

AAOIFI Shariah Committee Statement on Sukuk

Accounting and Auditing Organization for
Islamic Financial Institutions (AAOIFI)

Bahrain,

As to what follows:

In view of the expanding application of Sukuk (*Islamic asset-backed certificates*) worldwide, the public interest in them, and the observations and questions raised about them, the Shariah Committee of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) studied the subject of Sukuk issuance in three sessions: firstly, at Madinah in Saudi Arabia on 12 Jumadah Al-Akhirah, 1428 AH (27 June, 2007); secondly, at Makkah in Saudi Arabia on 26 Shaban, 1428 AH (8 September, 2007); and thirdly in Manama in Bahrain on 7 and 8 Safar, 1429 AH (13 and 14 February, 2008) respectively.

Following the meeting of the working group it appointed on 6 Muharram, 1429 AH (15 January, 2007) in Bahrain which was attended by a significant number of representatives from various Islamic banks and financial institutions, the said working group presented its report to the Shariah Committee.

OWNERSHIP OF ASSETS

Following its consideration of what took place at these meetings, and of the papers and studies presented there, the Shariah Committee, while emphasizing all that has been stated concerning Sukuk in the Shariah Standards, advises Islamic financial institutions and Shariah supervisory boards to adhere to what follows when issuing Sukuk:

◆ **First:** Tradable Sukuk must represent ownership for Sukuk holders, with all of the rights and obligations that accompany ownership, in real assets, whether tangible or usufructs or services, that may be possessed and disposed of legally and in accordance with the Shariah. All of this should be in accordance with Shariah Standard (17) on the subject of Investment Sukuk, Articles (2) and (2/1/5). The manager of a Sukuk issuance must establish the transfer of ownership of such assets in its books, and must not retain them as its own assets.

◆ **Second:** It is not permissible for tradable Sukuk to represent either revenue streams or debt except in the case of a trading or financial entity that is selling all of its assets, or a portfolio which includes a standing financial obligation such that debt was incurred indirectly, incidental to a physical asset or a usufruct in accordance with the guidelines mentioned in Shariah Standard (21) on the subject of Financial Paper.

◆ **Third:** It is not permissible for the manager of Sukuk, regardless of whether the manager acts as a Mudarib (investment manager), or a Sharik (partner), or a Wakil (an investment agent), to undertake to offer loans to Sukuk holders when actual earnings fall short of expected earnings.

GUARANTEE OF PRINCIPAL

It is permissible, however, to establish a reserve for the purpose of covering such shortfalls to the extent possible, on condition that the same be mentioned in the prospectus.

There is no impediment to the distribution of expected earnings on account, in accordance with Shariah Standard (13) on the subject of Mudaraba, Article (8/8), or to obtaining project financing on the account of the Sukuk holders.

◆ **Fourth:** It is not permissible for the Mudarib (investment manager), Sharik (partner), or Wakil (investment agent) to agree to purchase assets from Sukuk holders, or from whoever represents them, for a nominal value of those assets at the time the Sukuk are extinguished at the end of their respective tenors.

It is permissible, however, to agree to purchase the assets for their net value, or market value, or fair market value, or for a price agreed to at the time of their purchase, in accordance with Shariah Standard (12) on the subject of Partnership and modern partnerships, Article (2/6/1/3) and with Shariah Standard (5) on the subject of Guarantees, Articles (1/2/2) and (2/2/2).

It should be understood that the Sukuk manager acts as guarantor of (investor) capital at its nominal value in cases of negligence or malafides or non-compliance with stated conditions, regardless of whether the manager is a Sharik (partner), Wakil (agent), or Mudarib (investment manager).

If, however, the assets of a Sukuk al-Musharaka, or Mudarabah, or Wakalah, are of lesser value than assets leased by means of a lease ending in possession (Ijarah Muntahiyah Bi't-tamlik), then it will be permissible for the Sukuk manager to agree to purchase those assets at the time the Sukuk are extinguished for the remaining lease payments on the assets, by considering these payments to be the net value of those assets.

SHARIAH ADVISORY CYCLE

◆ **Fifth:** It is permissible for the lessee in a Sukuk al-Ijarah to agree to purchase the leased assets when the Sukuk are extinguished for their nominal value, as long as the lessee is not also an investment partner, Mudarib, or agent.

◆ **Sixth:** Shariah supervisory boards must not consider their responsibility to be over when they issue a fatwa on the structure of Sukuk. Rather, they must review all contracts and documentation related to the actual transaction, and then oversee the ways that these are implemented in order to be certain that the operation complies at every stage with Shariah guidelines and requirements as specified in the Shariah Standards, and that the investment of Sukuk proceeds and what those proceeds are converted to takes place in accordance with one (or another) of the approved Shariah methods of investment as stated in Shariah Standard (17) on the subject of Investment Sukuk, Article (5/1/8/5).

In addition to all this, the Shariah Committee advises Islamic Financial Institutions to decrease their exposure to debt-related operations and to increase their operations based on true partnerships and the sharing of risk and reward and thereby achieve the higher purposes of the Shariah. ▲

Editor's Note: This is a very slightly abridged version of the original statement on Sukuk from the Shariah Committee of AAOIFI, to fit in with the editorial style of the magazine. Readers can get a copy of the original statement on Sukuk directly from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), P.O.Box: 1176, Manama, Kingdom of Bahrain. Tel: +973 17 244496; Fax: +973 17 250194; Email: info@aaofii.com