The Critical Shariah Issues of Sukuk

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Abstract

Purpose: The aim of the paper is to review some of the important Shariah issues of sukuk, especially in light of the controversies harboring some of them. The paper treats the three most critical Shariah issues of sukuk, which govern the legitimacy of sukuk from issuance to redemption. They relate basically to guaranteeing the capital invested and the return to the sukukholders, the sukuk being real representative of ownership of the underlying assets and the tradability of the sukuk.

Methodology: The paper employs a qualitative research methodology that adopts a textual and fiqh comparative analysis approach. The methodology also incorporates a macro perspective for treating the subject by analyzing the overall picture of sukuk in their current status.

Findings: The study primarily finds that certain controversies harbour the current standard stuructes of sukuk, which necessitates a revisit to sukuk engineering as it may have unnecessarily challenged the potential of sukuk on one hand and may have challenged some of the Shariah principles on the other.

Limitations: The study does not cover the accounting assepts of Sukuk nor does it cover their financial aspects.

Practical Implications: The study should help reconsider how sukuk should be structured to meet Shariah requirements.

Originality: Although the paper addresses some of the issues that have been addressed before, it acquires its significance and value from setting the basis for what constitutes Shariah compliant sukuk as an Islamic capital market insturments and showing the areas that need reform and resconsiderations.

Keywords: Sukuk, Guarantees of Sukuk, Tradability of Sukuk, Ownership of the Sukuk Assets

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Introduction

Bonds are one of the most important financial and investment instruments. They enable the bond issuer to receive finance, and the bondholders to gain profit while having easy access to liquidity by reselling the bond when needed in the financial market (the capital market). However, bonds are based on the principle of a loan with interest, i.e. riba, as the buyer of the bond is considered a lender who earns interest from the issuer. The bond issuer promises to return the face value (i.e. the amount of the loan) upon the maturity of the bond, and pay an additional fixed amount on top of it. The issuer's guarantee of the face value of the bond makes it a loan, which renders the increment repaid on top of it riba. The trading of bonds is another problem from Shariah perspective, because it involves a sale of debt that does not fulfil its Shari'ah conditions, i.e. the maturity of the debt sold and the equality in the counter-values.

Sukuk (sing. sakk) have been proposed as a Shariah-compliant alternative to bonds. They help the sukuk issuer get the needed finance and the sukuk holders gain a profit with investment flexibility in terms of easy exit, similar to bonds, but in a Shariah-compliant fashion. It is natural that the Shariah legitimacy of this alternative arrangement necessitates the absence of guaranteed capital or return, as this is the main reason for the prohibition of bonds.

The common structure of sukuk is when the party that is in need of financing sells assets that it owns to the sukuk holders so that they become the owners of the assets. The same party then rents the assets from them. Hence, the sukuk holders earn from the rental amount. The sukuk issuer promises to buy the assets at a specified date in the future that is the maturity date of the sukuk. Through this sale contract, the sukuk holders get their capital back if the second sale price is the same as the first.

The paper treats different issues pertaining to the sukuk structure. These issues are ones that should distinguish sukuk from bonds. Basically, they relate to guaranteeing the face value and the 'projected' return of sakk to the sukukholders, the sukuk being real representative of ownership of the underlying assets and the tradability of the sukuk. While all these issues pose Shariah concerns, they are not of same importance. In fact, the first issue, i.e., guarantee of the sakk face value and return acquires special importance, as it is what practically distinguishes sukuk from bonds. This guarantee can be achieved by different means, and it varies according to the sukuky type. Some guarantees can be accepted, while others cannot. All this necessitates extensive study of the guarantee issue, and hence, it has been allocated a significant part of the paper.

After examining the detailed guarantee issues of sukuk, the paper proceeds to discuss how sukuk should represent common ownership of the sukuk underlying assets, and how failing to do so

may invalidate the very structure of the sukuk and thus undermine the very legitimacy of the sukuk. The paper, in this context, exposes certain market practices that may confirm the nature of some of the modern-day sukuk not being representative of real ownership, as those practices legitimately question the very sale of the sukuk assets to the sukuk holders. Finally, the paper tackles the last Shariah issue of sukuk; the tradability of the sukuk in view of the composition of their underlying assets, and it envisages four different scenarios in this regard. The paper then concludes with results and remarks.

In fact, the importance of the papers stems from tackling the above issues with the use of a critical scholarly methodology that subjects all relevant issues to careful Shariah scrutiny. The paper, unlike the most of the studies of sukuk, investigates sukuk in their real practices and not in their theory or ideal form. While comparing sukuk with bonds throughout the study, the paper implicitly draws the outlines of what constitutes genuinely Shariah compliant sukuk, so that their identity can be assured as Islamic and not just a replica of bonds.

The essential difference between a sakk and a bond is that a bond is a financial paper of a specified value representing a right to debt with interest, i.e., riba. The debt amount is made up of the original purchase price of the bond and the riba earned for its period. As for the sakk, it represents a right in the ownership of existing underlying assets that may include some cash and debt. In any case, a Shariah-compliant sakk does not guarantee the holder the amount invested (the face value of the sakk), or any return above that, unlike the bond, which guarantees to the holder its face-value and a fixed return on top of it. In addition, the circulation of sakk is not a circulation of debt, as a sakk represents underlying assets. If a debt is present in the sakk assets, it may only be part of it.

1. The Shariah Issues of Sukuk

It can be noticed that since their inception, Sukuk have been harboring some Shariah concerns. Most of the sukuk that have been issued so far have practically provided guarantees of the face value of the sakk, i.e. it original paid price, as well as its promised return. From a Shariah perspective, this removes any substantial difference between a sakk and a bond. It has also been noticed that the sukuk holders do not have actual ownership of the sukuk assets, as the sukuk holder does not actually own the sukuk underlying asset. This shall also affect the legitimacy of the sukuk and render their circulation a circulation of debt, and not the assets represented by the sukuk.

If the two concerns mentioned above occur in any sukuk issuance, they strip sukuk of their Shariah legitimacy and place them in the same basket of bonds. In fact, these two issues, in

addition to the tradability of sukuk, are the most serious Shariah issues of sukuk, and hence the need to discuss them in detail, as follows.

1.1 Firstly, Guaranteeing the Face Value and the Return of the Sukuk

Sukuk issuance includes various guarantees for the sukuk holders, some are problematic from Shariah perspective while others are acceptable[2]. The types of guarantees are discussed as follows:

1.1.1 Types of Guarantees Presented to the Sukukholders

a. Guarantee from the Sukuk Manager Based on the Feasibility Study

It is an established rule of the Shariah that the fund manager is not liable for loss unless when caused by his negligence, misconduct, or breach of the investment terms and conditions. Thus, the fund manager cannot entice potential investors by providing them a guarantee of their funds or return. However, some contemporary ijtihād tends to permit the sukuk manager - whether as a partner (sharīk), or an entrepreneurial partner (mudārib) or an investment agent (wakīl) to guarantee the face value of the sukuk, i.e., the invested capital of the sukuk holders, or its projected return, on the basis of the feasibility study, which the sukuk manager submits prior to the investment.[3] Usually, the sukuk manager conducts a feasibility study (on the feasibility of the investment project), showing the likely success of the project and its profitability. According to this opinion, the sukuk manager can be held liable for this study so that if afterward he claims the occurrence of loss and fails to prove that the loss occurred for a reason beyond his control, he becomes responsible for the loss. If, however, he proves that he is not to blame for the loss, then he bears no financial liability.

This ijtihad is predicated on the premise that the default position is the soundness of the feasibility study, i.e. that the project is profitable. If the manager claims loss for no obvious reason, the manager goes against this default position and is required to show proof that the loss was not caused by his misconduct or negligence. If he is unable to do so, he must bear the loss. The reasoning here is that the loss in the aforementioned case indicates the deception (taghrir) of the investors by the manager. This deception entails a guarantee/compensation[4] (damān as is known

[2] It is worth noting that we see "Islamic" sukuk receiving an excellent credit rating by conventional international rating agencies, despite the fact that their rating is primarily based on guarantee of capital and return, which is inconsistent with the essence of Islamic investment. There would be no problem in rating the sukuk if the criteria used in the rating were Islamic, not based on the guarantee factor, but rather on matters such as the experience and solvency of the investment manager in the event he became liable due to mismanagement or violation of the investment terms and conditions.

[3] Al-Fatawa Al-Shar'iyyah, Dubai Islamic Bank, 2/88.

[4] For details on the effect of *taghrir* see Haidar, Ali, Durar al-Hukkam Shareh Majllat al-Ahkam, 1/312.

in fiqh). This ijtihad is also based on the hadīth: "The hand is responsible for what it takes until it return it back"[5]; so accordingly, the investment manager is responsible for the money until he proves his innocence.

Considering the reasoning of this ijtihad, and the general investment conditions and mechanisms in our time, this ijtihad seems acceptable but after qualifying it with certain conditions. The purport of ijtihad is shifting the burden of proof from the fund provider to the fund manager. Either way, the sukuk remains a trustee (amīn) and not liable for any loss so long as he can prove that there was no violation of trust or negligence on his behalf with regard to the management of the sukuk. This, in fact, involves a slight modification of the stand of the jurists regarding the liability of the fund manager. They consider him a trustee (amīn) and do not hold him responsible for proving that there was no shortcoming or misconduct on his part regarding his role as the fund manager, such that he would have to provide compensation. Instead, they consider him to have performed his duty and is free of such a responsibility until the fund provider proves the opposite.

In other words, the established Fiqhi stand would not hold the fund manager responsible for losses until the fund provider proves that the manager acted in a way that would necessitate compensation from a Shariah perspective. However, the novel ijtihad differs from the known Fiqh position on determining who is required to give proof with respect to the extent of the responsibility of the fund manager. In the established Fiqh it is the fund provider, while according to this new view, the burden of proof is on the fund manager.

In fact, this new opinion has its merit, especially that the investment manager is a claimant from one perspective as he has made a prior claim of the project's feasibility and its profitability that is supported by a detailed study; therefore, he should stand behind his study (claim), defend and maintain his non-negligence. Furthermore, the investment conditions of the present-day differ from the past, as the fund manager could be an Islamic bank or an Islamic institution that invests the money of thousands of customers. It cannot afford to expose their money to unnecessary risk, especially in light of the proliferation of fraud and the weakness of the religious inner-conscience people, in general, have nowadays.

From another perspective, accepting and adopting this view that the investment manager is responsible until the otherwise is proven encourages Islamic financial institutions to enter into real investment activities through mudaraba or musharaka. Besides, it should reduce their

[5] Ahmad, *Musnad*, No. 20086, 33/277; Abū Dāwūd, *Sunnan*, No. 3536, 3/321; al-Tirmidhī; *Sunnan*, No. 1266, 3/566.

reliance on securing profits through financing based on a formalistic sale of commodities, which may not differ in essence from conventional finance.

Nevertheless, the above has to be circumscribed with the following conditions:

- The prospectus clearly includes the liability of the sukuk manager in the way described above, and the sukuk manager agrees to it.
- The prospectus clearly states the reasons of loss for which the investment manager shall not deem liable, such as unpredictable market volatility, financial crises, or natural disasters.
- In case of loss, the parties must invoke an independent external arbitrator with Shariah credentials and necessary business experience to determine the extent of the sukuk manager's liability, if any.
- In case the sukuk manager is unable to prove non-responsibility for the loss, his liability must be limited to the capital invested only, i.e., the nominal value of the sukuk, so it does not go beyond that to include any profit or the market value of the sukuk prior to loss. This is because this Fiqhi opinion comes as an exception to treat a certain problem, so it cannot be expanded to include other than the amount actually invested (upon subscription).
- In case the sukuk manager is held liable for the loss, a distinction has to be made between what lies within his responsibility and what does not. This is because his infringement could be preceded by an event that he could not be considered responsible for, such as a sudden fall in the market value of the sukuk assets below their face value. Accordingly, in this case, the sukuk manager should not be held liable for the entire face value of the sukuk, but rather only for the market value of the sukuk before his infringement. In other words, his liability for loss should correspond to his fault only.

b. Promising to Buy the Sukuk Assets

Typically, the sukuk manager promises to buy the sukuk assets (redeem the sukuk) on their maturity date. However, the sukuk differ in the type of promise given. It could be a promise to buy the sukuk assets for the following values:

- The market price of the sukuk assets at the time of redemption
- A fair' price (a valuation of the assets by experts)
- A price agreed upon at the time of redemption

- The face value

- A price determined when giving the promise.

It is noticeable that there is no capital protection in the promises to buy the sukuk assets at the market price, at a fair price, or at a price agreed upon at the time of buying. This is because the price in all three cases is not predetermined, and it could be much lower than the face value, which negates the capital being guaranteed.

However, if a price is determined beforehand, or agreed beforehand, whether explicitly or implicitly, to be equivalent to the face value of the sukuk, then the prohibited capital protection materializes. In the first case, the sukuk issuer or manager guarantees a certain price for the sukuk holders. Even if this price is less than the face value, it is still unlawful because it involves a partial capital guarantee, while the capital, according to Shariah, must not be guaranteed at any magnitude. The same applies to promising to buy the sukuk assets at the face value, as it renders the capital fully guaranteed. Such a promise goes against the rules and principles of investment in Islamic financial law, which clearly define the relationship between the fund provider and the investment manager in terms of liability for loss and capital or profit protection, as discussed earlier.

It is also worth noting that the occurrence of this prohibited guarantee is not negated by the possibility that the promise is not effective or acted upon in case the sukuk assets are lost or destroyed, due to the absence of that which the promisor could buy in this case.[6] This is because the mere issuance of such a promise is prohibited, not to mention the fact that the total loss or destruction of the sukuk assets is rare, and Shariah rules cannot be established on rarities.

I. The Position Permitting a Promise To Buy Sukuk at Their Face Value on the Basis That the Market Price of the Investment Sukuk Equals Their Face Value in Cases Where There Is No Loss

Some contemporary opinions deem it permissible to issue a promise to redeem the sukuk at their face value on the basis that the market price of the investment sukuk does not differ practically from the face value in cases where no losses occur.[7] This is because the sukuk manager distributes the profit periodically, and the determination of the amount of profit to be distributed is done in reference to the capital, because profit is that which is in excess of the capital. Hence, if the profit

[6] It has been argued that even with the purchase undertaking to redeem the sukuk at the face value, the capital protection is negated, since in case the sukuk underlying assets are totally lost or destroyed, no sale would take place, which would negate, in principle, guaranteeing the face value of the sukuk.
[7] Al-Fatawa Al-Shar'iyyah, Dubai Islamic Bank, 4/89.

is all distributed upon maturity of the sukuk, then what remains is the capital (i.e. the value of the sukuk assets after profits are distributed is the same as the face value). The same occurs if there is no profit or loss - the face value will be the same as the market value. Hence, there would be no issue with giving a promise to buy the sukuk assets (redeem the sukuk) at the face value, because in practice, it is the same as the market value.

However, the argument above may apply only to cases when the sukuk proceeds are utilized in cash financing only. It does not apply to the cases where the sukuk proceeds are converted into assets, such as real estate properties or goods, for the sake of renting them out or trading them, and are not finally liquidated until the maturity of the sukuk. Such assets are supposed to be sold at the end of the investment in the market, i.e., for the market price. Most likely, their selling market price would not match their original purchase price.

Besides, even if we accept that the face value is equal to the market value in cases when profit is made, or at least no losses occur, this does not justify permitting the sukuk issuer to promise or undertake to redeem the sukuk at face value. This is because even if a loss is not expected to occur, it still could happen as long as we consider the whole process a real investment project and not a form of financing with a guaranteed profit, i.e., with hidden interest. The very existence of this promise/undertaking implies a guarantee that is prohibited by the Shariah, just like it is prohibited for a mudārib or a partner (sharīk) or investment agent to guarantee the capital even if the probability of the loss is next to nil.

II. Promise to Buy Ijarah Sukuk Assets

Ijarah sukuk are the most popular type of sukuk, as mentioned earlier, especially the structure which involves selling an asset by the sukuk issuer, then leasing it back from the buyer. This structure of sukuk corresponds to securitization in conventional finance, where an owner of an asset securitizes the asset; i.e., issues securities against it to obtain cash from the subscribers. These sukuk also achieve a reasonable risk-free return for their holders. Besides, there is no Shariah restriction on their tradability from issuance to redemption, which makes them more appealing to the Islamic capital market than the other types of sukuk.

Practically, the promise to buy the sukuk assets in ijarah sukuk is either at a price equivalent to the remaining unpaid installments in the case of sukuk of ijarah ending-in-ownership, or at their face value in the case of sukuk of operating ijarah, as follows.

III. Promising to Buy the Sukuk Assets in a Lease (Ijarah) Ending-In-Ownership

Ijarah ending-in-ownership is an ijarah contract that ends with transferring ownership of the leased asset either by a sale at a token price or by gifting. The lessor is not harmed by this, as he

covers the costs of ownership of the leased asset and achieves profit on top of that through the total rentals that the lessee has paid up until the end of the agreed rental period.

Some ijarah sukuk have been designed in accordance with this contract, whereby the sukuk issuer sells the assets to the sukuk holders and then returns to lease them in an ijarah ending-in-ownership. Some fatwas (e.g. AAOIFI) permit the sukuk manager to promise to buy the assets at the end of the ijarah period for the remaining unpaid rental installments (if the ijarah contract ended for any reason), on the basis that the remaining unpaid rentals represent the net value of these assets.[8]

However, this opinion sounds debatable because two scenarios are perceivable here. The first one when the sukuk manager is also the (original) seller of the assets and then is the lessee in an ijarah ending-in-ownership. The second scenario is when the sukuk manager is not the original seller of the rented assets, who then leases them from their new owners (the sukuk holders).

In the first case, a prohibited guarantee of the capital occurs in addition to a guarantee of the profit; the sukuk manager who is the seller of the assets promises in case of the ijarah contract being broken for any reason to pay an amount equal to the remaining amount of the rental installments. In this financial structure, the lessee/financed party guarantees - through the sukuk – for the financing party (i.e., the sukuk holders) the amount of finance (issuance amount) and a profit on top because the total amount of rent for the contracted rental period is more than the amount of the sukuk issuance, i.e., the amount of financing. This constitutes a prohibited guarantee of capital and return. There are also some potential problems surrounding this structure, where the seller himself leases what he sells through an ijarah ending-in-ownership.

As for the second scenario, the guarantee of capital and profit is also achieved for the sukuk holders from a non-independent party, i.e., the sukuk manager. The market value of the leased assets could be less than the total remaining rental instalments of the ijarah ending-in-ownership. The lease contract could also be nullified after a short period from its start, making the loss greater upon the sukuk manager, who is the guarantor.

IV. Promising to Buy the Sukuk Assets in An Operating Ijarah at Their Face Value

According to AAOIFI Shariah standards[9], it is permitted that the lessee in ijarah sukuk, where the Ijarah is a normal operating ijarah, to promise to buy the leased assets at the maturity of the sukuk for the face value of the sukuk, as long as the lessee is not as a partner, a mudarib or agent of the investment in this sukuk structure.

[8] The fatwa by AAOIFI Fatwa Council related to Sukuk as appendix to it.
[9] The fatwa by AAOIFI Fatwa Council related to Sukuk as appendix to it.

However, in the practical application of this type of sukuk, the lessee in the operating ijarah is normally the seller of the leased assets. He pays the rentals throughout the rental period and then buys the leased assets for the face value of the sukuk, i.e. for the price that he originally sold the asset. The net rentals that the lessor/buyer (sukuk holders) gains during the rental period is an increment over the money (finance) he has paid as a price of the assets. This price (finance amount) is going to be repaid to him when he sells back the asset to the same lessee. This practice resembles what is known in Fiqh literature as bay' al-istighlal',[10] which is a legal-tick to riba if the lessor does not practically assume the liabilities of the leased corpus.[11]

Thus, it is necessary not to view this undertaking as a promise from a party that is independent of the party managing the sukuk, but rather to look at the structure in its most common practical application.

1.1.2 Various Issues Related to Sukuk Guarantees

a. Provision of Implicit Capital Guarantee through the Inclusion of Incentive Clause Combined with the Auction Sale

Incentive and auction sale have been used_as a trick in some sukuk structures to provide face value protection to the sukuk holders.

Since the undertaking by the sukuk manager/issuer to redeem the sukuk at their face value (repurchase of the assets sold at the same original selling price) is unlawful, in view of the capital protection such undertaking achieves, some Sukuk issuances involved a contrivance to this basic rule. In the prospectus, it is stipulated that the sukuk holders waive to the sukuk manager/issuer upon redemption whatever amount exceeds the face value of the sukuk. Upon maturity of the sukuk, the sukuk underlying assets are offered for sale at auction, whereby the sukuk manager/issuer is one of the bidders. Therefore, no one can compete with or overbid the sukuk manger/issuer as the amount in excess of the face value of the assets eventually reverts to him by virtue of the incentive. Thus, although such prospectus does not involve an undertaking to redeem the sukuk at face value, but implicitly it does.

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[10] Ibn Abdeen, Al-Hashiyat, 4/248; Ibn Taimiyah, Al-Fatawa, 30/333-335.

[11] In practice, the sukukholders are absolved of all the liabilities that are associated with ownership. After signing the lease contract with the sukukholders, the lessee assumes the owner-type liabilities on behalf of the owner (sukukholders), and then whenever he pays some expenses on the lessor's behalf, an equivalent amount will be added up to rental payable in the subsequent lease period. Thus, the owner/lessor does not bear effectively the ownership liabilities, but rather the lessee does.

Effectively, the auction in the above structure is useless, as it is only meant to justify providing the sukuk holders with capital protection. On the other hand, it does not give them the chance to make any capital gain, thanks to that incentive.

b. Guaranteeing the Face Value of the Sukuk by a Third Party

If the guarantee to the face value of the sukuk or their return is issued by a third party that is truly independent of both sukuk parties, such that it can be considered a pure donation, then the guarantee can be deemed permissible. This is because it is a donation (hiba) in essence, even though it is called 'guarantee'. Effectively, it is a gift to the beneficiaries (sukuk holders) but conditional on their losing the invested money or failure to achieve the expected rate of return. The gharar (uncertainty) befalling the gift, due to being conditional on an uncertain event, is unobjectionable in the Shariah, because gharar can be tolerated in contracts of donation.[12] Therefore, such a third-party guarantee may be accepted as long as it can be regarded as a pure gift and so long as it is independent of the contract that governs the relationship between the sukuk parties, as stated in the resolution issued by the OIC Fiqh Academy.[13]

c. The Sukuk Manager Guaranteeing a Particular Party He Deals with

If the sukuk manager selects a particular party to deal with despite the risk or doubts surrounding him, such as an a particular construction company or a particular supplier of commodities, then guaranteeing this party by the sukuk manager in favor of the sukuk holders is acceptable from Shariah perspective. However, the guarantee has to be through a separate contract and without compensation, i.e. it has to be free of charge. Such kafāla (guarantee) does not involve the protection of profit or capital to the sukuk holders. At most, it implies a voluntary commitment from the sukuk manager towards the sukuk holders that the party he selects to deal with stand up to its agreements, such as executing projects or repayment of the debts that result from contracts. Executing such agreements may not necessarily produce a profit to the sukuk holders or prevent a loss. Hence, such kafala does not involve a guarantee of the sukuk face value or their expected return, which makes the matter acceptable.

d. Provision of Guarantees through SPV

When the SPV (Special Purpose Vehicle) is established by the sukuk issuer/manager, the guarantees of the sukuk face value or return become unacceptable, simply because the SPV is not, from a Shariah perspective, an entity that is independent from the sukuk issuer/manager. Companies that have the same owners or shareholders (sister or parent companies) should be

[12] Al-Dasuqi, Al-Hashiyat, 3/22; Al-Hattab, Muwahib Al-Jaleel, 4/37.
[13] OIC Fiqh Academy resolution No. 30 (4/5).

treated like one company according to the Shariah. This makes the guarantee given by the SPV a guarantee given by the party that established the SPV, and hence the invalidity of guarantee. In fact, if such guarantee were permissible, it would constitute a legal device to circumvent the prohibition of guaranteeing the capital or the return.

e. Distributing Prizes to the Sukuk Holders

The sukuk sponsors may announce prizes through a raffle that is aimed at attracting people to subscribe to the sukuk. Here we have different scenarios:

One: The cost of such prizes are ultimately born by the sukuk holders, i.e. the cost of prices affect their distributable profit. In this case, the sukuk holders unknowingly enter the draw with their own money. This involves deception and makes the matter akin to gambling (qimār).

Two: The cost of the prizes is not ultimately paid by the sukuk holders. In this case, if the prizes are significant in value there is a suspicion (shubha) of gambling because the chance of winning prizes could be the reason why some people subscribe, meaning that they pay the price for entering the raffle, which is prohibited. If, however, the prizes are insignificant in value, such that they do not constitute a real motivating factor leading people to subscribe, then they could be undoubtedly acceptable.

Likewise, if the prizes are given to all the subscribers and paid by the sukuk manager, then in order to be permissible, they should not be of high value, because if they are of high value, the process then involves guaranteeing part of the capital that the subscribers contribute towards. This part of the capital is the value of this prize that the sukuk holders receive, i.e., they are guaranteed some money in an investment where no money should be guaranteed. If the sukuk manager deducts the value of the prizes from the anticipated profits of the sukuk holders, then the process involves deception (taghrīr), since there are no real prizes in this case.

f. Forming a Reserve from the Sukuk Returns to Cover Possible Future Losses or Unstable Income

OIC Fiqh Academy[14] ruled that it is permissible to deduct a certain percentage of the sukuk profits at the end of every investment period, whether paid from actual profit achieved or on account of revenue expected and to place it in a special reserve to meet the various risks that may face the investment.

[14] Resolution No. 30 (4/5) regarding *Muqarada* and investment sukuk.

However, such fatwa should be qualified by enabling the sukuk holder to regain what has been deducted from his profit to form this fund when he withdraws from the investment because he does not consent to deduct it as a donation. Rather, he consents in order to benefit from it himself afterwards in order to achieve a regular return. He does not leave it to others but leaves it for himself in order to receive it at a future period, given that the whole undertaking is an investment with the aim of increasing wealth. This process differs from Islamic takāful insurance, which does not aim to be an investment or gain an investment return but to overcome life hardships. Therefore, it should be the right of the sukuk holder who exits to regain that which was deduced from him when forming the reserve, if not utilized.

g. Reclaiming the Sukuk Face Value After Subscription Ends and Before the Investment Commences

If the sukuk holder is allowed to regain the face value of the sukuk before the investment commences, this is not a prohibited guarantee but a decision not to invest, which is permissible. This is because the investment, which is prone to loss, has not yet commenced. As such, by giving the sukuk holder the right to regaining the face value no prohibited guarantee occurs.

1.2 Secondly, the Issue of Sukuk Holders Owning the Sukuk Assets

With respect to the sukuk being representative of their underlying assets, sukuk can be classified into two types, the asset-based sukuk and the asset-backed sukuk.

The difference between the two is that from a technical legal perspective the sukuk assets of the first type (the asset-based sukuk) are a security (rahn) against the value of the sukuk. These sukuk do not actually represent ownership of the assets. In addition, the sukuk owners are not given any specific rights over these assets, but rather they are treated as normal debtors in case the issuer goes bankrupt. As for the second type, the sukuk holders have specific rights over these assets, and are not treated pari passu with the other debtors in case the issuer goes bankrupt. Rather, when the sukuk assets are sold, they are the first to receive their claim from the proceeds of the sale. However, from a legal perspective, the holders of those sukuk are not considered owners of the assets. Rather, the assets are a mortgage (rahn) against the money that they paid when buying the sukuk, and they have priority rights over the remaining creditors if any, but they do not own the balance of the sale proceeds, if there is a balance. Furthermore, they are not legally allowed to act upon the assets as an owner does. In many sukuk structure of this type, ownership is transferred to an SPV that the sukuk issuer establishes and owns so that the SPV acts as an agent representing the sukuk holders in the ownership of the assets. However, the sukuk holders remain unable to dispose of or act upon these assets, and they are not considered legal owners of the assets.

This is the difference between these two types of sukuk. It relates to having a specific claim right over the underlying assets, but it has nothing to do with the real or legal ownership of the underlying assets, as both are the same in this regard. This difference, in fact, is not unique to sukuk, but rather a common difference in bonds and other types of debt documents, as known in the literature related to debt securities.

If this is the case, then sukuk of both types do not, from a Shariah perspective, represent ownership of the underlying assets. Rather, these assets are simply security (rahn) provided by the sukuk issuer against the value of the sukuk, i.e., the sukuk proceeds. This undermines the legitimacy of the sukuk and turns them into debt. Consequently, the profit that is distributed to sukuk holders cannot, therefore, be justified from Shariah perspective, as debt is not supposed to generate any income to the creditor, and the very circulation of sukuk becomes problematic due to their being debt securities in essence.[15]

Therefore, sukuk have to represent ownership of the underlying assets, and this is the basis of their validity and legitimacy from the Shariah perspective. If this core requirement were compromised, sukuk would effectively be nothing but bonds.

The following facts harboring most of the issuances of sukuk confirm the nature of modern-day sukuk not being representative of real ownership, as these practices question the very sale of the sukuk assets to the sukuk holders:

- It is possible, that the sukuk underlying assets are not valid for sale in the first place, such as some government properties. The laws of a country may not allow the government to transfer its properties to the private sector, or the government may not be willing effectively to sell them. Yet, we may witness in such countries sovereign sukuk where the underlying assets are ports, airports or some essential public services! The structure of the sukuk necessitates that the government has sold the underlying assets to the sukuk holder. However, in reality, the sukuk holders do not own these assets and cannot own them, and if the sukuk are Ijarah sukuk , as in most cases, then there is no real lease that justifies receiving the rentals, rendering thus the whole process as financing with a guaranteed interest return.

- In most cases the sukuk assets selling price does not reflect their market price, but rather the required financing amount. This amount could be significantly more or less than the market

[15] Sale of debt is subject to strict Shariah rules, the breach of which leads to Riba. Trading sukuk, if deemed debt securities, in the secondary market breaches these rules. Al-Dasuqi, Al-Hashiya, 3/63; Al-Sherbini, Mughni Al-Muhatj, 2/71; Al-Hattab, Muwahib Al-Jaleel, 4/368; Al-Bahuti, Kashaf al-Qinah, 3/307; Ibn Abedeen, Al-Hashiya, 4/160.

value of these assets. Neither the issuer nor the sukuk holders would care, because the 'selling' party would 'repurchase' them afterwards for the same price that he 'sold' them for, and not the market price. This matter confirms that the sale of assets is a mere formality. If the sale was real and the ownership would actually be transferred to the sukuk holders, they would be cautious not to own them for a value above the market price, and the seller would be cautious not to sell them for less than the market price. However, in practice none of the parties, the issuer or the sukuk holders, could be aware of the sale thing, but they appreciate that they have to formulate the contracts in a 'peculiar' manner to fulfill the requirements of 'Shariah compliance'.

- The sukuk holders do not benefit from any appreciation in the market value of the underlying sukuk assets. Practically, the sukuk issuer 'buys' back the sukuk assets for the same amount that he 'sold' them for, and they have no option but to 'sell' them to the issuer, and for the same price. If the sukuk owners were the real owners of the underlying assets, they would be able to possibly gain from the selling price of these assets (achieve capital gain), or even have the option to sell them to a third party, in case they could not reach an agreement with sukuk issuer.

1.3 Thirdly, the Tradability of the Sukuk

Trading of securities representing different types of assets, such as sukuk and shares, could be problematic from the Shariah point of view. It is established in the Shariah that the sale of cash money or debt is subject to certain Shariah restrictions. The Shariah requires that when money is sold for money, the two counter values must be equal in amount, and the transaction must be executed on the spot, such that none of the two counters value can be delayed.[16] Similarly, debt is subject to the same rules as long as the debt is money, and since the debt is a liability in the description and not payable on the spot, its sale for cash money or counter debt becomes impermissible.

In the context of sukuk, they typically represent different types of assets, which most likely include debt or cash. While cash and debts are not tradable in essence, the sukuk other typical assets, such as real estate properties, commodities, and services, are tradable.

However, there are some considerations that relate to the sale of securities in general and sukuk in particular, on the basis of which we may tolerate trading the debt or the cash included in those securities.

[16] Al-Dasuqi, Al-Hashiya, 3/63; Al-Sherbini, Mughni Al-Muhatj, 2/71; Al-Hattab, Muwahib Al-Jaleel, 4/368; Al-Bahuti, Kashaf al-Qinah, 3/307; Ibn Abedeen, Al-Hashiya, 4/160.

In this regard, we can distinguish between four cases:

1. The first case: The case where the entity that owns the assets has a name (a registered trademark) that has a market value, so that its name has an impact on the price of the security that represents those assets. This applies to shares of companies and shares of commercial and financial institutions.

Undoubtedly, the trademark value of a company is taken into account when pricing its stocks since the value of the stock is affected by the performance of the company and the people's confidence in it. Very often, the market value of the stocks varies from time to time, regardless of the changing value of their underlying tangible assets.

In truth, the trademark (the name of the company) is the main reason that attracts people to the socks of a particular company, whether for investment or trading and not the value of its tangible assets, although the value of the trademark could also be affected by the value of those assets. This makes the trademark an integral part of the stock when acquired or traded. Accordingly, the name of a company should not be overlooked when considering the company assets.

In fact, the trademark has a monetary value that is recognizable by the Shariah, and it is a valid subject matter of sale on its own.[17] Besides, its trading admits no restriction from the Shariah perspective, as it is neither cash nor debt.

Thus, if the trademark is the core factor for subscribing to socks, then it has to play the major role in determining the tradability of the company stocks, because when people trade stocks, they buy and sell the trademark before anything else and hence, there is room to tolerate the composition of the company's other assets when being untradeable.

This also includes the stocks of the financial institutions that primarily deal with money and debt, such as Islamic banks and money exchange companies, as long as their trademark value is significant and plays the primary role in attracting stockholders.

2.The second case: The case where the entity that owns the assets is an entity that does not have its own trademark, but the activity in which those assets are invested is one that normally generates debts and cash. That is, the underlying assets are in constant change from cash to debts, commodities, benefits, services, and the like. Here, the components of the assets should be overlooked due to their constant change and the inability to maintain a particular ratio of the tradable assets.

[17] OIC Fiqh Academy resolution 32 (7/4).

For example, the real investment sukuk would normally involve the investment of the sukuk proceeds in various and renewable investment activities that may include buying, selling, leasing, etc. Those investment activities would normally yield tangible assets, cash, and debt throughout the investment period. Maintaining a specific minimum ratio of the assets composition is extremely difficult and impractical, given the volatility of the investment underlying assets. Besides, the performance of the sukuk is also a consideration that potential buyers take into account when buying sukuk, similar to stocks of company, where the trademark of the company becomes part of the company assets and is tradable without any restriction.

3.The third case is the case where the sukuk represent the assets whose investment involves a single activity that generates debts, so that the assets do not fluctuate between what is tradable and what is untradeable, i.e., debt and cash. Examples include Murabaha Sukuk and Salam sukuk, where the sukuk proceeds are used to purchase commodities to be sold on Murabaha or Salam basis in one deal. Once sold, the sukuk will represent the receivables, which are debts. Tradability of such sukuk must be governed by the nature of their underlying assets. The criterion (ratio) that should be used here is the criterion of preponderance[18]so that the debt and/or cash must constitute less than 50% of the total underlying assets in order for the sukuk to be tradable. This is unlike the sukuk under the second case, where the underlying assets are in constant change, which makes it impractical and almost impossible to maintain a certain ratio.

4.The fourth case relates to the sukuk of the first and second type, but with debts being intentionally brought and added to sukuk assets for the purpose of justifying their trading by making them ancillary to the tradable assets. Such sukuk should be ruled as unlawful to trade regardless of the ratio of the debt to the total assets, in view of the purposeful and the unnecessary inclusion of the debts. This corresponds to the resolution of the OIC Fiqh Academy No. 188, which states that it is not permissible to add debts that are independent of the sukuk assets to those assets, in order to justify their circulation.[19]

[18] Fiqh Academy (Resolution No. 30 (5/4) decides in the issue of sukuk that includes money and debt that majority preponderates; if money or debts constitute the majority of the sukuk assets then they cannot be traded. According to some standards like AAOIFI Shariah standards (No. 21 (3/19), it is only 30%, which means that sukuk are tradable as long as their underlying cash or debt components do not exceed 70% of the sukuk total assets. However, the Fiqh literature support the majority or the preponderance criterion. For example, in Fiqh, counterfeit gold - i.e. gold that is mixed with brass or another metal - is treated as pure gold if the gold constitutes the majority, while it is no longer gold if the other metal constitutes the majority. If the gold and the counterfeit metal are equal in amount, both are treated as gold by way of caution. The same applies to silver and all *ribawi* money. Ibn Al-Humam, Fateh Al-Qadeer, 6/275; Al-Dasuqi, Al-Hashiya, 3/47; Al-Sherbini, Mughni Al-Muhatj, 2/22; Al-Hattab, Muwahib Al-Jaleel, 4/346; Al-Soyoti, Al-Ashbah wal Nazair, 1/107-120-121.

[19] OIC Fiqh Academy resolution No. 188.

Conclusion

In conclusion, the occurrence of the above Shariah concerns combined in one sukuk issuance makes it a mistake to find a separate exist (makhraj) for each partial Shariah issue in sukuk. Even if we find partial Shariah exits (solutions) to the individual sukuk issues, the sukuk eventually become in their final outlook a strange structure that is not harmonious with the spirit of the Shariah, or its principles and rules, and probably closer to the prohibited bonds than to a Shariah-compliant crowd investment.

Indeed, if the sukuk were really investment sukuk, structured on an actual profit and loss basis, and being representative of real ownership of the underlying assets, it would then be possible to overlook some partial issues harboring them. This includes obliging the sukuk manager to provide a loan if the actual profits fall below the expected rate of return and the sukuk holders waiving any actual profits in excess of the expected return. However, with the sukuk being structured in way that guaranties to their holders their capital and return, and with sukuk failing to represent real ownership of the underlying assets, the sukuk in their totality become nothing but debt securities similar to bonds, denying thus any room for rectification.

The paper also records the following primary results:

- Providing a capital or return protection to the sukuk holders invalidates the sukuk, unless the guarantee to the capital or the return is provided by a third party that is genuinely independent from all sukuk parties, such that it can be regarded as pure donation from the provider.
- The sukuk have to represent real ownership of the underlying assets, so that the assets legally belong to the sukuk holders and they are not just a security (rahn). If this does not materialize, the very legitimacy of the sukuk is undermined.
- The tradability of the sukuk in view of the nature of its underlying assets should not be treated as a major Shariah issue, as long as the nature of the underlying investment necessitates constant change of the assets types and no independent debts are purposefully inserted to justify their trading.
- Finally, and in light of the above, both Shariah scholars and sukuk market players should really revisit and reconsider the current structures of sukuk and attempt to amend them; otherwise sukuk will fail to play their perceived role as a capital market instrument that achieves the purpose of bonds but without leading to the evils and harms of riba.

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