

***Sukūk* as Negotiable Instrument in Islamic Commercial Law: *Sharī'ah* Appraisal, Applicability and the Issues (A Realistic Approach)**

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Abstract

Sukūk, being an important lego-economic aspect, is minutely discussed by *Sharī'ah* (Islamic law). Such discussion, however, is made through the extension of general principles, envisaged by Islamic law for the trading in currencies; owing to the fact that *Sukūk* is entirely a contemporary concept. The tool, used herein for such extension, is *Ijihād*. The purpose of this work is, therefore, to explain the conceptual basis of *Sukūk* (as negotiable instrument in Islamic Law) from *Sharī'ah*'s perspective and to investigate, at the same time, the legal issues involved therein.. Being a relatively newer paradigm, *Sukūk* does not hold, indeed, a very strong theoretical background in Islamic law- as mentioned earlier. A descriptive approach is, therefore, used in this research paper to provide a strong theoretical background about the origin of *Sukūk*, its design, issuing procedures and to sort out, too, non *Sharī'ah* compliant concerns. *Sukūk*, beyond any doubt, have gained an immense growth rate and wide acceptability in the contemporary financial market. They are proving very helpful instrument, at the equal level, in order to manage liquidity problems in Islamic finance. They are, though, being criticized by some scholars on account of *Sharī'ah*'s concerns. Well thought out regulations, in complete accord with Islamic commercial law, needs to be developed and rigorously executed by international Islamic financial regulators. The present work is going to serve, of course, as a strong theoretical base; enhancing the quality of *Sukūk* issuance, clarifying/resolving any legal issues involved therein and etc.

Keywords: Sukūk, Ijarah Sukūk, Sharī'ah, Financial Institutions, Islamic Law, Sharī'ah, Islamic Commercial Law, Negotiable Instruments

Introduction:

The practice and application of Islamic finance has increased enormously over the past few decades, not only in the Islamic states but also in a few non Islamic countries as well. Islamic Financial system, since its inception in 1960 until now, has made many advances, fundamentally, through the profusions of various types of investment securities provided inside the system.¹ This remarkable growth is also an outcome of *Sharī'ah* (Islamic Law) compliant customers who are modifying their lives according to the principles of Islam and are switching, as a result, their financing and investment modes in harmony with the *Sharī'ah* guidelines.² Islamic financial system, in all its ways, is proving itself as an absolute edifice to the conventional financial system; owing to the variety inherent in Islamic financial system.

Islam, since its inception, has encouraged a fair and viable economic system, emphasizing, predominantly, fair distribution of wealth among various classes of the

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¹ [Nathif J. Adam, Abdulkader S. Thomas](#), *Islamic Bonds: Your guide to issuing, structuring and investing in Sukuk*. Euromoney Books, 2004.

² Mohammed El Qorchi, "Islamic finance gears up." *Finance and Development* 42, no. 4 (2005), p.46

society. Being a typical type of economics, financial system provides the basic tools and instruments in order to run an economic system appropriately. Financial development has a significant impact on the economic development, and Islamic financial system provides the necessary support in this regard, by offering a complete set of financial instruments.³ Islam since primitive times has laid stress on the financial well-being of the whole society and, therefore, a complete set of rulings is present regarding financial matters in classical *Fiqh* (Islamic Law) literature- developed by the men of genius nature like Imām al-Shawkānī⁴, Imām al-Kāsānī⁵, Ibn Qudāmah al-Maqdisī⁶, Abū al-Walīd Muhammad ibn Ahmad ibn Rushd⁷, Imām Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī⁸, and Ibn ‘Ābidīn⁹. Many innovative investment techniques have been introduced by such jurists as like *Mushārakah* (partnership), *Murābahah* (sale with profit), *Ijārah* (leasing), *Salam* (advance payment sale), and *Istisnā* (manufacturing contract) and etc.¹⁰ In recent times, Islamic Finance is practicing many modes of financing as per *Sharī‘ah* rules, but has gained special impetus in the field of securitization, and *Sukūk* (Islamic certificates), in particular.¹¹

The very first issuance of the *Sukūk* was carried out in Malaysia in 1990 by a non-Islamic company, named Shell MDs, worth 125 million Ringgits, based on *Bai’ Bithaman Ajjal* (sale with deferred payment basis). *Sukūk* went international, for the first time when Bahrain issued its International Sovereign *Sukūk* in September 2001.¹² The market has been developing and expanding ever since. The regional break up for *Sukūk* issues up to 2009 is given beneath in tabular form.

Regional break-up of the Sukūk Market

| Country | Volume | No. of Is-sues | % of Total Value |
|--------------|-----------------|----------------|------------------|
| | (US\$ millions) | | |
| Malaysia | 67,872 | 792 | 66.8% |
| Indonesia | 1,923 | 48 | 1.9% |
| Pakistan | 1,657 | 31 | 1.6% |
| Brunei | 740 | 13 | 0.7% |
| Singapore | 99 | 2 | 0.1% |
| Saudi Arabia | 7,665 | 10 | 7.5% |
| UAE | 7,151 | 10 | 7.0% |
| Bahrain | 1,508 | 77 | 1.5% |
| Qatar | 137 | 1 | 0.1% |
| US | 167 | 1 | 0.2% |

³ Zamir Iqbal and Abbas Mirakhor. "financial Inclusion: Islamic finance perspective." (2012), pp.35-64

⁴Shawkānī, *Nayl al-Awtār*, (Dār Ehiā al-Tourath al-‘Arabī, 1st Edition.2001).

⁵Abū Bakr ibn Mas‘ūd al-Kāsānī, *Bādā’i‘ al-Sanā’i‘*, 1st Edition, (Beirut: Dār al-Fikr Labnan, 1996)

⁶Ibn Qudāmah al-Maqdisī, *Al-Kaḥf*, 5th Edition, (Beirut: Al-Maktab al-Islāmī, 1988).

⁷ Abū al-Walīd Muhammad ibn Ahmad ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, Vol. 2, 1st Edition. (Beirut: Dār al-Fikr Labnan, 2003).

⁸Abū Bakar Muhammad ibn Abī Sahal Sarakhsī, *Al-Mabsūt*, (Beirut: Dar-Ehyā al-Turāth al-Arabi, Edition.2002).

⁹Ibn ‘Ābidīn, *Radd al-Muhtār*, , (Beirut: Dār al-Fikr, 2005).

¹⁰ Ms Kazi Farzana. Understanding Investment. Available at: <http://scholar.google.com.pk/scholar...>(accessed on 5th February 2013).

¹¹ Muhammad Ayub, *Understanding Islamic Finance*. Vol. 462. John Wiley & Sons, 2009.

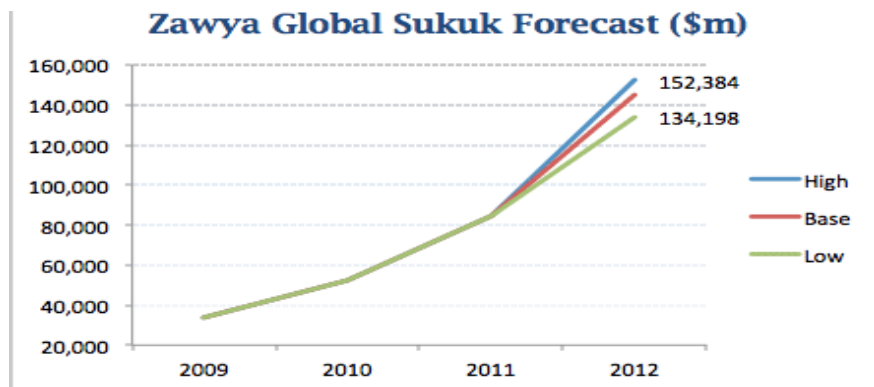
¹² International Islamic Financial Market, “Sukūk Report (1st Edition, 2010)”, available at: <https://docs.google.com> (accessed on 5th march 2013).

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| | | | |
|---------|---------|-------|--------|
| Germany | 123 | 1 | 0.1% |
| Gambia | 0.388 | 1 | 0.0% |
| Sudan | 12,614 | 20 | 12.4% |
| Total | 101,656 | 1,007 | 100.0% |

(Source: IIFM *Sukūk* issuance database)

Since last year, global economy had faced upheavals due to the crises in the European economy. Despite the same, along with the growth in conventional bond markets, *Sukūk* had kept growing consistently and had reached another record setting point in 2011. Malaysia and Indonesia, therefore, were largest *Sukūk* issuing countries in 2011 for sovereign *Sukūk*'s category reaching US \$2 billion. By the same token, in 2011 Islamic financial institutions kept on issuing *Sukūk* in order to enhance liquidity management. Malaysia has remained the market leader in *Sukūk* industry from the very onset and, hence, in 2012 the size of *Sukūk* issuance by Malaysia reached 60-70 % of the global *Sukūk* issuance, whereas the volume of *Sukūk* industry reached 40 billion US\$.¹³ According to a forecasted analysis performed by Zawya, the global *Sukūk* issuance was expected to grow up to 150 billion USD, assuring a least expected volume of 134 billion USD through the last quarter of 2012.¹⁴ The graphical illustration of the forecasted growth rates of *Sukūk* is given below:



(Source: Quarterly *Sukūk* Bulletin 3Q 2012)

In spite of the rapid growth and mass acceptability for *Sukūk* from all Islamic financial sectors, they are highly criticized for some structural and functional malfunctions. It is often objected, particularly by the people who are conversant with the field of Islamic finance, that *Sukūk* violate the Islamic principle of equitable distribution of wealth by providing fixed/ known returns and, hence, in this way bear a resemblance very much to the conventional bonds. Muhammad Taqi Usmani, for instance, has vastly criticized *Sukūk* and even declared that outputs of *Sukūk* are producing economic effects

¹³ Islamic Finance News. (February 2012). *Sukūk* Market Review & Outlook for 2012 (by AmInvestment Bank): IFN 2012 guide. Available at: http://www.islamicfinancenews.com/listing_article_ID.asp?nm_id=25594 (accessed on 5th march 2013).

¹⁴ Zawya (2012). "Zawya Research: *Sukūk* Quarterly Bulletin (Q3- 2012)". Available at: http://www.zawya.com/story/Zawya_Research_Sukuk_Quarterly_Bulletin_Q32012-pdf_031012092046/ (Accessed 5th April 2013).

analogous to the economic effects of the conventional financial securities.¹⁵ Muhammad Tahir Mansoori, has recently objected a relatively different aspect of Islamic finance, encompassing *Sukūk* issues inside. The writer has highlighted the juristic views about the use of *hayil* (legal stratagems) and issues raised in Islamic finance owing to its excessive use.¹⁶ It has been acclaimed by the writer that in certain forms of *Sukūk* e.g. in sale and lease back structure no true ownership transfer takes place and *Sukūk* issuers rely on the use of *hayil*. It produces, therefore, the consequences that are not enveloped by the permissibility bounds of *Sharī'ah*. It has been highly disparaged that many of the *Sukūk*'s transactions resemble very much with that of *Bay' al Ināh* (buy back transaction). The writers, thus, aim to sort out some strong theoretical basis to the above mentioned issues.

The basic and foremost objective of this study is to highlight the essence of *Sukūk* as a mode of Islamic finance and investment, and to cope with above mentioned aspects in *Sukūk* which are not *Sharī'ah* compliant. The second objective is to facilitate an apt solution for these non-compliance acts. Thirdly, to characterize the entire state of affairs in an affirmative way by providing some solution of real expediency. Finally and more importantly, this will help out those who want to provide true *Sharī'ah* compliant securities as a mode of investment or financing.

This paper is well thought-out in a way as to illustrate the overall global progress in the *Sukūk* market, structuring of the *Sukūk* issuance, issues in *Sukūk* structuring, and finally provide remedies for these issues. Numerous regulatory standards and implications with an attempt to evaluate the impact of various financial instruments on society and economy are brought up frequently. For Islamic financial institutions these regulations, most of the times, are devised in the form of *Sharī'ah* standards. Since *Sukūk* has emerged as potential secondary market securities in Islamic financial system from the last two decades; very little research work, therefore, has been carried out on it. This work shall therefore prove as a useful contribution towards the broader objective of analyzing the origin of *Sukūk*, their structural feature and contemporary issues involved therein.

Literature on *Sukūk* in Islamic Commercial Law:

Being a complete code of life, *Sharī'ah* provides guidance in every aspect of life.¹⁷ Economic aspect, as one of the important among these, is also discussed with minute details. The work of classical Muslim jurists, like Imām al-Shawkānī¹⁸, Imām al-Kāsānī¹⁹, Ibn Qudāmah al-Maqdisī²⁰, Abū al-Walīd Muhammad ibn Ahmad ibn Rushd²¹,

¹⁵ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*. Quranic Studies publishers (Maktaba Ma'ariful Quran), Karachi. 2008), pp.18- 147

¹⁶ Muhammad Tahir Mansoori, "Uses of Hayil in Islamic Finance and Its Sharī'ah legitimacy" *Journal of Islamic Business and Management*, 2011, 1 (1), pp.69-92

¹⁷ There is not an animal (That lives) on the earth, Nor a being that flies on its wings, but (forms Part of) communities like you. Nothing have we omitted From the Book, and they (all) Shall be gathered to their Lord In the end". (*Qur'ān* 6:38) translated by Abdullah Yūsuf Alī, (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 15 July2012); One day We shall raise From all Peoples a witness Against them, from amongst themselves: And We shall bring thee As a witness against these (Thy people): and We have sent down To thee the Book explaining All things, a Guide, a Mercy, And Glad Tidings to Muslims". (*Qur'ān* 16:89) translated by Abdullah Yūsuf Alī, (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 15 July2012).

¹⁸ Shawkānī, *Nayl al-Awtār*, (Dār Ehiā al-Tourath al-'Arabī, 1st Edition.2001).

¹⁹ Abū Bakr ibn Mas'ūd al-Kāsānī, *Bādā'i' al-Sanā'i'*, 1st Edition, (Beirut: Dār al-Fikr Labnan, 1996)

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Imām Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī²², and Ibn 'Ābidīn²³, is solid evidence in this regard. *Sukūk*, being a contemporary economic activity is not elaborated by such jurists. A profound study of their work, however, reveals that some rules and regulations, provided by such scholars for the exchange of currencies, are very much identical to those of *Sukūk* certificates- by one way or another. The work of Imām Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī²⁴, for instance, can be resorted for the identification of such similarities. In addition, such principles (of currencies), elaborated therein, can be extended to *Sukūk* through the analogy of *Ijihād*.²⁵

Sukūk have, indeed, their origin in the medieval Muslim regions for international trade, and have found their revival, in the contemporary world, through Islamic finance.²⁶ *Sukūk* are serving as powerful financing tools in the contemporary financial system and they are playing an immense role in fund mobilization and liquidity management of Islamic financial institutions.²⁷ In certain Islamic countries *Sukūk* are becoming significant financing instruments apart from IPOs and bank loans.²⁸ In the coming decade *Sukūk* will prove as a most efficient financing mode in Islamic finance.²⁹ As Islamic banks and other financial institutions cannot finance, principally, on the basis of interest, *Sukūk* are providing a superior prospective.³⁰ As mentioned earlier, *Sukūk*, are widely accepted beyond the Muslim world and many non-Muslims, therefore, have also gained expertise in these securities. For instance, the first oil and gas backed *Sukūk*, issued by US.³¹ Despite the crises in US economy *Sukūk* are showing paradoxically rapid growth rates.³²

²⁰Ibn Qudāmah al-Maqdisī, *Al-Kaḥfī*, 5th Edition, (Beirut: Al-Maktab al-Islāmī, 1988).

²¹ Abū al-Walīd Muhammad ibn Ahmad ibn Rushd, *Bidāyāt al-Mujtahid wa Nihāyat al-Muqtasid*, Vol. 2, 1st Edition. (Beirut: Dār al-Fikr Labnan, 2003).

²²Abū Bakar Muhammad ibn Abī Sahal Sarakhsī, *Al-Mabsūt*, (Beirut: Dar-Ehyā al-Turāth al-Arabi, Edition.2002).

²³Ibn 'Ābidīn, *Radd al-Muhtār*, (Beirut: Dār al-Fikr, 2005).

²⁴Abū Bakar Muhammad ibn Abī Sahal Sarakhsī, *Al-Mabsūt*, (Beirut: Dar-Ehyā al-Turāth al-Arabi, Edition.2002).

²⁵ The meaning of *Ijihād*. is to strive with one's ability to derive the divine laws from the *Qurān* and *Sunnah* of the Holy Prophet(SM). This derivation should be done by a person having capacity for *Ijihād*, described by the classical Muslim jurists. The derivation of rules without having the capacity for *Ijihād*., has been prohibited in *Sharī'ah* (Islamic Law). See for further details. Imam Abū Zahrah, *Usūl al-Fiḥ*, Dārul Fikru al Arabi, p.379

²⁶ Nathif Jama Adam. "Sukuk: A Panacea for Convergence and Capital Market Development in the OIC Countries." In *Compiled papers presented at the 6th International Conference on Islamic Economics and Banking in 21st Century, Jakarta, Indonesia, 21-24th November 2005*. 2005.

²⁷ Jhordy Kashoogie Nazar. "Regulatory and financial implications of sukuk's legal challenges for sustainable sukuk development in islamic capital market." *Ethics, Governance and Regulation in Islamic Finance* (2015), p.135

²⁸ Alsaeed, Khalid. "Sukuk issuance in Saudi Arabia: recent trends and positive expectations." PhD diss., (Durham University, 2012).

²⁹ Rodney Wilson. "Overview of the sukuk market." *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk*, Euromoney Books, London (2004), pp.6-7

³⁰ Zohra Jabeen. "Significance of Sukuk Securitisation For Banks, Structuring for Risk Regulation and Pricing." *Conference Proceedings*. 2007.

³¹ Ayman H. Abdel-Khaleq., and Christopher F. Richardson. "New horizons for Islamic securities: Emerging trends in Sukuk offerings." *Chi. J. Int'l L.* 7 (2006), p.409

³² Heiko Hesse, Andreas A. Jobst & Juan Solé, "Trends and challenges in Islamic finance." *World Economics* 9, no. 2 (2008), pp.175-193

Khalil, a contemporary scholar in the field of Islamic finance, has tried to explain the structure and some risks involved in the issues of *Sukūk* after elaborating and defining the paradigm shifts in securitization sector of Islamic finance.³³ The paper also presents, with the same length, some potential benefits for *Sukūk* holders. Since debt market is not an active part of the Islamic finance, *Sukūk* are the only well accepted debt securities in this area. The choice for the issuance of *Sukūk*, consequently, become a crucial point that can lead to various *Sharī'ah* implications.³⁴ In his research work, the authors have tried to explain the acceptability of *Sukūk* with regard to the interest rate and exchange rate policies of various *Sukūk* issuing countries.

Tariq has also elaborated the basic characteristics of *Sukūk* and their budding significance in the current era, besides discussing some of risk factors that are inherent in the structuring of *Sukūk*.³⁵ Another study describes the emergence of securitization process in Islamic finance after the jurisdiction of Fiqh Academy³⁶ about securitizes and bond structured *Sukūk*. The issuance of bond structured *Sukūk* has accelerated since then. This study is a comprehensive illustration of the rising impact of *Sukūk* on the world economy, however, this paper takes into account only the transactions and issuances in USA and West.³⁷ As *Ijārah Sukūk* are most commonly issued, they have been paid special attention in most of the research work on *Sukūk* structures, including risk factors involved and issues in their structuring.³⁸ Due to some structuring issues, mass media sometimes misrepresent *Sukūk* same as conventional bonds.

The research work of Mohamed Ariff, and Meysam Safari empirically has taken the above aspect into account, and have highlighted major differences between these terms by investigating into the yield curves of both *Sukūk* and conventional bonds.³⁹ Markets distinguish between conventional bonds and *Sukūk*; this aspect has been

³³ Khalil Ahmed. *Sukuk: Definition, Structure and Accounting Issues*. No. 33675. University Library of Munich, Germany, 2011.

³⁴ Nursilah Ahmad, and Muhamad Muda. "Currency of Choice for Sukuk." In *4 th International Conference on Business and Economic Reseach*. 2013.

³⁵ Ali Arsalan Tariq, "Managing financial risks of sukuk structures." *Loughborough University, UK, September (mimeo)* (2004).

³⁶ See for example Decision No. 5 of the 4th Annual Plenary Session of the OIC Fiqh Academy, held in Jeddah 18-23/6/1408H (6th – 11th February, 1988).

³⁷ [Michael J. T. McMillen](#). "Asset securitization sukuk and Islamic capital markets: Structural issues in these formative years." (2007).

³⁸ See for example the work of Salman Syed Ali. *Islamic Capital Market Products-Developments & Challenges (Occasional Papers)*. No. 213. The Islamic Research and Teaching Institute (IRTI), 2005; Kristel Richard. "A closer look at ijara sukuk." *Standard and Poor's, Research* (2005); Dinna Rohmatunnisa. "Design of Ijarah sukuk." *Unpublished MA in Finance and Investment, University of Nottingham, Nottingham, UK* (2008); Rafisah Mat Radzi, "Implication Of Sukuk Structuring: The Comparison On The Structure Of Asset Based And Asset Backed Ijarah Sukuk." In *2nd International Conference on Business and Economic Research (2nd ICBER 2011) Proceeding*, no. 2011-466. Conference Master Resources, 2011; Nursilah Ahmad and Syazwani Abd Rahim. "Sukuk Ijarah vs. Sukuk Musyarakah: Investigating Post-Crisis Stock Market Reactions," *International Journal of Humanities and Management Sci-ences (IJHMS)* 1, no. 1 (2013).

³⁹ Mohamed Ariff, and Meysam Safari. "Are sukuk securities the same as conventional bonds?." (2012).

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investigated through an empirical study in Malaysia.⁴⁰ Due to some problems experienced in *Ijārah Sukūk*, *Mushārah Sukūk* came into origin in order to deal with those issues.⁴¹

Noriza Binti Mohd Saad, and Nor Edi Azhar Binti Mohamad have conducted a remarkable work on *Sukūk* related issues in the Malaysian market e.g *Bai' Bithaman Ajjil* on *Sukūk* yield- by applying multivariate regression model where the results showed a positive influence of variables.⁴² In spite of the fact that *Sukūk* has provided vast potential for investment and liquidity management, yet there are some issues in their structuring.

Muhammad Al-Bashir has investigated into some governance related issues of various types of *Sukūk*.⁴³ He elaborates innovations and challenges in the *Sukūk* market with minute details. According to Safdar Ali Butt and Arshad Hassan various valuation and accounting issues have emerged in Islamic financial system with the increase in number of securities and redeemable certificates.⁴⁴ Islam allows the securitization process only if securities are based on some real life tangible assets. Asset backed vs. asset based securities often mislead many investors, but there is a vivid difference between the structures of both types of *Sukūk*.⁴⁵ Jabeen has investigated deep into the *Sharī'ah* compliance of *Sukūk* with the AAOIFI⁴⁶ *Sharī'ah* standards and regulatory compliance with the regulations of Basel II.⁴⁷ Ellis has sorted out the level of accord between convention bonds' market and *Sukūk* market.⁴⁸ Although *Sukūk* has provided investors with a *Sharī'ah* compliant mode of financing for finance large projects, yet many immature *Sukūk* issues are leading to the bad repute of *Sukūk* at global markets level.

⁴⁰ Christophe J. Godlewski, Rima Turk, and Laurent Weill. "Do markets perceive sukuk and conventional bonds as different financing instruments?." (2011).

⁴¹ Rahail Ali . "An overview of the sukuk market." *Sukuk and Islamic Capital Markets*. Edited by Rahail Ali. London: Globe Business Publishing Ltd (2011), pp.7-20

⁴² Noriza Binti Mohd Saad, and Nor Edi Azhar Binti Mohamad. "Sukuk in Malaysian capital market." In *3rd International Conference on Business And Economic Research*. 2012.

⁴³ Muhammad Al-Bashir Muhammad Al-Amine,. "Sukuk market: Innovations and challenges." *Islamic Capital Markets* 33 (2008).

⁴⁴ Safdar Ali Butt, and Arshad Hassan. "Valuation and Accounting for Redeemable Corporate Capital: An Islamic Perspective." (2011).

⁴⁵ Khalid Howladar. "The Future of Sukuk: Substance over Form? Understanding Islamic securitisation, Asset-Backed and AAOIFI principles." *Moody's Investors Service* (2009), pp.1-13

⁴⁶ The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shari'a standards for Islamic financial institutions and the industry. Professional qualification programs (notably CIPA, the Shari'a Adviser and Auditor "CSAA", and the corporate compliance program) are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures. This institution was established in accordance with the Agreement of Association which was signed by Islamic financial institutions on 1 Safar, 1410H corresponding to 26 February, 1990 in Algiers. Then, it was registered on 11 Ramadan 1411 corresponding to 27 March, 1991 in the State of Bahrain. <http://www.aaofi.com> (accessed December 25, 2011)

⁴⁷ Zohra Jabeen . "Sukuk: structural Analysis for Shariah and Regulatory Implication in Islamic Financial Intermediation." Ph.D diss., Mohammad Ali Jinnah University, Karachi, 2010.

⁴⁸ Theodore Reuben Ellis. "The Piety Premium of Islamic Bonds." *Middle East Quarterly* (2012).

Among the various issues in *Sukūk*, a stable return rate or constant profit rate is the prominent one that needs governance rules from *Sharī'ah* scholars.⁴⁹ Apart from this, there are other issues with the structure of Special Purpose Vehicle (SPV), and the originators and ownership rights.⁵⁰ *Sukūk* returns resemble the returns of conventional bonds; owing to the feature of protecting the returns of *Sukūk* holders.⁵¹ Kaseb analyzed the role of *Sharī'ah* advisors in resolving various issues, like those mentioned in the above lines, concluding that the role of *Sharī'ah* advisors is an *amānah* (trust) which should be discharged by due diligence.⁵² Unsettled issues in *Sukūk*, therefore, should be sorted out without delay, as otherwise, these issues can erode confidence in this mode of Islamic finance.⁵³

Methodology:

Research is an ongoing process of exploring facts, concepts and alternatives. A content analysis technique of qualitative research method has been used in the present work. Moreover, the inductive approach is adopted for the purpose to generalize the conclusion and findings. As securitization, particularly *Sukūk*, is a relatively newer paradigm of Islamic financial system; owing to the fact that no evidence is found in classical *Fiqh* literature. Rulings about classical *Mudārabah* and *Sharikah* can be found at the times of Holy Prophet (SAW), no such direct rulings, undeniably, are available about securitization/ *Sukūk*. Therefore, the contemporary Muslim scholars, predominantly those who are conversant with the field of Islamic finance, have used the tool of *Ijtihād* (intellectual endeavor of a jurist/jurists) to derive various rules regarding the permissibility and designing of *Sukūk*. In addition, *Sukūk* face criticism for their structural issues regarding risk involved; return policies and ownership rights, in the wake of insufficient literature available on the topic. There is, hence, a strong need for theoretical and descriptive research work in this field to convince institutions on the subprime eminence of *Sukūk* securities. The secondary data is used throughout the research paper in order to accomplish the content analysis technique for the investigation of the issue. Such data is collected from printed books, both available online and in typical libraries, periodical journals (largely those which are related to the field of Islamic finance), official websites of Islamic financial institutions, institutional reports and etc.

Origin of *Sukūk* in Islamic Commercial Law:

According to Stephen Quinn and William Roberds, Nasir- I Khosrau, an Iranian voyager from the eleventh century stopped over in a city of Iraq known as Basra and he, for the first time, documented *Sakk* (singular of *Sukūk*).⁵⁴ *Sakk* was a form of payment at that time and merchants were used to make payments through these from their bank

⁴⁹ Yean, Tan Wan. "Sukuk: Issues and the way forward." *International Legal News* 6, no. 2 (2009), pp.1-20

⁵⁰ Mohammad Saad Lahlou, and Joseph Atangan Tanega. "Islamic Securitisation: Part I- Accommodating the Disingenuous Narrative." (2007).

⁵¹ Zohra Jabeen and Mohammad Tariq Javed. "Sukuk-structures: an analysis of risk-reward sharing and wealth circulation." *The Pakistan Development Review* (2007), pp.405-419

⁵² Albadran Badr Kaseb. "A mini project submitted in fulfilment of the requirements for the completion of Qualitative Research Methods course, for Doctor of Philosophy in Business Administration." PhD diss., International Islamic University Malaysia, 2010.

⁵³ Mohammad Akram Laldin,. "Sukūk in Various Jurisdictions: Sharī' ah and Legal Issues." *Journal of Islamic Business and Management* 2, no. 1 (2012), pp.15-34

⁵⁴ Stephen Quinn and William Roberds. "The evolution of the check as a means of payment: a historical survey." *Economic Review-Federal Reserve Bank of Atlanta* 93, no. 4 (2008): I.

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accounts. Along with this they provided another evidence that Ashtor derived the English word *check* from this 'Arabic word *Sakk* in 1972. Moreover, the Islamic literature on classical commercial system in the medieval era reveals many words like "*Sakk*", "*Sakuk*" and "*Sakaik*". These words were in common use at the time to carry out international trades alongside other business terms e.g. *Mudārbah* and *Hawālah* (transfer of debt in Islamic Law), frequently used in that period.⁵⁵ In the current era, one can find the modern basis of *Sukūk* or securitization process in a resolution of Islamic Jurisprudence Council.⁵⁶ According to such resolution, *Sukūk* are any mixture of assets or their usufruct (majority of assets being tangible) in the form of written financial instrument, and, therefore, can be traded at the market price. *Sukūk* must be backed by some tangible assets so their holder can claim on those tangible assets; based on the matters of ownership and profit and loss sharing.⁵⁷ In addition, *Sukūk* become tradable in the secondary market through such ownership, on the basis of tangible assets, and their trade no longer remains *Bay' al Dayn bil Dayn* (sale of debt for debt).

Literal and Technical Meanings of *Sukūk* in Islamic Commercial Law:

Sukūk is an 'Arabic word, a plural of *Sakk* (certificate or Islamic certificate) and is very commonly used for Islamic securities. Literally it can be defined as, "certificates" which may include notes, or papers possessing liquidity and tradability in the market.⁵⁸ In technical terms, *Sukūk* are entitlement scripts whereas each *Sukūk* (script) representing a fractional ownership in an underlying asset or project, which may even include the investment like that for a motorway project. Some people unwittingly call these as Islamic bonds.

The first definition of *Sukūk* came in 1988 after the fourth annual session of Islamic *Fiqh* Academy. On presenting its *Fatwa* (a ruling on a point of Islamic law given by a recognized authority) about the securitization of assets (more specifically *Muqārdah* bonds), the council of OIC passed a resolution defining these bonds as;

"Investment instrument which allocate the (Muqārdah) capital by floating certificates, as an evidence of capital ownership, on the basis of shares of equal value, registered in the name of the owner, as joint owner of shares in the venture capital or whatever shape it may take, in proportion to... each ones share therein".⁵⁹

Sukūk have been defined by AAOIFI as;

"Certificates of equal value representing undivided share in the ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity".⁶⁰

⁵⁵ Abraham L. Udovitch. *Partnership and profit in medieval Islam*. (Princeton University Press, 2011).

⁵⁶ See for example Decision No. 5 of the 4th Annual Plenary Session of the OIC *Fiqh* Academy, held in Jeddah 18-23/6/1408H (6th – 11th February, 1988).

⁵⁷ Mohamed Ariff, Munawar Iqbal, and Shamsheer Mohamad, eds. *The Islamic debt market for sukuk securities: The theory and practice of profit sharing investment*. Edward Elgar Publishing, 2012.

⁵⁸ Nursilah Ahmad, , and Muhamad Muda. "Currency of Choice for Sukuk." In *4th International Conference on Business and Economic Research*. 2013.

⁵⁹ Mohamed Ariff, Munawar Iqbal, and Shamsheer Mohamad, eds. *The Islamic debt market for sukuk securities: The theory and practice of profit sharing investment*. Edward Elgar Publishing, 2012.

⁶⁰ Auditing and Accounting Organization for Islamic Financial Institutions (2007/ 1428 H). *Sharī'ah Standard No.17*, registration No. 834/2002. State of Bahrain. ISBN: 99901-23-07-1. pp.306-322

A relatively newer definition of *Sukūk* is given by the Securities Commission of Malaysia as “certificates of equal value which evidence undivided ownership or investment in the assets using *Sharī‘ah* principles”⁶¹

Classification of *Sukūk* in Islamic Commercial Law:

Sukūk can be categorized in numerous forms, depending upon many things e.g. the type of underlying asset, technical or commercial features, or type of underlying contract and etc. Various classifications of *Sukūk* have been discussed beneath in order to make underlying features of *Sukūk* clear.

AAOIFI Classification (2004):

AAOIFI has classified *Sukūk* into fourteen types which are as follows:

- I. Certificate of Ownership in leased assets
- II. Certificate of ownership in usufructs
 - a. Certificate of ownership of described usufruct of future assets
 - b. Certificate of ownership of services of a specified property
 - c. Certificate of ownership of existing assets
 - d. Certificate of ownership of described future services
- III. *Mudārabah* Certificate
- IV. *Salam* Certificate
- V. *Istisnā’* Certificate
- VI. *Musāsqāt* (irrigation) Certificate
- VII. *Muzār‘aat* (Sharecropping) Certificate
- VIII. *Mughārasah* (agricultural) Certificates
- IX. *Mushārahah* Certificates
 - a. Investment Agency *Sukūk*
 - b. *Mudārabah* Certificates
 - c. Participation term Certificates

Islamic Financial Services Board (IFSB) Classification (2005):

IFSB classified *Sukūk* into two broad categories i.e. Asset Based and Equity Based.⁶² *Sukūk* issues consisting of assets that end up in fairly predictable returns are known as asset based *Sukūk*. These may be based on contracts like *Salam*, *Istisnā’*, and *Ijārah*. The equity based *Sukūk*, on the other hand, do not offer any predictable return, as the return on them is calculated on the profit and loss basis of the investment return. Underlying contracts for this type of *Sukūk* can be *Mushārahah* and *Mudārabah*.

Asset Backed vs. Asset Based Concept in Islamic Commercial Law:

In order to comprehend the structuring of *Sukūk*, one needs to single out between the most controversial statements regarding *Sukūk* issuance besides the adopted mode of financing i.e., the asset based or asset backed disclosure. Despite the fact that both terms appear identical, there is a considerable disparity among asset-based and asset-backed, concerning the credit risk involved.⁶³ Howladar has, logically, segregated

⁶¹ Securities Commission. "Resolutions of the Securities Commission Syariah Advisory Council." *Securities Commission: Kuala Lumpur, Malaysia* (2003).

⁶² Islamic Financial Services Board. *Capital Adequacy Standard for Institutions (other Than Insurance Institutions) Offering Only Islamic Financial Services*. Islamic Financial Services Board, 2005.

⁶³ Tan Wan Yean. "Sukuk: Issues and the way forward." *International Legal News* 6, no. 2 (2009), pp.1-20

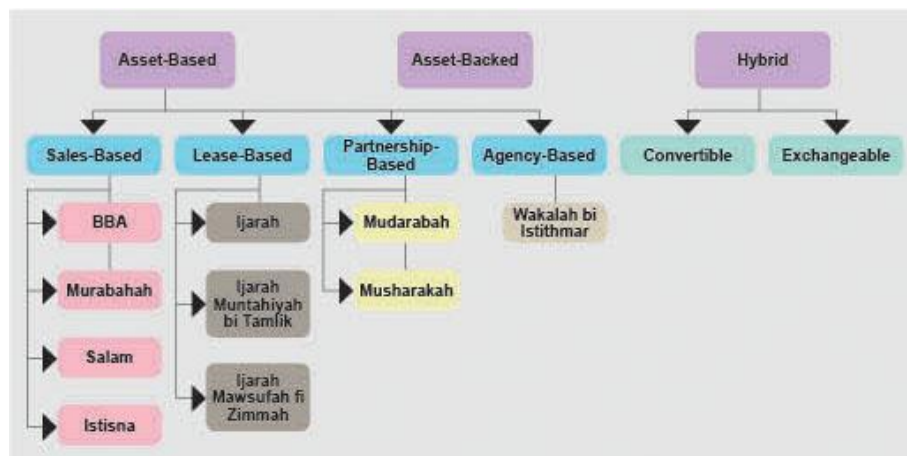
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these two types of *Sukūk* on the basis of form vs. substance.⁶⁴ In his scholastic view, the key substance of any type of *Sukūk* is their risk level, return rate, profitability, expected return etc. In the other context, form is the basic design of *Sukūk*. Thus, an asset backed *Sukūk* is the one in which ownership rights pertain to some actual physical assets. *Sukūk* holders, in this case, bear loss in case of damage to the assets, and credit risks are measured on the basis of actual performance of the assets. In the asset based *Sukūk*, artificial ownership rights over some property are transferred to *Sukūk* holders, whereby the performance is measured on the basis of corporate rating methodologies, and *Sukūk* holders have recourse to the credit worthiness of the assets only.⁶⁵

Classification of *Sukūk* on the basis of underlying contract in Islamic Commercial Law:

Securities Commission of Malaysia has classified *Sukūk* into various forms in light of the most issued *Sukūk*.⁶⁶ As per this classification different types of *Sukūk*, formerly categorized by AAOIFI, have been sub categorized under three main headings i.e., asset based, asset backed and hybrid securities.

(Source: Securities Commission Malaysia 2009)



Features:

Most of the *Sukūk* are issued, in the contemporary market, on the bases of property, real estate, energy sector, oil and gas and financial services sectors. *Sukūk* has provided this great facility to invest in real life assets and not in mere debt instruments. In addition, they have enhanced the size of Islamic modes of financing, to a very great extent, by providing the investors with the option of tradable *Sharī'ah* compliant

⁶⁴ Khalid Howladar. "The Future of Sukuk: Substance over Form? Understanding Islamic securitisation, Asset-Backed and AAOIFI principles." *Moody's Investors Service* (2009), pp.1-13

⁶⁵ Radzi, Rafisah Mat. "Implication of Sukuk structuring: The comparison on the structure of asset based and asset backed Ijarah Sukuk." In *2nd International Conference on Business and Economic Research (2nd ICBER 2011) Proceeding*, no. 2011-466. Conference Master Resources, 2011.

⁶⁶ Securities Commission. "Resolutions of the Securities Commission Syariah Advisory Council." *Securities Commission: Kuala Lumpur, Malaysia* (2003).

securities.⁶⁷ *Sukūk* are asset backed, stable income and tradable securities that can be structured with various techniques like *Ijārah*, *Mushārahah*, *Murābahah*, *Mudārahah*, *Salam* and *Istisnā'*.⁶⁸ Most of the *Sukūk* are highly profitable, steady income stream, provide medium to long term returns and, more importantly, are *Sharī'ah* compliant tradable securities.⁶⁹ *Sukūk* are the best way to finance large projects that may lie outside the purview of a single party to finance.⁷⁰

Structuring of *Sukūk* in Islamic Commercial Law:

As conventional bonds are not accepted in Islamic finance, due to their interest bearing nature, there is a prevailing need to develop and float some efficient tradable and liquid securities in Islamic financial system that could assist Islamic banks and other financial institutions to manage their liquidity issues in a better way. *Sukūk* are structured in a way that can fabricate the economic effects, similar to that of conventional bonds (Mohammad *et al.*, 2012: 52). As such, no direct rule regarding *Sukūk* is found in classical *Fiqh* literature. They are developed on the basis of a well-known *Sharī'ah* maxim "*Al Aslu fil Ashyā al Ibāha*" *i.e.* The general rule for things is permissibility.

In February 2008, AAOIFI has issued six regulations regarding the structuring and designing of various types of *Sukūk*.⁷¹ These regulations are listed below in a concise form:

1. The assets underlying *Sukūk* issue must be owned by *Sukūk* holders, and managers should make the transfer of ownership to *Sukūk* holders in the books of accounts.
2. In order to avoid the jurisdiction about the prohibition of sale of debt, *Sukūk* certificates should not represent any debt or receivables, as this will render *Sukūk* non-tradable in the secondary market.
3. In any kind of *Sukūk*, the manager cannot/should not promise *Sukūk* holders an offer to give them loans in conditions of shortfalls; rather he can create some reserve in order to meet such shortfalls.
4. At the termination of the contract, it is not allowed for the originators to buy back units of ownership (*Sukūk*) at some predetermined nominal value; instead they can buy these units at their net face value.
5. Only in the case of *Sukūk al Ijārah*, originator/ lessee can take back the units of ownership at their nominal value.
6. It is a binding responsibility of the *Sharī'ah* supervisory board to keep a keen eye at each and every stage of the *Sukūk* issuance, implementing the regulations and assessing the *Sharī'ah* compliance of underlying transactions.

Following is a proper procedure/sketch for the issuance of *Sukūk* and sharing of the rental. Since, most of the *Sukūk* are issued on the basis of *Ijārah* like the WAPDA

⁶⁷ Clifford Chance. "Introduction to Sukuk." (2006).. Available at: <http://www.cliffordchance.com>. (Accessed on 12th March 2013).

⁶⁸ Liquidity Management Center, The guide to Sukūk market, 2008, Accessed from: www.lmc Bahrain.com. (Retrieved on 12 January 2012).

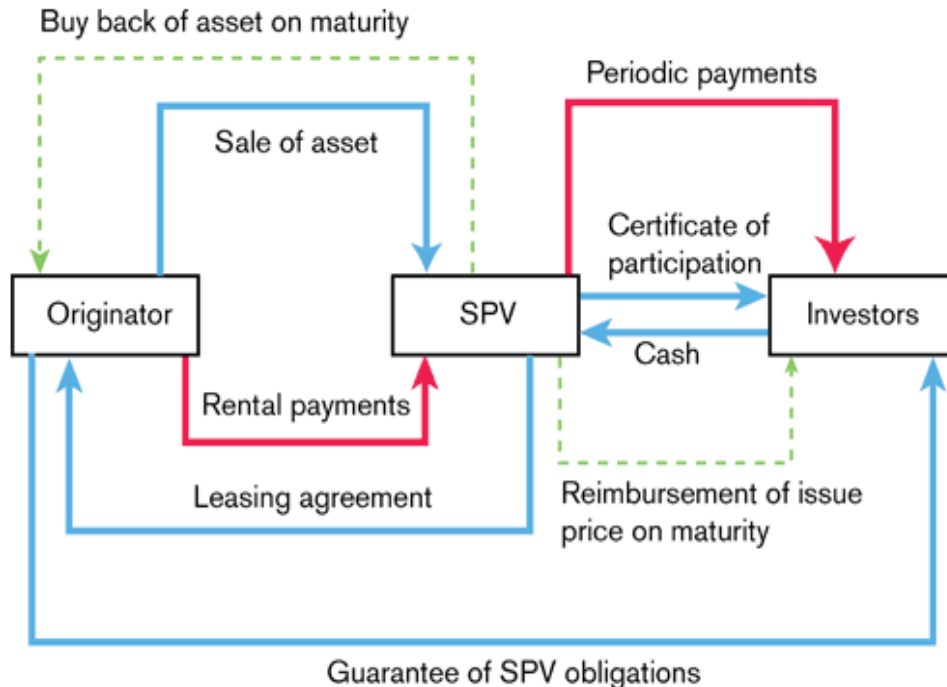
⁶⁹ Khalil Ahmed. *Sukuk: Definition, Structure and Accounting Issues*. No. 33675. University Library of Munich, Germany, 2011.

⁷⁰ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, pp.18- 147

⁷¹ Auditing and Accounting Organization for Islamic Financial Institutions (2007/ 1428 H). *Sharī'ah Standard No.17*, registration No. 834/2002. State of Bahrain. ISBN: 99901-23-07-1. pp.306-322

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Sukūk or the Motorway *Sukūk*, the structuring and issues, particularly, in the *Ijārah* based *Sukūk* will be discussed with minute details.



Source: Mauritius *Sharī'ah* (IFLR)

Here the originator forms a special purpose vehicle (SPV) or a special purpose company. SPV takes cash from the investors against certificates of participation (*Sukūk*) and, by means of this; cash buys assets from the originator, followed by leasing them back to the originator. On the other hand, SPV takes rental payments against leased assets and make periodic payments to the investors. At maturity, asset is bought back by the originator and reimbursement of issue price is made to the investors. SPV provides intermediary services between the originator and the investors.⁷²

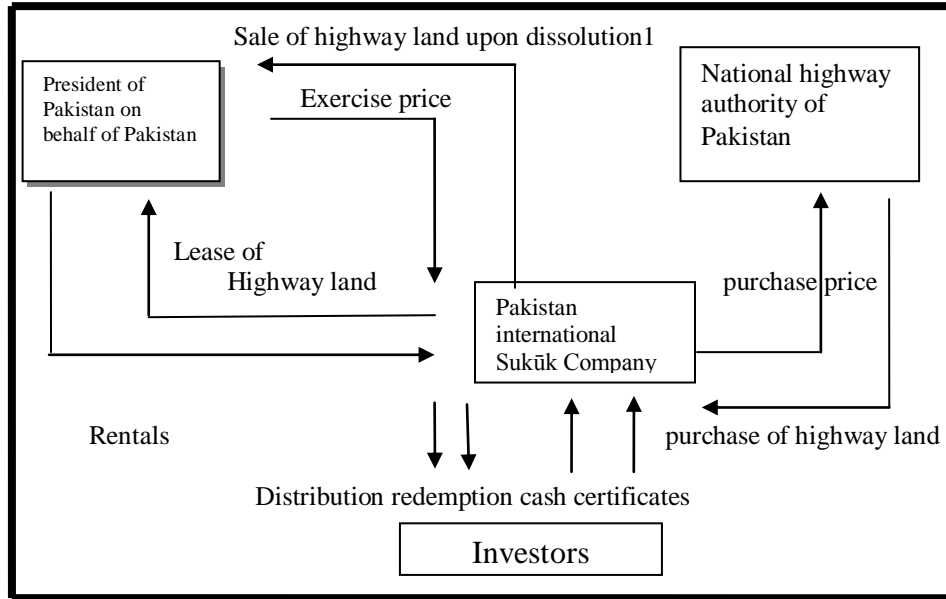
Structuring of Motorway *Sukūk* in Pakistan:

Ayub in his renowned book “understanding Islamic finance” explains this issue as: Pakistan ever first issue of *Sukūk* was launched in 2005 and it was worth 600 million US\$.⁷³ A special purpose vehicle named as, “Pakistan International *Sukūk* Company” was made and bought highway land (the land of Motorway- 2) from national highway authority (NHA)- a government based institution. After purchasing the land SPV/ PISC issued trust certificates (*Sukūk*). This issue later got a B+ rating from standard & poor (S&P). An offer was made as a result of which 1200 million US\$ orders were received from different accounts and after selecting worth 600 million US\$ the land was sold at par against 220 basis points above six months LIBOR. PISC bought motorway 2 lands and issued trust certificates after which the land was leased backed to the government of

⁷² Muhammad Ayub, *Understanding Islamic Finance*. Vol. 462. John Wiley & Sons, 2009.

⁷³ Ibid

Pakistan for a period of five years. The government of Pakistan made periodic payments as rental against the leased asset and, at maturity, will buy back the leased assets from SPV/PISC. A procedural diagram is given below for elaboration.



Structuring Of WAPDA *Sukūk* in Pakistan:

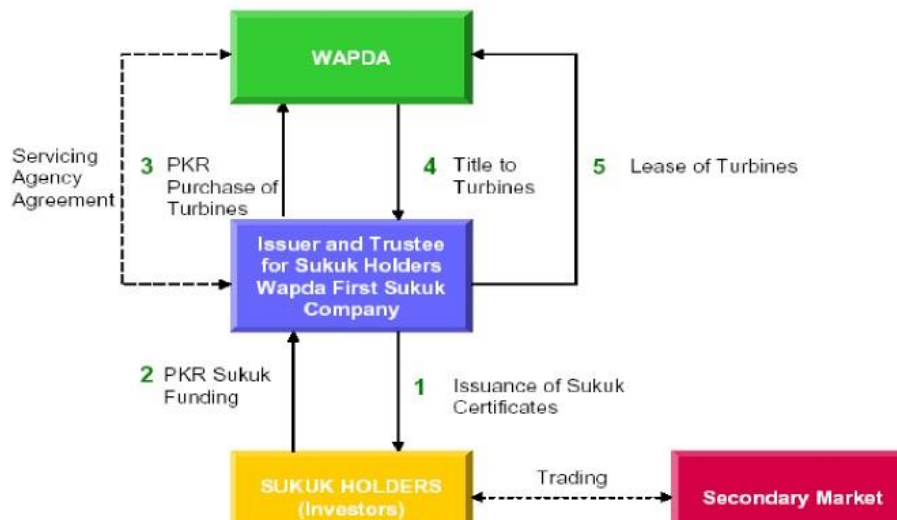
Water and Power Development Authority (WAPDA) of Pakistan issued *Sukūk* for the purpose of generating finances for Mangla Dam project (up to 8,000 million PKR⁷⁴). This *Sukūk* Company limited was named WAPDA SPV. Basically, these were long term *Sukūk* where the SPV was a wholly owned subsidiary of WAPDA and the funds were to be used for the purpose of financing small scale hydro power projects.

The structure of WAPDA *Sukūk* was designed on the basis of *Ijārah*. SPV sold certificates worth PKR 10,000 million to investors and used those funds to purchase identified units of hydro power generation turbines from WAPDA. Afterwards, WAPDA SPV leased those turbines back to WAPDA for a period of ten years. Return rate rentals were, therefore, benchmarked with KIBOR and those returns were distributed every six months. WAPDA promised to buy those turbines back at the end of the lease period at exercise price.⁷⁵

⁷⁴ Inclusive of a green shoe option of 2000 million PKR

⁷⁵ Hamad Rasool Bhullar. *Sukūk for Agriculture*, 2009. Online available at: www.slideshare.net/alhudacibe/Sukuk-by-hamad-rasool-bhullar (accessed on 10th April, 2013).

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(Source: Hamad Rasool, WAPDA transaction)

ISSUES IN *SUKŪK*- Islamic Commercial Law Perspective:

Despite of the fact, that *Sukūk* has gained an immense fascination during the last decade, certain issues have evolved in its development, structure and performance. Assorted Islamic Financial regulatory bodies, the world over, have tried to pass on various regulations and jurisdictions regarding these *Sharī'ah* and legal issues. Yet a range of practical issues continue to snub on daily basis. A good number of researchers have tried to mainstream these issues. The following details will further explore such issues.

Fixed Return:

It's a point of stern critique that the return rate on *Sukūk* is almost fixed or stable just as it thumps the return rate of conventional bonds. Almost in all *Sukūk* issues it's been acclaimed that the return should be based on the actual underlying business activity, nevertheless, actual practice shows that in most *Sukūk* issues it is related to the conventional return rates like LIBOR or KIBOR etc. Moreover, if the earning is less than the promised rate, the manager pays the residuals from his side as a loan to the investors. These loans are covered by keeping excess profits in times of good returns over the business. This practice of taking excessive profits and providing loans to the creditors by managers' is not allowed by *Sharī'ah* under any stretch of explanation.⁷⁶ There is hence a dire need, predominantly at jurisprudential level, to adopt a return rate devising mechanism that is not benchmarked with interest based system.⁷⁷ Linking of return rate with KIBOR is strictly criticized by the contemporary scholar. For instance, Muhammad Taqī Usmānī, a renowned scholar in the field of Islamic banking and finance, has the same opinion by saying that the use of KIBOR as a bench mark for the determination of profit surely makes the transaction (of *Murābahah* and *Ijārah*) resemble an interest based financing, at least in appearance, and keeping in view the severity of prohibition of

⁷⁶ Muhammad Taqī Usmānī, *An Introduction to Islamic Finance*, pp.18- 147

⁷⁷Mohammad Akram Laldin, "Sukūk in Various Jurisdictions: Sharī' ah and Legal Issues." *Journal of Islamic Business and Management* 2, no. 1 (2012), pp.15-34

interest, even this apparent resemblance should be avoided. He further adds that the Islamic banks and the financial institutions should get rid of this practice as it takes the rate of interest as an ideal for a *Halāl* business which is not desirable. Moreover, he says that the Islamic banks and other Islamic financial institutions should develop their own bench mark for the determination of profit.⁷⁸

Issues Pertaining to Guarantees/the issue of *Ribā*:

As mentioned above, almost in all types of *Sukūk*, the issuers guarantee a fixed or principal return to *Sukūk* holders, which is not in *Sharī'ah*.⁷⁹ Fixed return in Islamic law is always considered *Ribā*- an economic activity that is austere prohibited by *Sharī'ah*.⁸⁰ This can be taken as an extension of the issue related to the payment of a fixed return rate to *Sukūk* holders, and especially on those *Sukūk* that have been issued on the basis of *Ijārah*. For example, in a well know issuance of *Sukūk* by the Islamic development Bank in 2003(which was worth of 400 Million US Dollars), return rate for all the years, till their maturity in 2008, was calculated on the basis of fixed rate i.e. 3.635%. Another hard fact related to the distribution of returns on *Sukūk*, is the nonpayment of return on actual or realized profit and loss basis. Even, sometimes, the distributed returns are not the ones that are actually earned or generated by the assets underlying *Sukūk*; rather they might be generated by other enterprise activities.⁸¹ Therefore, it should be insured by the Islamic financial institutions that all returns are based on the actual profit, earned by the *Sukūk* asset. The rule of *Sharī'ah* Advisory Board, of the concerned financial institution, is very much vital in this regard.

Repurchase at Face Value:

Sharī'ah does not allow anyone to promise a stipulated fixed return, except in few cases. It has been severely criticized by Muhammad Taqī Usmani, the prominent *Sharī'ah* scholar and Chairman of AAOIFI. In his view, making a promise to *Sukūk* holders, while issuing *Sukūk*, especially the *Ijārah Sukūk*, that the asset will be purchased back from the *Sukūk* holders at its face value rather than nominal value at maturity, is not based on the principles of Islamic commercial law.⁸² This gives birth to certain issues e.g. the depreciation or any damages to the underlying asset are not taken into account while

⁷⁸ Muhammad Taqī Usmānī, *An Introduction to Islamic Finance*, pp.118-120

⁷⁹ Muhammad Tahir Mansoori, "Uses of Hayil in Islamic Finance and Its Sharī'ah legitimacy" *Journal of Islamic Business and Management*, 2011, 1 (1), pp.69-92

⁸⁰ *Sharī'ah* strictly prohibits interest based loans. There are many verses of the Holy *Qur'ān* and *Hadīth* of the Holy Prophet (SAW) that confirms this prohibition. For instance, in the Holy *Qur'ān Allāh*, the exalted, says "O Ye Who Believe! Fear *Allāh*, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and His apostle. But if ye turn back ye shall have your capital sums: deal not unjustly and ye shall not be dealt unjustly. (*Qur'ān* 2:278-279). In another verse the Lord of Universe says "That they took *Ribā* (usury), through they were forbidden and that they devoured men's substance wrongfully. We have prepared for those among men who reject faith a grievous punishment". (*Qur'ān*4:161) From Jābir, may *Allāh* be pleased with him, said: "The messenger of *Allāh* (SAW) has cursed one who charges *Ribā*, he who gives it, one who records it, and the two witnesses; and he said, "They are equal" (*Muslim Sahīh*, Chapter on *Ribā*, *Hadīth* no.1598).

⁸¹ Salman Syed Ali., *Islamic Capital Market Products-Developments & Challenges (Occasional Papers)*. No. 213. The Islamic Research and Teaching Institute (IRTI), 2005

⁸² Muhammad Taqī Usmani. "Sukuk and their contemporary applications." In *Translated from the original Arabic by Sheikh Yusuf Talal DeLorenzo, AAOIFI Shari'a Council meeting, Saudi Arabia*. 2007.

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making such a guarantee of repurchase at face value. This situation is tantamount to taking of others property by illegal means which is strictly prohibited by *Sharī'ah*.⁸³

Ownership Related Issues:

In most of the *Sukūk* Issuances, no true sale is executed in the books of record and accounts; while a true sale execution is the first and foremost important stipulation for the *Sukūk* to be *Sharī'ah* compliant. For instance, in the *Nakheel Sukūk* issue, which was an asset based structure, the rights of the leaseholders or *Sukūk* holders were not viewed as real property rights. This was so because no property law concerning such scenario was applicable in UAE.⁸⁴ Duski & Mokhtar have written in detail on the rules pertaining to the issues of *Taqabz* (possession or ownership) or the underlying asset in a contract.⁸⁵ The one basic element of the contract is that the subject matter of the sale should be in the possession of the seller, and should be in existence;⁸⁶ and complete ownership will be transferred immediately at the conclusion of the contract. The sale contract is otherwise deemed to be invalid. Muhammad Taqi Usmani has the same opinion by saying that no pro rata ownership exists in the case of *Mushārahah Sukūk*.⁸⁷

In *Sukūk* issuances, mostly the transfer of ownership to the SPV is a meager relocation of ownership. This is not in perfect accordance with the rules of *Sharī'ah*. *Sukūk* may be asset based in substance but may become asset backed in form. Furthermore, *Ijārah Sukūk* are very inflexible in nature i.e. the asset till the maturity of the *Sukūk* can't be used for any other purpose. In most of the cases it's not well defined who will pay the tax? Moreover, the wear and tear and the risk should be borne by the investors while in most of cases, ironically, it is accepted by the originator! All these aspects are related to the concept of ownership by one or another way. There is a dire need of academic research at this very aspect of *Sukūk* in order to rooted out these issue and many others of the same nature. The rule of contemporary *Sharī'ah* scholars, particularly those who are conversant with the field of Islamic finance, is very much imperative in this connection.

Issues of *Bay' al Ināh* (Buy-back Transaction in Islamic Commercial Law):

A big majority i.e., 68% of the *Sukūk* issued in Malaysian capital market are based on the contract features of *Bai' Bithaman Ajil* (i.e. sale and purchase at deferred price bases) due to the high yield producing nature of such *Sukūk* (Saad & Mohamad, 2012). There are many *Sharī'ah* issues regarding the permissibility of such a sale contract; owing to which most jurists have not given their consent to it.

Another commonly practiced sale contract, *Bay' al Ināh*, in various *Sukūk* markets, is also not an approved or valid contract from *Sharī'ah* perspective, however,

⁸³ For example the Holy *Qurān* says “And do not eat up your property among yourselves for vanities, nor use it as bait for the judges, with intent that ye may eat up wrongfully and knowingly a little of [other] people's property”. Al-Qurān, Al-Baqarah:188

⁸⁴ Omar Salah,. "Dubai debt crisis: A legal analysis of the nakheel sukuk.", (2010).. *Berkeley Journal International Publicist* 4, pp.19-32

⁸⁵ Asyraf Wajdi Dusuki, and Shabnam Mokhtar, Critical Appraisal of Sharī'ah Issues on Ownership in Asset- Based Sukūk as Implemented in the Islamic Debt Market. *International Sharī'ah Research Academy for Islamic Finance*. (2010) Paper No. 8.

⁸⁶ Shwkāni, *Nayl –al-Awtār*, vol. 5, pp.174-175

⁸⁷ Muhammad Taqi Usmani. "Sukuk and their contemporary applications." In *Translated from the original Arabic by Sheikh Yusuf Talal DeLorenzo, AAOIFI Shari'a Council meeting, Saudi Arabia*. 2007.

designed and issued in many countries e.g. Malaysia. Principally, in *Bay' al Ināh* the asset is being sold twice in the same session, first is on spot payment basis and secondly at a deferred and relatively higher price. This sale contract is, therefore, not supported by *Sharī'ah* due to its *Ribā* bearing nature. In the Malaysian capital market, *Sukūk* are issued and securities have been traded on the basis of *Bay' al Ināh* and *Bay' al Dayn* (Rosly & Sunasi, 2001).

In the recent times, some issues are also found in *Ijārah Sukūk*. In *Ijārah Muntahiya Bitamleek* (transfer of ownership at the end of the contract period) the issue of *Bay' al Wafā*; a type of *Bay' al Ināh*, exists which is not a valid commercial transaction from *Sharī'ah* perspective. In addition, the structure of *Ijārah Sukūk* is designed on the basis of sale and lease back; a sale contracts inviting high criticism from the scholar of the field.⁸⁸ On the same way, Goldman Sachs intended to issue a \$2 billion *Sukūk* on *Mudārabah* basis. At the very early of its issuance, many scholars rejected it by stating that it was a reverse *Tawarruq Sukūk* and, consequently, not permissible under *Sharī'ah*.⁸⁹

Issues Pertaining to *Sukūk* Ratings:

Jabeen has presented a very strong theory on *Sharī'ah* and current legal bases of *Sukūk*, comparing the structure of *Sukūk* to the clauses of Basel II.⁹⁰ In her view, the ratings of *Sukūk* yields or *Sukūk* performance is done through conventional rating agencies like Standard & Poor's; due to the lack of *Sharī'ah* compliant rating agencies. These rating agencies check the performance of any *Sukūk* type on the basis of its credit risks or credit yields.⁹¹ These credit rating agencies, in most of the cases, do not provide investors with the accurate information regarding the *Sharī'ah* compliance or quality of underlying assets in *Sukūk*. These fact, in real terms, create concerns for the *Sharī'ah* scholars, predominantly for those who are conversant with the field of Islamic finance. These credit rating companies, therefore, need to provide the investors full fledged information regarding the quality of underlying assets so that *Sharī'ah* concerned investors make better choices.⁹²

Issues Related to Asset Disposal:

After subscribing to the *Sukūk* securities, investors become the actual owners of the underlying assets or property as per *Sharī'ah* guidelines. Investors, therefore, own the actual property rights, the rights of disposing the underlying assets, distribute profit and share loss. In spite of these vibrant rules, issues regarding the disposal of *Sukūk* arise in almost all asset based *Sukūk*; where no rules regarding disposal are found in the contract deed under *Sharī'ah* head. This gives rise to the basic difference that exists between the asset-based and asset-backed *Sukūk*, as in case of the former, investors have no recourse

⁸⁸ Muhammad Tahir Mansoori, "Uses of Hayil in Islamic Finance and Its Sharī'ah legitimacy" *Journal of Islamic Business and Management*, 2011, 1 (1). pp.69-92

⁸⁹ Ahmad Khurshid (2012). *Sukūk and Associated Problems*. Retrieved from: <http://businessislamica.com/2012/07/10/Sukūk-and-associated-problems/> (accessed on 23rd March, 2013).

⁹⁰ Zohra Jabeen., "Sukuk: structural Analysis for Shariah and Regulatory Implication in Islamic Financial Intermediation." PhD diss., Mohammad Ali Jinnah University, Karachi, 2010.

⁹¹ Jhordy Kashoogie Nazar. "Regulatory and financial implications of sukuk's legal challenges for sustainable sukuk development in islamic capital market." *Ethics, Governance and Regulation in Islamic Finance* (2015), p.135

⁹² Jamal Abbas Zaidi, *Nature of Risk Present in Sukūk Structure Rating Agency Perspective in Sukūk: Islamic Capital Market series*. (Malaysia: Sweet & Maxwell Asia, 2009).

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to the underlying assets, while in the latter an actual sale takes place and *Sukūk* holders, therefore, have a right in the underlying property or assets.⁹³ The practice of trenching⁹⁴ is also subjected to severe criticism of scholars while disposing off assets.⁹⁵

Other Issues:

As a general practice almost all Islamic financial institutions have their *Sharī'ah* advisors in supervisory boards who keep eagle eyes on various financial instruments. However, the implicit desire of making exorbitant profits sometimes plagues this system too; just like the conventional banking system. These *Sharī'ah* advisors should, therefore, keep a strict eye on the prevalent practices of their concerned institutions.⁹⁶ Most of the *Sukūk* are issued on the basis of *Mudārabah* structure and certificates are disposed of while the assets are, ironically, still in cash form. This is a clear form of *Ribā* by one way or another.⁹⁷ Additionally, there is lack of well-structured and designed secondary markets on *Sharī'ah* basis where they can be traded freely.

Conclusion:

Being a complete code of life, *Sharī'ah* provides a comprehensive guideline for *Sukūk*, either through its general principles or through the extension of *Ijihād*. These generic principles are, of course, thoroughly discussed by the classical *fuqahā* in their academic endeavors since long; primarily during the elaboration of general guidelines of Islamic commercial law and, specifically, in the literature available on trading in currencies. All these, particularly, the latter ones can be effectively used by the contemporary scholars for the development and growth of *Sukūk*. Moreover, the issues involved therein, predominantly, those raised by the critiques, can be solved through the same way (principles).

As a matter of fact, the theory behind the Islamic economic system is far different from that of the capitalist and the communist, too, owing to many reasons. Islam believes, for instance, on justice and equality in all economic affairs and ensures, with the same force, the realization of these principles at any cost. In addition, it does not believe, to a small possible extent, on any type of discrimination on the basis of colour, creed, religion, sect and etc. - and follow the golden principles of equality and equity in all aspects of life including the economic one. While following this, Islamic lego-economic system endeavors to achieve a fair distribution of wealth by properly utilizing all factors of production, and aims at establishing a legal system, all together, where everyone is allowed to earn fair and legitimate earnings. By keeping in mind these guidelines, the believers are supposed to make all their

⁹³ Khalid Howladar, "The Future of Sukuk: Substance over Form? Understanding Islamic securitisation, Asset-Backed and AAOIFI principles." *Moody's Investors Service* (2009), pp.1-13; Dusuki, Asyraf Wajdi, and Shabnam Mokhtar, Critical Appraisal of Sharī'ah Issues on Ownership in Asset- Based Sukūk as Implemented in the Islamic Debt Market. *International Sharī'ah Research Academy for Islamic Finance*. (2010) Paper No. 8.

⁹⁴ Trenching is a prioritization process through which losses are distributed to various layers of investors.

⁹⁵ Mohammad Akram Laldin, "Şukūk in Various Jurisdictions: Sharī' ah and Legal Issues." *Journal of Islamic Business and Management* 2, no. 1 (2012), pp.15-34

⁹⁶ Albadran Badr Kaseb., "A mini project submitted in fulfilment of the requirements for the completion of Qualitative Research Methods course, for Doctor of Philosophy in Business Administration." PhD diss., International Islamic University Malaysia, 2010.

⁹⁷ Muhammad Taqi Usmani, *Sukūk and their contemporary applications*. Available at: www.iefpedia.com/english/wp-content/uploads/2009/11/Sukūk-and-their-Contemporary-Applications.pdf (accessed on 12th April, 2012).

commercial deals fair, and if anything is felt doubtful, resort can be made to the Holy *Qurān* and *Sunnah* of the Holy Prophet (SAW).

The present work elaborates the origin and features of contemporary *Sukūk* in Islamic *Fiqh*, followed by a legal and practical compatibility of *Sukūk* features, structures and current market practices with the *Sharī'ah* and regulatory guidelines. *Sukūk* market is, indeed, on the verge of maturity, and the numbers of *Sukūk* issuances, therefore, have consistently been increasing over the last two decades. In 2012, the volume of *Sukūk* issues reached US\$ 40 billion. *Sukūk* has been accepted and issued by giant business groups excessively due to the greater potentials for profit. Almost all of the *Sukūk* issuances have proved profitable so far and very few defaults have been witnessed in *Sukūk* as compared to the conventional bonds. Yet, there are some religious scholars who have shown their concerns over various issues, involved in *Sukūk* from *Sharī'ah* point of view. Such issues, without any doubt, spring out qualms on the *Sharī'ah*'s compliance nature of *Sukūk* in the minds of potential customers. The most important among these are those which are linked with the asset based *Sukūk*. The writers conclude that contentious *Sharī'ah* issues in *Sukūk* structures should be resolved through a rigorous consultative process, by duly improving the regulatory framework for securitization. *Sukūk* are, indeed, a very potent means of financing and investment but need close supervision (from the *Sharī'ah* scholars) to obliterate ambiguous things, featuring both in their structure and procedures. By clearly following the guidelines provided by AAOIFI and keeping a noble intention of gaining *thawāb* (heavenly return), *Sukūk* can emerge as the best mode of Islamic finance. To achieve, however, these intended objectives the concept (of *Sukūk*) can be applied in its spirit, envisaged by Islamic commercial law from its inception. Above all, it should not be used, under any stretch of explanation, as a mere tool for the maximization of profit- a purpose adopted by the contemporary conventional financial institutions.

The formation of certain prudential regulations regarding securitization in Islamic Finance is recommended by prominent *Sharī'ah* scholars. Besides, some recommendations, too, have come to the mind of researchers while studying various research works for the investigation of the issue. In accumulation, these are as under.

1. The classical literature, offered by the classical Muslim jurists, should be studied for structuring *Sukūk*'s theory.
2. The rules and regulations in Islamic commercial law, predominantly, those related to law of currencies should be kept in mind while dealing *Sukūk*'s trading.
3. The objectives of *Sharī'ah*, typically called *Maqāsid-al- Sharī'ah*, should be kept intact while structuring *Sukūk*.
4. There should be a complete possession, either physical or constructive by the *Sukūk* holders in the book entries and records. No undertaking for purchase at face value should be made. Manager should not offer loans in case the actual profit is less than the investment made. Let the investors share the loss.
5. Interest based mentality needs to be given up in order to gain greater reward hereafter, by making risk based, or profit and loss sharing securities.
6. *Sharī'ah* advisers should play a critical and active role in order to make all financing truly *Sharī'ah* compliant.
7. AAOIFI recommendations, mentioned earlier, should be followed.
8. In areas where non *Sharī'ah* compliance issues are faced due to use of *Hiyal* or other factors, new verdicts should be issued that confine acts to remain within the purview of Islamic boundaries.