

## Recommendations from the 3<sup>rd</sup> Roundtable on Challenges in *Sukūk* Issuance 2015

In the name of Allah, most gracious, most merciful

Praise be to Allah, the Lord of the universe. Peace and blessings be upon our Prophet, his family and companions.

### **Recommendations of the participants in the 3rd Roundtable on Challenges in *Sukūk* Issuance (sessions 1, 2 and 3).**

The International Islamic Liquidity Management Corporation (the IILM) with the cooperation of the International Shari'ah Research Academy (ISRA) organised the 3<sup>rd</sup> Roundtable meeting during the period 7 - 8 April 2015 which was dedicated to the topic "Challenges in *Sukūk* Issuance: Shari'ah Aspects of Guarantee and Collateral on Financial Transactions". The Roundtable was attended by a number of notable *Shari'ah* scholars, researchers in Islamic jurisprudence and economics, as well as banking experts and practitioners.

Over a day and half, the participants of the Roundtable presented various papers and listened to the comments and discussions related to the papers. The discussions were transparent and constructive. The Roundtable ended with the following recommendations being made:

**One:** *Daman*, according to Islamic jurists, relates to the liability of the guarantor. It is a relationship by which the guarantor undertakes responsibility for the liability established against the guaranteed party. Ali Khafif defined it as "assuming liability for a financial obligation or for an obligatory act that has become obligatory for any cause". The term *daman* in the parlance of Islamic financial institutions includes every means by which an obligation is secured, including collateral and sureties.

**Two:** The following are some types of *daman* that the participants recommend financial institutions to use in issuing *Sukūk*:

- a. Third-party guarantee of the *Sukūk* assets as per the parameters mentioned in the resolution of the International Fiqh Academy (IFA) and the *Shari'ah* standards. The IFA resolution limited the guarantee to the capital in *Mudarabah Sukūk* and in *Musharakah*. The basic rule is that the guarantor should be an independent legal entity with an independent financial liability from the *Sukūk* management in case the *Sukūk* assets are guaranteed. However, further research is

required in case the beneficiary of the *Sukūk* subscription and the guarantor are the same owner;

- b. There is no objection to an Islamic financial institution accepting any form of guarantee that the beneficiary puts forward to enhance its credit rating in order to ensure receipt of the periodic payments of the leased assets and the amount required for repurchase of the assets.

**Three:** Protecting the *Sukūk* depends on mitigating risk through a series of measures and mechanisms other than direct guarantee. Among the forms of protection are:

- a. Takaful insurance;
- b. Hedging using instruments that do not contradict with *Shari'ah*;
- c. Preventative measures to compensate for damages or to amend profits or interests and other measures, which are not considered guarantees;
- d. Guarantee funds provided by governments to protect financial institutions and instruments - such as *Sukūk*, shares and fund units - from defaults.

**Four:** Examples of guarantees that are prohibited by the *Shari'ah*:

- a. A contractually stipulated guarantee of the capital or of a partner's share that is extended either by the *mudarib* (entrepreneur) or by a capital-providing partner whether or not he is the managing partner;
- b. The guarantee which results in breaking the partnership by depriving the partner (or one of the partners) of his share of the profits of the partnership.

**Five:** It is permissible to supply as collateral *Shari'ah* compliant securities such as *Sukūk*, shares, fund units in all their forms whether they are negotiable or not.

**Six:** It is permissible to use investment portfolios as collateral, even if they consist of a mixture of *Shari'ah*-compliant and *Shari'ah*-noncompliant assets, as long as the *Shariah*-compliant component comprises the majority.

**Seven:** The basic rule is that it is not permitted to accept interest-based securities such as bonds, *Shariah*-noncompliant stocks and conventional investment portfolios as collateral. However, in special cases of need, the ruling is to be decided by the *Shari'ah* board of the

institution, which should deal with the need in proportion to its magnitude. In case there is a need to liquidate the collateral to recover the creditor's rights, only the portion of the consideration that represents the principal is permitted to be used for that purpose, not the interest or non-*Shariah* revenues. That is because it is not considered valid loans in *Shari'ah*. The owner (debtor) or a third party such as a trustee should be assigned as the agent to sell the assets. It should not be done by the creditor. The participants reaffirm the resolutions of the *fiqh* academies and the *Shari'ah* standards that prohibit issuing or dealing with or trading in such instruments.

**Eight:** The basic rule is that the benefit and revenue arising from the collateral are the right of the mortgagor (debtor). Jurists have mentioned certain exceptional cases in which (the mortgagee) may benefit from the collateral. For some of these cases the permissibility is a matter of agreement, while for others it is disputed. This issue requires further research, especially when it comes to contemporary applications; for example, the income from *Sukūk* and shares when they are offered as collateral. The participants suggest that this be made the theme for discussion at the next Roundtable.

**Nine:** The participants advise that effort be made to establish an Islamic financial institution to safeguard collateral and manage it, selling it when necessary in order to recover associated rights from it, as well as other matters related to the collateral. This would standardize the associated operations and contracts, as well as facilitate the processes, while adhering to the relevant *Shari'ah* parameters.

**Ten:** The participants advise that the resolutions of the *fiqh* academies and the *Shari'ah* standards related to guarantees, collateral and the protection of capital and financing be referred to in order to know the detailed rulings on them, and that these rulings be adhered to in the applications.

Peace and blessings be upon our Prophet, his family and companions.