

Commentary on Research Paper entitled "The Critical Shariah Issues of Sukuk"

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Comments

The author successfully highlighted wrong practices in Sukuk issuance, ownership, and tradability. Unfortunately, such wrong practices are backed by tricky fiqh justifications. The author discussed justifications (or so-called fatwas sometimes) and pointed out their loopholes. He analyzed every deviation from Shariah in the Sukuk businesses separately and made reference to how the right position ought to be, depending on authentic Shariah sources. He is quite right in asserting in his conclusions that "even if we find partial Shariah exits (solutions) to the (undesirable) 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."

However, I have a few comments that do not run in the opposite direction to the article's main theme. I hope to empower the author's analysis. All my remarks are based on Islamic economics philosophy, which would never neglect Fiqh, but it takes classic fiqh rules to contemporary financial transactions as guidable but not necessarily submissive. It is the job of Islamic economists to go deeply into our today's problems and distinguish haram and halal based on the exact principles of the Quran and Sunnah. This is important for understanding my comments.

1- In discussing Types of guarantees presented to the Sukuk holders, the author in P. 4 takes the case of (Guarantee from the Sukuk manager based on the feasibility study). Firstly, on purely economic grounds, Sukuk is business, and we have to adopt the right procedures to make sure such business is economically and financially viable. Secondly, we have to ensure that everything concerning Sukuk is straight forward run in compliance with Shariah, i.e., that Sukuk is genuinely profit-loss sharing securities without any tricks or backdoors devices. The author analyzed the guarantee offered by the Sukuk manager, "based on the feasibility study."

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In fact, it should not be treated as a guarantee if the Sukuk contract is designed from the beginning on the basis of Restricted Mudaraba. The Sukuk manager (the Mudareb) should submit a well-prepared feasibility study based on a sound economic criterion and consider all changes that can be expected in the financial market during the Sukuk tenure. If accepted by the buyers of Sukuk, such a study should be taken as obligatory to the manager as he voluntarily submitted and accepted. If profits that the manager has expected are achieved under such Restricted Mudaraba contract, there will be no problem. If a loss happens or gains are not realized, though the market has not been subject to any failure or extraordinary shocks, i.e., nothing happened against the factors and figures that the feasibility study was built upon. The manager immediately would be responsible to compensate the Sukuk holders. We do not have to find if the manager was negligent or had observed market rules and standard practices. Gharar could have been involved deliberately or unconsciously in his feasibility, but this would be taken simultaneously against him. It is a Restricted Mudaraba Contract. The Sukuk holders will need only in such a contract a third party to guarantee that the Sukuk manager will fulfill the contract's compensation condition in case of loss. In an efficient Sukuk market, the expected buyers of Sukuk will surely give preference to those projects promising higher profit on the basis of Restricted Mudaraba. The Sukuk market will grow more competitive and efficient over time.

2-I have to emphasize that a promise to buy Sukuk at their face value on any basis is incorrect. The author managed successfully to discuss different cases in detail. I would agree with him. But, in my opinion, we don't need to involve ourselves in a lengthy debate or dialogue about this matter! Let us be straight forward. Islamic Sukuk is a loss/profit business once it is arranged through Mudaraba or Musharaka contracts. Thus, even if the investment Sukuk market price would be equal to their face value (in cases where there is no loss, as the author argued), why give a promise? As the author attained. Secondly, if the Sukuk are involved in non- Shariah-compliant transactions, we better don't discuss promises to give back the face value. In general, if Sukuk are rightly issued and committed to the holders' ownership of real assets, such assets may be subject to an increase or decrease in price at the end of their tenure. We should not exclude any possibility. In my opinion, if we desire to exclude any suspicious action, we have to exclude any proposition or guarantees to pay the face value at the end and let free-market forces determine the value. If the market is not competitive, then we need to arrange for a neutral, independent, and efficient arbitration.

3-Suppose Sukuk is issued based on an investment Wakalah contract. Unlike the Mudaraba contract, the Wakalah contract allows the manager to agree with the Sukuk holders (Principal) that it would be his right to maintain for himself any extra profit above a given rate of profit (if this has actually been realized). However, the agent is a trustee (Amin) and is not responsible for loss if this happened. Thus, he cannot guarantee to maintain the invested capital's face value, except if negligence or misconduct is proved. "It is permissible to stipulate that the agent, in addition to his fee, is entitled to all or part of any amount over and above the

expected profit as a performance incentive." (AAOIFI, Shariah Standard Rules- No. 46). It would be better, however, if the agent, "6/6: with the principal's consent, to set aside a portion of the profit to create a profit equalization reserve for the benefit of the principal. 6/7 Upon liquidation, the balance of the profit equalization reserve is returned to the principal without affecting the agent's entitlement to the fixed fee or performance incentive for the period in which the reserve was set aside". The face value of the invested capital can be realized in the case of continuous profit without promise.

4-In page 13 under the subtitle "Guaranteeing the face value of the Sukuk by a third party. My comment is: It is Important is to answer; Why gives a gift to Sukuk holders who are, in fact, doing business? Moreover, may they be rich people? And who is the donor? Wherefrom does he get the resources of his gifts? In fact, in several important cases, the guarantee of Sukuk's nominal value and their rate of return was supported by sovereign entities (e.g., the governments of Malaysia, Bahrain, and Qatar, etc.). Guarantees given by sovereigns are claimed to be Shariah permissible because governments were considered (through the tricky Sukuk mechanism) to be a third party, which is not valid. In principle, the government, in many cases, was the actual originator and beneficiary. Guarantees given by sovereigns to Sukuk's capital or its returns are unacceptable when Shariah tenets (Maqasid) are considered. This is because, in case of loss, public revenues would be used in favor of Sukuk holders who are, nevertheless, represent only one section (probably a tiny one) of the society. This issue calls for new Shariah treatment since it unfairly affects national income distribution. Besides, State in an Islamic system should not be involved in projects which the private sector is capable of carrying (Yousri, "A Critique of Sukuk Experience, and their Possible Role in Muslim Countries Development, International Journal of Islamic Economics and Finance Studies, October 2018) 5- Comments on "the tradability of the Sukuk" PP.19-21

5-The author argued that "In truth, the trademark (the name of the company) is the main reason that attracts people to the stocks of a particular company, whether for investment or trading *and not the value of its tangible assets*"! This is a very sweeping statement and, in fact, is misleading. First, The terminology "Trade Mark" is a name, symbol, or other devices that are generally used to identify and promote a company's product or service, but not that company. When talking about corporations or companies, we talk about their "reputation" and not "trade mark". The author maintains that "the trademark has a monetary value that is recognizable by the Shariah, and it is a valid subject matter of sale on its own! We need to know and discuss: in what way the so-called "trademark" is recognizable by Shariah? In fact, the market reputation or position of any corporation or company that is issuing common stock or other securities is dependent on its "Net Worth," i.e., the value of the assets the corporation or company owns, minus the liabilities they owe. Buyers of common stock or other financial securities issued by a corporation or a big company are indeed affected by its Net Worth, which has a definite impact on its market fame or reputation. But there are other factors In practice, that also influence market reputation and the value of its assets and securities. Most

important among these factors are recent and current realized profits (distributed dividends) and expected ones. And, more accurately, in comparison to other competitive businesses. Famous credit rating houses such as Standard and Poor's, Moody's, and Fitch Group plays a significant role in rating the financial position of all different players in the financial market. They have no concern with Islamic Shariah. Would the author explain how the rating is done on a Shariah basis? Or how would this compare with what the famous credit rating houses do? I think it is too hasty and somewhat inaccurate to say that "the trademark has a monetary value that is recognizable by the Shariah, and it is a valid subject matter of sale on its own." I think that we have to work hard before we reach a definite conclusion here.

6-Thereupon, I would raise my objection to statement such as "its trading admits no restriction from Shariah perspective, as it is neither cash nor debt."! ... adding "because when people trade stocks, they buy and sell the trademark before anything else." The author emphasizes the point by stating that "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 attracting stockholders."

I would say that "Common Muslims" for practical reasons have to trust their Islamic financial Institutions and their products as long as they have Shariah boards and claim to be Shariah-compliant! But nothing more specific can be said on halal and haram. Under present circumstances, we have to examine case by case to know whether or not tradability of Sukuk is Shariah permissible. If Sukuk are backed by real assets and run on genuine Shariah grounds, i.e., by avoiding all wrong practices which the author highlighted and discussed, why deny permissibility of their tradability?