Ethics & Finance Roundtable

KLIFF 2011 Kuala Lumpur Malaysia

بِسۡمِ ٱللَّهِ ٱلرَّحۡمَٰنِ ٱلرَّحِيمِ

الحمد لله والصلاة والسلام على نبيا محمد وعلى آله وصحبه وسلم وبعد :-

Brothers and Sisters

Ladies and Gentlemen

Assalamualiekum

It is indeed a great pleasure and honor to address this august gathering this morning. I thank the organizers for giving me this wonderful opportunity.

The title of my speech today is: How solid is the Shari'ah foundation of Sukuk.

Ever since the first Sukuk were issued I believe in the early 1990's Sukuk, were subjected to a relentless scrutiny and a never ending probing determined to undermine the Shari'ah foundation of Sukuk.

It reached a level were we frequently hear some commentators claiming that Sukuk are nothing but conventional bonds in disguise. And they raise doubts about many aspects of Sukuk such as promise to purchase, liquidity facility reserve account… etc. and the smoking gun to the opponents of

Sukuk the fact that Sukuk holders become creditors to the issuer at one point in the life of Sukuks.

I will try to lay down certain facts about Sukuk which will hopefully clear the air.

Firstly: it is frequently claimed that Sukuk were the invention of the latter day Shari'ah scholars for the sole purpose of imitating the conventional bonds and a real Islamic economy must not have these strange creatures.

The fact of the matter is that the first Sukuk were actually issued by the second Caliph of Islam Omar Ibn AlKhattab and they were called Sukuk and surprise surprise.

These were debt based Sukuk. For the removal of doubt the Sukuk holders were creditors to the treasure i.e. Bait Al mal. Yes they were simple Sukuk but they were designed for simple time and yes ours are as complex as the time we are living in.

It remains nevertheless that the principles are the same. Furthermore, no aspect of the modern Sukuk has attracted more criticism than the promise to purchase. The promise to purchase is an important aspect of Sukuk structures as we all know.

The promise to purchase in the Sukuk structure is founded on a well known and highly acclaimed fatwa issued by the Figh Academy of the OIC no doubt the most esteemed academic institution dedicated to fatwa in Muslim world.

That fatwa spelled out the meaning of Waad i.e. promise as an undertaking i.e. a binding promise and yes promise to purchase that was the exact wording of the OIC Figh fatwa and yes it was in the context of Islamic banking. What else do the critic’s want? Is this enough? No! they say it is different they claim that in the case of Sukuk the promissory is the same entity that sold i.e. the issuer or the same entity that purchased i.e. the

Sukuk holders and that the said fatwa of the Figh Academy is therefore not relevant.

To their disappointment this particular issue was addressed by even a higher authority that the OIC Figh Academy.

In researching the classical books of Figh we found that Imam Ahmad the founder of the Hanbali school thought was actually asked about Shari'ah permissibility of an individual who sold something and made it a condition on the purchaser that if he ever wanted to sell he has the right to buy it at the same original price. His answer was on affirmative i.e. it is OK. In reaching this conclusion, Imam Ahmad relied on authentic narrations from some of the companions of the Prophet PBUH, on an incident similar to the one in question. Was this enough to mute the onslaught of allegations?

Not really. They say: wait a minute. May be the promise to purchase is OK but the eventual outcome of the promise to purchase is to convert a Sukuk which stated as Mudarabah Sukuk or Ijarah Sukuk or Musharakah Sukuk, convert them to a debt obligation and the relationship between issuer and Sukuk holders becomes that of lender-borrower. They start as Mudarib they say and convert debt. I do not hesitate to say this is correct. Sukuk do convert to a debt obligation at one point in their life. But it was never an oversight or a slip of the tongue. This also does have a precedent in the jurisprudence of contracts converting from one form to another is not an abnormality in the Shari'ah jurisprudence of contracts.

There are ample examples especially in the Hanafi school of thought of contract starting as one thing and then converting to another.

Read what Hanafi books say about Istisna'a: they say it starts as Ijarah and then convert to sale. A reciprocal gift they say it starts as gift and convert to sale contract. The loan contract starts as donation and terminates as sale then a well documented story of the two sons of Omar Ibn Alkhattab is relevant here were he actually converted their contract with the

government collector from loan to Mudarabah to make the treasury share in the profits they made.

Can I rest my case?

No way they say.

They come back and say but non of the cases you sited converted a Mudarabah or Musharakah to a debt obligation transforming the relationship between the two parties to lender-borrower. As is the case for Sukuk.

My answer is: thank you very much now I can rest my case. Why?

Actually a Mudarabah contract changing form into a debt obligation at maturity is the general case it is found in almost all the books of jurisprudence and agreed upon by almost all scholars.

When the Mudaraba contract is terminated, the Mudarib must pay back the amount due to Rab ul mal and at that point it becomes a debt obligation on the Mudarib and the relationship becomes that of lender-borrower. I now can rest my case.

Brothers and sisters

Ladies and gentlemen going into more of the “oral argument” of the case of Sukuk Vs the critics may take longer than 10 minutes allotted to me.

However, the moral of my story this morning is simple and straight forward the standard structure of the Sukuk which include the promise to purchase is based on unshakable Shari'ah foundation.