputing the fact that retail prices are lower 'non-standard transactions used by SPV. Pricing BIB does not explain some of the important guarantee of risks, including the risk of growing consumer interest rates. Although none of the transactions of the Bank are not Michigan has been delayed, quite the contrary, some of the transaction is paid in advance for 6 months in advance, BIB worried that since their introduction in the U.S. banking market in 1996, no deal would not obey the Islamic world on the court.

Consequently, there was no definitive evidence that any of the Islamic mortgage alternative transaction enforceable.

Among the proposals BIB, there were two distinct issues on insurance. First, the user selected to provide accident insurance, regardless of the bank. Could the consumer actually insure the area under a homeowner? All customers of the bank have done this, but one insurance company refused to do, citing the local law and established procedures, provides for this. Therefore, it was necessary to change the portfolio securities to insure against the loss of assets. Second, the insurance from a defect of title insurance policy was the owner, some policies used by the lender and some-direct consumer endorsements. BIB objected and a portfolio of securities has been rewritten from the policy owner and the endorsement lease.

It made BIB part with worries about what the securities portfolio had a higher than average risk, thus giving the authority to set prices below the average. But BIB did not allow purchase of insurance Michigan Bank Securities from GRI for an additional 25 basis points. One reason for this decision may be unannounced choice BIB, to anticipate the first loss and retain excess cash on their own account in his favor [6].

Rating agencies are facing some difficulties in assessing the liquidity of sukuk. Most of the sukuk are held and do not participate in transactions, therefore, less risk, due to volatility of prices and pricing efficiency. Typically, the rating agencies assess the depth of the secondary market, although the sukuk market is not as intense to have a secondary trading system outside Malaysia.

Risks Associated with the Shariah: Area Supervisor risks normally associated with the issuance of securities, including accounting, regulatory risks and risks related to compliance. Risks associated with Shariah are not considered key Western rating agencies. Failure to

properly comply with local standards of Shariah may lead to the fact that the union (pool), the transaction or the legal act can be considered unresolved and therefore, it is in most part of the regulatory risk.

Kuwait: Attempts were made to structure the transaction in respect of assets sekyuritiztsiey Kuwait. Until now, the regulator made the distinction between conventional assets securitized as sanakat and quantifiable Islamic asset securitization, considered as sukuk. The former have specific rules, but the latter were by mid-2005, the subject of yet unfinished rule-making in the Central Bank of Kuwait. Privately placed sukuk issuance admitted with severe restrictions in anticipation of a formal rule sukuk. There is great potential in this market and the possibility that some of the first securitization transaction, which will be in Kuwait to be associated with either commercial property or contracts auto financing [7].

Qatar: Qatar has undergone tremendous growth in the financial sector of the Islamic world and a large number of Islamic capital was directed to Qatar. Most of these funds have been invested in the project financial transactions, Shariah compliant (mainly in the oil and gas sector). Financing contemplated, both Islamic and conventional banks to support these transactions will likely require re-financing (these deals because of its sheer size is a significant factor in depleting bank liquidity) of re-financing through securitization with the Shariah [8].

Indonesia: Islamic finance is only taken root in this market and the first international transaction with Islamic financing was structured in 2005 to Pertamina ((Pertamina) state oil and gas company). Judging by the rapid development of the Islamic consumer finance industry (in particular, auto financing and micro-financing) in Indonesia, the great natural resources that exist in Indonesia in the near future, there is a possibility of the securitization with the Shariah of one of these two asset classes.

Malaysia: Probably the most active market for Islamic finance in the world - Malaysia. Malaysian Islamic bankers have spent considerable resources developing the Islamic capital markets. In 2005, Time Engineering Bhd. released a five-year tranche of 556 million RM (150 million dollars) from sekyuritizatsiney according to Shariah. This proposal was considered in accordance with the present securitization Malay government and supported

by payments coming from the founder of the Malay government under contracts for the supply of training equipment and training in the schools of the state. In addition, GAMAGAS (secondary mortgage company, controlled by the Malay government) has launched a securitization of mortgages, Shariah compliant, organized by HSBC Amanah. These transactions are not isolated and are part of a sound plan for expanding the boundaries of Islamic financing transactions within the local and regional markets.

In the early stages of development of Islamic capital markets assumed that certain Islamic financing techniques allowed by the Malay Shariah experts, will be acceptable guardians of Shariah in the Middle East (Islamic jurisprudence is divided into four main schools of thought and those that prevail in the Middle East are different from those as in Malaysia). However, lately there has been a consensus between experts of Shariah in Malaysia and the Middle East on certain concepts, such as Ijara, which, in particular, refers to the future development of the Islamic capital markets. There is hope that the growth of the Malay securitization market, Shariah compliant, will be a catalyst for the development of the Middle East market.

Continental Europe, United Kingdom and United States:

There is no reason why the Islamic securitization can be structured using the assets in non-Islamic countries. In fact, the attention of investors and ordinary Islamic investment bank focused on such jurisdictions-particularly in the area of commercial real estate. If underlying lease agreements / arrangements for transactions structured in accordance with Shariah (doing this should not, in general, diverge from the usual practice of such operations), the securitization in accordance with the Sharia can be structured in such assets with less difficulty. For example, in 2004 the organization Freddie Mac (Freddie Mac), mortgage financier, regulated by the U.S. government provided the securitization of certificates in the amount of U.S. \$ 200 million for housing transactions, using the declining balance method of collaboration. Judging by the proximity of Middle Eastern investors in relation to the European and American real estate, it is probable that there will be a significant demand for such securities. Given the overall demand for sukuk certificates, there is the possibility that these documents can provide a more competitive cost of funding than similar conventional documents. We can say with confidence that this area will grow in the near future. [9].

Kazakhstan: Development Bank of Kazakhstan (DBK) plans to debut issue Islamic bonds Sukuk "al-Murabaha". The estimated amount of emissions-up to \$ 500 million, with the amount of the first issue will be about \$ 200-300 million will mature-at least five years, the bonds are positioned as a mid-term. The decision made by the Board of Directors of DBK March 14, 2012. The securities will be a medium-term Islamic bonds issued in accordance with the laws of Malaysia. The organizers of the debut issue of Islamic bonds Sukuk "al-Murabaha" DBK has appointed HSBC Bank Malaysia Berhad, The Royal Bank of Scotland Berhad and JSC «Halyk Finance».

As reported in the media, now DBK together with its consultants addressed to the regulatory authorities of Kazakhstan in order to determine the order and organization of production and placement of bonds Sukuk "al-Murabaha". Meanwhile sukuk has a number of distinctive features of ordinary securities, primarily is that the income from them is not fixed. In fact Sukuk is a loan for a specific project in the real economy, that is most close to direct investments. It's not the money lent for resale commitments at a better price. De facto, investors purchasing sukuk, become co-owners of a business and get profit from this project and not the interest on the debt, as in the usual case.

In the opinion of the experts, this type of borrowing in the market as sukuk bonds, has its advantages. "The appearance of this type of bond in the Kazakh market" certainly extend tool for investors ", - said analysts of JSC" BTA Securities ". In addition, the legal framework for Islamic finance has been actively developed and supplemented. However, the question as to whether these papers are interesting to domestic institutional investors, remains open. "Judging by the fact that these papers are located on the Malaysian and Kazakh markets, we can assume that the profitability of these medium-term securities can be compared with the yield of the domestic medium-term government securities-in the range of 4 to 6.5%,"-experts say.

RESULT

The importance of the first transaction has increased threefold. First of all, LIB demonstrated the depth of corporate financial skills and the ability to rationalize in order to satisfy the basic requirements of a multinational corporation. Second, although it is expected that the Bank Negara stimulated Global Oil bargain deal, Global Oil did so with enthusiasm, every time showing his support.

Ultimately, the deal with the application of the modern approach to the classic Islamic methods succeeded in simple modern corporate finance transaction, creating a commercial security. As a result, the deal has set stage for Islamic institutions to expand their clientele and the role of the market. Chairman of the Malaysian branch of Global Oil said: "Securitization fees according to Islamic agreement of purchase and sale does Islamic finance exciting and viable alternative to other methods for increasing capital investment." The wide network of Malaysian finance 'Islamic duty' dropped on the basis of the original transaction by 'bisaman adhil [10].

Sukuk related to the ever increasing amount of the assets, based in the United Kingdom, Continental Europe and the United States are structured in the present tense, as Islamic investors are willing to invest securities with specified risk profiles, given its portfolio of securities. In addition, the non-Islamic issuers are trying to take advantage of the increased liquidity, which, in the present case in the Islamic world. A striking example of this trend was demonstrated when the German Federal Government of Sachsen-Anhalt, sukuk issued in \$ 100 million in 2004. Regional Finance Minister said that the main reason for issue of the document corresponding to the Shariah had two sides:

On the one hand there are economic reasons. There are investors and provide a sense of their merchandise. On the other hand, it is an element of international etiquette. We want to send a message to a respectful attitude towards other cultures that have different rules of investing.

Geography investors, according to the sukuk certificates, is a vast network of non-Islamic investors are increasingly involved in the production of such documents. For example, the issue of sukuk in 2005, 48% of the issue was for ordinary investors, 11% of which were fund managers, 24%-institutional investors and 13%-by central banks and government institutions. It seems that the credit risk in the Middle East has become more attractive to European investors.

The greatest challenges for Islamic securitization markets is limited opportunities legislation, the limitations of a foreign owner to own the assets and businesses, limited opportunities to infrastructure, such as SPV and permitted by the Trust Deed and the methods for its formation or its transfer to foreign representatives. As for the standard securitizations, the homogeneity of assets and stable cash flows make them the most successful emissions.

For the banks, if the local law allows it, securitization is always a must, impelled by the regulatory body. 8% of the costs to the private sector, according to the system of Basel I, induces banks to write off high-quality assets from its balance sheet, a form of arbitrage through securitization. This leaves the banks with lower-quality assets and without the main reasons for re-evaluation of the operating complexity. What has been said is always true, no matter with what the bank to transact with the Islamic or conventional. Basel I rule this universal element, but does not reduce the tendency to convert assets into cash equivalent and spread risk due to securitization [11].

The legal and regulatory aspects of securitization, Shariah compliant capital markets experienced on the allocation of the credit risk of the assets of the credit risk of the issuer raises the question of the true sale. Question of the true sale - subject specific guarantees that, when violations are demanding the return of the asset. Inside the large markets such as the United States is no difficulty, but this does not apply to transactions spanning the boundaries of multiple countries. Novation (novation) are less well understood, or even not permitted in many emerging markets, unlike the laws of the United Kingdom and the United States that allow the replacement of the creditors through novation of rights and obligations under a contract with the consent of all parties. Innovations are best suited transferable assets in securitizations.

For a successful securitization, the transfer must be absolute and with notice debtor. Equitable assignment, at which there is no notification and partial translation is common to the whole business securitization and transferring large units. None of this is not established sufficiently in emerging markets. Transmission method, conducted according to certain jurisdictions, is a translation of the assets in equity to avoid stamp duty on securities and transfer tax.

In issuing the securities, there is a difference between floating and fixed pledge and pledge shall extend to all assets and collateral procedures applicable to specific assets. The former have a lower priority in bankruptcy.

Securitisation- Islamic and conventional-dependent on the achievement of true sale of assets. But if the sale is redefined as a loan or a fixed charge is redefined as a floating, the essence of the transaction may change completely, endangering the rights of investors. The risk of override can be significant, since some of the organizers are trying to perform a transaction arbitrage, using the difference between the loan and the sale of assets [12].

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