

DFM Standard For Issuing, Acquiring and Trading Sukuk

حيث ملتقى السيولة
Connecting Liquidity

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Introduction

All praise is due to Allah, Lord of the Worlds; and His blessing and mercy be upon his last Messenger, his family, his companions and upon all who rightly follow them, till the Day of Judgment.

One of the most important features of Islamic finance is that it is based on collecting funds from their owners through Mudaraba, Wakala Bil Istithmar (Investment Wakala) and other contracts that achieve the integration of the finance sector with the real economic and investment sector, away from the mere dealing in cash for cash, in form or essence¹. Under Islamic finance, the collected funds are invested through Shari'a compliant financing and investment contracts, which may be simple or compound. In all cases, immediate money is not offered to finance-seekers in exchange for future money, but rather the dealings are conducted on tangible assets, usufructs and financial rights. For instance, Islamic financial instruments started with dealing in shares, and then witnessed a development with the beginning of this century by dealing in new financial instruments called "Sukuk".

A valid question may arise on the difference between a share and a sakk . It can be said in this regard that shares are usually confined to being common rights in the ownership of the assets of a specific legal company, and they remain in use as long as the company itself remains in existence. Sukuk, however, although they represent common rights in the ownership of assets, they are not necessarily limited to the assets of a specific company; besides, sukuk can be issued for a specified period after which they can be redeemed or without specifying a duration for redemption.

When sukuk first originated in the beginning of this century, they were considered a substitute to bonds, and for that reason sukuk borrowed (took) from bonds some mechanisms, procedures and terminologies which did not conflict with Shari'a rules. In fact, this standard intends to regulate the issuance and trading of the sukuk with a care that the sukuk will retain their Shari'a origin and the mechanisms, the rules and the guidelines being used are in consistent with Islamic jurisprudence. This way, sukuk become a genuine Islamic financial instrument as their Shari'a originality dictates.

The development of the sukuk sector however calls for sincere efforts to be exerted by the Muslim scholars and whoever is interested in the Islamic financial thought, in order to innovate and come up with new Islamic financing instruments that serve both the Islamic and world communities, and so enable these communities to benefit from the fairness of Islamic finance and its efficiency in achieving constant and balanced growth.

Hence, the interest of Dubai Financial Market was towards the establishment of its own standard for acquiring of and trading in sukuk. However, in order to prepare this

¹ Other Islamic financial modes include: Musharaka, Diminishing Musharaka, Restricted and Unrestricted Mudaraba, Restricted and unrestricted Investment Wakala, Bay' Bithaman Ajel, Murabaha for the purchase order, operating and financial lease (Ijarah Muntahia Bittamlik), Istisna' and Salam Sale.

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standard, the Fatwa and Shari'a Supervisory Board of Dubai Financial Market has reviewed and studied the existing Shari'a sukuk standards and the relevant fatwas that were issued by the reliable fatwa bodies, and then it prepared this new standard.

This new standard, which was prepared by the Fatwa and Shari'a Supervisory Board, aims at subjecting sukuk to the principles and rules of Shari'a in order to assure sukuk holders and enable Islamic finance industry to achieve more progress in the future.

Just Allah's pleasure is our ultimate goal; and success is unachievable without His Favor.

1. THE SCOPE OF THE STANDARD

This standard covers Definition of the sukuk, Types, Parameters and listing requirements.

2. TYPES OF SUKUK²

2.1. Finance Sukuk

2.1.1. Murabaha Sukuk

These are issued on the basis of Murabaha contract, and their issuance realized fund is used to finance the purchase of the Murabaha assets for the purpose of selling the same to the party promising to buy them. The Murabaha sakk represents a common share in the ownership of these assets – this would be - after the purchase of Murabaha assets and prior to their sale and delivery to the Murabaha buyer. After their sale to the party promising to buy them, the sakk represents a common share in the selling price of the Murabaha asset. The return of these sukuk originates from the difference between the Murabaha assets' purchase and selling prices.

2.1.2. Istisna' Sukuk

These are issued on the basis of Istisna' contract, and their issuance realized fund is used to finance the manufacturing of the asset sold on Istisna' basis for the purpose of delivering the same to the buyer in another Istisna' contract. The Istisna' sakk represents a common share in the ownership of the manufactured asset, and it represents after delivering the asset to its buyer, a common share in the selling price. The return of these sukuk generates from the difference between the cost of manufacturing the asset and its selling price.

2.1.3. Salam Sukuk

These are issued on the basis of salam contract, and their issuance realized fund is used to finance the purchase of the salam asset. The salam sakk represents before taking delivery of the salam asset a common share in the ownership of the asset, and it represents after taking delivery of the salam asset a common share in the very asset, while the sakk represents after sale of the asset a common share in the selling price. The return of these sukuk generates from the difference between the salam asset's purchase and selling prices.

2.2. Ijarah Sukuk

2.2.1. Sukuk of Ownership of Leasable Assets

These are issued on the basis of sale and lease contracts, and their issuance realized fund is used to finance the purchase of a leasable asset (to own its title and usufruct) for the purpose of leasing it in particular or as a liability by description (Ijarah Mawsufa Bithimma), whether to its original seller or to someone else, for an agreed period, which is the duration of the sukuk, against an agreed rent. The sakk represents a common share in the ownership of the asset, its title and usufruct, and it represents after leasing it a common share in the rent, which represents the return of these Sukuk.

² Refer to definition of sukuk & distinguishing from bonds at appendix 2.

2.2.2. Sukuk of Ownership of the Usufruct of Leasable Assets

These are issued on the basis of purchase or lease of an asset. Their issuance realized fund is used to finance the purchase of a usufruct of an ascertained asset or an asset established as liability by description (Mawsufa Bithimma), then to resell the usufruct in particular or on the basis of liability by description (Ijrara Mawsufa Bithimma) against an agreed rent. The sakk represents a common share in the ownership of the usufruct of the asset and not its title, but after the sublease it represents a common share in the rent. The return of these sukuk generates from the difference between the usufruct buying and selling prices.

2.2.3. Sukuk of Lease of Services

These are issued on the basis of lease of services, and their issuance realized fund is used to finance the purchase of services from their provider for the purpose of selling the same to the services recipient. The sakk represents prior to the sale of the service a common share in the ownership of the service, which is yet a commitment on its provider, and it represents after selling the service a common share in its price. The difference between the service buying and selling prices forms the return of these sukuk.

2.2.4. Sukuk of Operating Lease

These are issued on the basis of lease of an asset against an agreed rent for a specific period after the end of which the leased asset reverts to its owner. The lessee, however, may undertake to buy the asset after the expiry of the lease contract.

2.2.5. Sukuk of Financial Lease

2.2.5.1. Sukuk of Lease of Specific Assets

These are issued on the basis of lease of an asset owned by the lessor against an agreed rent comprising two elements: a fixed rent, and a variable rent linked to an external index, for a specific period after the end of which the title of the leased asset shall be transferred to the lessee by virtue of an independent sale or lease contract.

2.2.5.2. Sukuk of Lease of Unspecific Assets

These are issued on the basis of lease contract of an asset which is not yet owned by the lessor at the time of contracting (Mawsufa Bithimma), but the lessor is committed to source it and deliver it to the lessee on a specific date.

2.3. Investment Sukuk

2.3.1. Mudaraba Sukuk

These are issued on the basis of Mudaraba contract, and their issuance realized fund is used to pay the Mudaraba capital to the Mudareb in order to invest it against a predetermined share in the profit. The Mudaraba sakk represents a common share in the ownership of the Mudaraba assets, which may include tangible assets, usufructs, cash money, debts and other financial rights. After sale of the Mudaraba assets, the sakk represents a common share in the selling price. The sukuk holders are entitled to a common share in the investment return of the Mudaraba assets; on the other hand, they share the investment risks in proportion to the number of sukuk they hold. The Mudaraba rules and conditions and the sukuk holders' profit share shall all be outlined in the Prospectus and the Shari'a contracts thereto.

2.3.2. Wakala Investment Sukuk

These are issued on basis of Wakala investment basis, and their issuance realized fund is used to form the capital which is paid to the investment agent to invest it against a predetermined fee. Every sakk represents a common share in the Wakala assets which may contain tangible assets, cash, debts and other financial rights; and it represents a common share in the Wakala assets price after they have been sold. The holders of the investment Wakala sukuk are entitled to the investment return and liable for the investment risks, each in proportion to the number of the Sukuk he holds. The investment agent, in return, is entitled to a guaranteed fixed fee payable by the sukuk holders, in addition to all or a percentage of the profit exceeding a certain threshold, as incentive if applicable. Rules and conditions of the investment Wakala contract and the investment agent fees shall be determined in the Prospectus of these sukuk and the Shari'a contracts thereto.

2.3.3. Profit Sharing Sukuk

These are issued on the basis of Musharaka contract, and their issuance realized fund is used to pay the sukuk holders' share in the capital of Musharaka, whose other partner is the sukuk originator. The Musharaka sakk represents a common share in the ownership of the Musharaka assets, which may include tangible assets, usufructs, cash money, debts and other financial rights. After sale of the Mudaraba assets, the sakk represents a common share in the selling price. The sukuk holders are entitled to a common share in the investment return of the Musharaka assets and are liable for the investment risks in proportion to the number of sukuk they hold. The Musharaka rules and conditions and the sukuk holders' profit share shall all be outlined in the Prospectus and the Shari'a contracts thereto.

2.4. Produce Sharing Sukuk

2.4.1. Muzara'a Sukuk

These are issued on the basis of Muzara'a contract (sharecropping), and their issuance realized fund is used to finance the cost of cultivating a land provided by its owner as a party to the Muzara'a contract. The Muzara'a sakk represents a common share in the ownership of the Muzara'a assets, with the exception of the land, and a common share in the crop after its emergence, and a common share in the price after selling the crop, while the land owner takes the other share. The Muzara'a rules and conditions and the shares of both the sukuk holders and the land owner in the selling price shall all be outlined in the Prospectus and the Shari'a contracts thereto.

2.4.2. MUSAQAT Sukuk

These are issued on the basis of MUSAQAT (irrigation of a planted land) contract, and their issuance realized fund is used to finance the cost of caretaking of a land planted with fruiting trees through irrigation, pruning, fertilizing and pest controlling until they yield fruits. The MUSAQAT sakk represents a common share in the ownership of the MUSAQAT assets, with the exception of the land and the fruits, and it represents a common share in the fruits after their emergence. The holders of these sukuk are entitled to a common share in the fruits and a common share in their selling price after the sale, while the trees owner takes the other share. The MUSAQAT rules and conditions

and the shares of both the sukuk holders as farmers and the trees owner in the fruits shall all be outlined in the Prospectus and the Shari'a contracts thereto.

2.4.3. Mugharasa Sukuk

These are issued on the basis of Mugharasa (land plantation) contract, and their issuance realized fund is used to finance the cost of planting a land with fruit trees, or any other value-producing trees, as well as their caretaking until they yield fruits. The Mugharasa sakk represents a common share in the ownership of the Mugharasa assets, i.e. the fruits, trees and land, according to the farmer's agreed percentage. The holders of these sukuk, as farmers, are entitled to the agreed common share in the trees and their fruits, while the land owner takes the other share. The Mugharasa rules and conditions and the shares of both the sukuk holders and the land owner in the fruits, trees and land shall all be outlined in the Prospectus and the Shari'a contracts thereto.

2.5. Sukuk of Investment Funds and Portfolios

These are issued on the basis of purchase of a Shari'a compliant investment fund or portfolio which is independent of the sukuk originator in its legal entity and financial liability, and which comprises tangible assets, usufructs, debts, cash money and financial rights whereby the tangible assets and the usufructs correspond to no less than 10% of the total asset. Each sakk represents a common share in the ownership of the portfolio.

3. ISSUANCE OF SUKUK

3.1. Sukuk Issuance Arrangements

- 3.1.1.** Sukuk are issued by an authorized entity or by a special purpose vehicle that it is independent in its legal entity and financial liability. The SPV receives the subscription proceeds and acts as the sukuk holders' trustee in holding title of the sukuk assets, and as their agent in investing and utilizing the same in what the sukuk were issued for, in addition to distributing their proceeds and redemption value. The SPV, on behalf of the sukuk holders, may also contract with the sukuk originator and any other parties involved in the sukuk issuance.
- 3.1.2.** The SPV may appoint an experienced party to handle some of its responsibilities; besides, the SPV must exercise its best efforts to protect the rights of the sukuk holders.
- 3.1.3.** The SPV shall maintain regular accounts of its operations, and the accounts shall be audited by at least one chartered accountant.
- 3.1.4.** The SPV shall be committed to send a copy of its financial statements, whether relating to the periodic financial statements, the annual financial statements, or the core events which the SPV is committed to disclose to the sukuk holders, the sukuk originator and the Sukuk Shari'a Committee.
- 3.1.5.** For every sukuk issuance there must be a Shari'a Committee comprising three members with PhD in Islamic law, or two members with PhD in Islamic law and one with a PhD in economics or finance. This committee shall be selected by the sukuk originator, who can also choose the DFM Fatwa & Shari'a Supervisory Board to handle the Shari'a Committee's responsibilities.

3.1.6. The Shari'a Committee's functions are as follows:

- 3.1.6.1. To give the Shari'a opinion on the sukuk meant for issuing and endorse their structure, contracts and prospectus.
- 3.1.6.2. To ensure that issuance, trading and redemption of the sukuk have all been in line with the Shari'a rules.
- 3.1.6.3. To ensure that the use of the sukuk issuance proceeds is in accordance with the purpose of issuance and that the distribution of the sukuk returns from issuance to redemption has been in line with the Shari'a rules.
- 3.1.6.4. To monitor and audit all parties involved in the sukuk issuance including the SPV, as well as all activities, projects and deals financed by the sukuk issuance proceeds in order to ensure that all have been executed in accordance with the Shari'a rules, and to submit periodical reports to the sukuk holders' association, if any.

3.1.7. The Sukuk Shari'a Committee shall have the authority to appoint one Shari'a auditor or more to carry out the auditing job and submit to it the relevant reports.

3.1.8. The Sukuk Shari'a Committee shall notify the Securities Commission in the Country of any violations of the Shari'a provisions found while performing its supervisory role.

3.2. The Issuance Prospectus

The Issuance Prospectus shall be prepared in coordination with the Shari'a Committee and all relevant parties, and shall include the following:

- 3.2.1. Both names of the sukuk originator and the sukuk issuer, their details, rights and obligations; and the subscription proceeds utilization channels.
- 3.2.2. A proper feasibility study of the project or the venture to be financed by the sukuk proceeds, which should include:
 - 3.2.2.1. Ample description of the project or the venture.
 - 3.2.2.2. The total cost of setting up or developing the project or the venture, its management, components, phases as per subscription, potential risks and their hedging instruments, Shari'a compliant guarantees and its expected profits.
 - 3.2.2.3. The feasibility study needs also to be endorsed by an independent financial adviser who is certified by Securities Commission in the Country, and the sukuk originator shall guarantee the accuracy of all data and information included in the issuance prospectus.
- 3.2.3. Defining the underlying issuance Shari'a financial contract; its rules, conditions and legal consequences.
- 3.2.4. A clause, in the issuance Shari'a contracts and their title-transferring contracts, to the effect that the title to the sukuk assets has been transferred to the sukuk holders or their representative from both Shari'a and legal perspectives.

- 3.2.5.** The Prospectus must also include a detailed fatwa issued by the sukuk committee to the endorsement of the sukuk structure and documents. This fatwa shall be deemed an integral part of the sukuk legal documents so that it forms the point of reference for interpretation and explanation of these documents. In addition, the Fatwa shall include a clause to the necessary adherence to Shari'a rules as decided by the Sukuk Shari'a Committee in all subsequent procedures.
- 3.2.6.** The sukuk issuance prospectus and its documents must include a statement to the Sukuk Shari'a Committee selected for the issuance and its responsibilities in supervising and auditing the project or the venture, where the Sukuk issuance proceeds are invested, and in submitting periodical reports on quarterly basis to the Sukuk holders and publishing them on the market. The Sukuk Shari'a Committee shall have the right to summon the Sukuk holders or their representatives to take the appropriate action in case of a flagrant infringement of Shari'a rules, procrastination or refusal of the project or venture manager to follow the Shari'a committee's instructions or to remedy any violations..
- 3.2.7.** A clause to the participation of the sakk owner in profit and loss in accordance with the sakk type and nature (as per Shari'a rules), and with the number of sukuk he or she holds.
- 3.2.8.** The nominal value of the sakk as well as the subscription value and duration.
- 3.2.9.** A report on the fair value of the sukuk assets by one of the chartered financial advisers of the Securities Commission in the Country, in case the sukuk were issued against existing assets.
- 3.2.10.** When the nature of the Sakk requires - An issuance credit rating certificate issued by a rating agency recognized by the Securities Commission in the Country. The rating must reflect, at least, the minimum ability to meet the commitments contained in the public prospectus.
- 3.2.11.** A record of the agreements signed between the sukuk originator and the parties participating in the issuance.
- 3.2.12.** The project or venture mechanism for profits distribution and loss sharing.
- 3.2.13.** Dates of subscription offering and closing, and rules governing the case of failing to meet the subscription percentage specified in the prospectus, without prejudice to the instructions of the Securities Commission in the Country.
- 3.2.14.** The method of sukuk allocation among subscribers in the case of oversubscription.
- 3.2.15.** The Shari'a rules governing the tradability and redemption of each type of the sukuk, in accordance with the Shari'a principles and the Shari'a issuance contract.
- 3.2.16.** Reasons that trigger the early maturity of the sukuk, treatment of cases of default and settlement of sukuk holders' rights.
- 3.2.17.** The name of the SPV if it is the issuer of the sukuk as well as its functions, authorities and relationship with the other parties participating in the issuance.

- 3.2.18. Any other data required by the Securities Commission in the Country or by the Sukuk Shari'a Committee.
- 3.2.19. The Prospectus may not include any clause that violates the provisions of the issuance contract or its Shari'a legal consequences.

3.3. Subscription Coverage

- 3.3.1. It is permitted to include in the Prospectus a clause to the appointment of a trustee, selected by the SPV and certified by the Securities Commission in the Country, to handle on behalf of the SPV the distribution of returns and the payment of the redemption value upon the maturity of sukuk, as per the provisions contained in the Prospectus.
- 3.3.2. It is permitted to have a sukuk underwriter certified by the Securities Commission in the Country to guarantee the subscription. It is permitted as well to have a redemption undertaker so as long this does not breach the rules of Sharia.
- 3.3.3. The sukuk issuance realized fund must be used for the same purpose the sukuk were issued for and in accordance with the Shari'a rules.
- 3.3.4. In case of insufficient subscription and suspension of issuance all amounts paid by the subscribers must be repaid to them during the period determined by the Prospectus.

3.4. Listing and Trading

- 3.4.1. All sukuk put to IPO must be listed and traded in the stock market; however, they can be listed and traded in international financial market. The Market BOD shall define the listing regulations and procedures, which must not be in conflict with any Shari'a rules.
- 3.4.2. It is permitted to request listing of the sukuk offered for private placement in the market, and in the case of non-listing they shall be sold over the counter, according to the regulations issued by the market.
- 3.4.3. Listing and trading of sukuk shall in all cases be subject to the Shari'a rules and the resolutions issued by the Sukuk Shari'a Committee and the Securities Commission in the Country.
- 3.4.4. The sukuk originator may undertake to redeem the sukuk upon their maturity and pay their value to their holders through purchase of the then-existing sukuk assets. He may also undertake to purchase these assets before maturity of the sukuk at a value defined according to the Shari'a guidelines outlined in the Prospectus.

3.5. Protection of the Sukuk Holders Rights

- 3.5.1. The sukuk holders of every issuance may form an association for the purpose of protecting the common interests of its members. It shall have a legal representative who is to be selected and dismissed in accordance with the Prospectus.
- 3.5.2. The association's representative shall take all actions to protect the sukuk holders' common interests, including litigation against the sukuk originator, the SPV or any other party, in accordance with the association's resolutions made in its appropriate meetings. The Prospectus shall determine the

guidelines and procedures pertaining to the association's call for convening, the eligibility criteria for attendance, the arrangements and venue of the meeting, the voting process as well as the association's relationship with the beneficiary form sukuk issuance and the SPV.

- 3.5.3.** It is permitted to establish a cumulative reserve to protect the sukuk holders from the investment risks. The reserve shall be financed through the deduction of a certain percentage of the sukuk holders' share in the realized profits until the reserve reaches a specific limit during the term of the sukuk. The Prospectus shall define how to form the reserve from the sukuk holders' share in the net profit after deduction of the Mudareb's or the investment agent's profit share, how to utilize this reserve and how to distribute the remaining balance among its respective owners upon the maturity of the sukuk.

The General Principles and the Shari'a Parameters³

4. The General Principles for Issuance of Sukuk

- 4.1. Sukuk must be issued on the basis of a Shari'a contract which must:
 - 4.1.1. satisfy its pillars and conditions,
 - 4.1.2. produce its legal effects and consequences,
 - 4.1.3. be implemented in a way that fulfils its Shari'a objective and;
 - 4.1.4. be void of conditions that contradict its essence and Shari'a objectives.
- 4.2. The activities: Issuance and trading of sukuk are not allowed if their issuance realized fund is meant to be used in unlawful activities, or if some of the Sukuk assets were unlawful.
- 4.3. Issuance, trading or redemption of sukuk must not involve or boil down to the sale of spot money against deferred but more money; consequently,
 - 4.3.1. It is not permitted for the transfer of ownership of assets from the seller in the Sukuk of tangible assets or the sukuk of usufruct of asset to be fictitious, i.e. it does not involve real and legal transfer of ownership.
 - 4.3.2. It is not permitted for the assets sold to the sukuk holders in sukuk of ownership of leased, or to be leased, tangible assets to be unsalable according to the official laws, or to remain as the property of the seller appearing thus in accounting terms on the balance sheet and not off the balance sheet.
 - 4.3.3. It is not permitted that the investment sukuk documents state that the sukuk originator (as Mudareb, managing partner or investment agent) is indebted for the sukuk sale proceeds or the sukuk assets value to the sukuk holders and not managing the Sukuk assets on a trust basis.
 - 4.3.4. It is not permitted that the sukuk prospectus or contracts state that the sukuk holders shall not have the right of recourse to the sukuk assets or to legitimately or legally dispose them of like normal assets owners do. On the contrary, such rights must be clearly stated for the sukuk holders in the Prospectus.

³ The sakk issuer is the one who utilizes the issuance realized fund. He could be the Mudareb, the investment agent, the managing partner, the seller in Salam, the Mustasni' (the buyer in Istisna'), the buyer in Murabaha, the Muzari', the Musaqi or the Mugharis (the farmer in the agricultural partnerships).

The issuer may be the one who initiates the offer by virtue of the prospectus so that the subscription of the sukuk holders is deemed the acceptance to the offer, and consequently the sukuk underlying contract is initiated. The issuer may also be the sukuk holders through their representative or a special purpose vehicle (SPV) acting as an agent and a trustee in favor of the sukuk holders. It also utilizes the sukuk issuance realized fund and accepts the offer through the signing of the sukuk underlying contract.

However, it is permitted for the sakk to be issued by a party like the Mudareb, so he expresses the offer to a Mudaraba whose terms and conditions comply with Shari'a, and requests from the capital provider to provide the capital. Nevertheless, the offer may originate also from the capital provider, and the acceptance from the Mudareb, and thus Mudaraba is concluded. In either case, Mudaraba capital shall be divided into equal units and certificates of equal value shall be issued against them so that every certificate represents for its holder a share in the capital of the project for whose financing the sukuk are issued, and when assets are purchased with the capital then the certificate represents a share in these assets.

As for the mechanism and the procedures, they are part of the legal system. For example, the very idea of SPV has originated from the British Law, while the Latin laws do not recognize it so they consider other means to issue Sukuk.

- 4.4.** The return on the Sukuk must reflect the outcome of sukuk assets investment, and it is neither a financial liability nor a commitment upon the sukuk originator in return of his utilization of the sukuk proceeds.
- 4.5.** The sukuk issuance proceeds shall throughout the duration of the investment be utilized as per the purpose of their issuance and according to the Shari'a rules and precepts.
- 4.6.** Sukuk may be nominal, i.e. carrying the name of the sakk holder, and their title is transferred by registration in a special record or by writing on them the name of every new holder. Sukuk may also be for their bearer, so title is transferred then by virtue of changing hands.
- 4.7.** If issuance of the sukuk is to finance the establishment or development of a project, then the following shall be observed:
 - 4.7.1.** Both the purpose and activities of the project are legitimate and in line with the Shari'a precepts.
 - 4.7.2.** The project is managed financially as in independent unit so that its financial position and outcome can be made known at the end of the investment period.
 - 4.7.3.** The project financial accounts are distinguished and independent of the accounts of any other projects which constitute a liability on the sukuk originator; the beneficiary of the sukuk issuance proceeds.
 - 4.7.4.** The project is that would yield some returns based on its feasibility study.
 - 4.7.5.** The project financial statements are prepared according to the accounting standards of AAOIFI.
 - 4.7.6.** The project accounts are controlled by a qualified financial controller(s) appointed by the SPV.
 - 4.7.7.** The project is audited by the Sukuk Shari'a Committee to ensure the compliance of its activities, profit distribution and loss sharing with the Shari'a rules.
- 4.8.** For protection of the sukuk holders' rights, the sukuk originator is responsible for the validity, accuracy and comprehensiveness of all data, information, documents and declarations contained in the issuance prospectus. The intentional concealment of the above or its misrepresentation shall trigger the liability of the sukuk originator.
- 4.9.** Investment sukuk must be void of any clause to the effect of the liability of the Mudareb, the partner or the investment agent for any taxes imposed on the sukuk returns or for any currency exchange price differences.
- 4.10.** AAOIFI Shari'a and accounting standards shall represent the binding reference for whatever general rules and principles not covered in this sukuk standard.

5. Shari'a Rules for the Issuance of Sukuk

5.1. The Special Purpose Vehicle

- 5.1.1.** It is permissible for the issuance of sukuk to be handled by a special purpose vehicle that has a financial liability that is independent of the liability of the sukuk originator or owners for the purpose of acting as the sukuk holders' trustee in holding title of the sukuk assets, and as their agent in directing the sukuk issuance realized funds towards investing them in what they were issued for, and for the purpose of contracting with the investors of the sukuk proceeds.
- 5.1.2.** The SPV may not be owned or managed by the sukuk originator (the user of the sukuk proceeds) if this shall result in breach of Shari'a rules, like in cases that involve sale or lease to one's self or involve conflict of interest as in the scenario of the Ijarah sukuk originator selling to the SPV leasable assets, or their usufruct, then leasing them back within a period that does not normally experience a change in their market price.
- 5.1.3.** An audited Financial Statements for the SPV must be annually prepared.

5.2. Stipulating an Incentive for the Sukuk Manager

- 5.2.1.** The Prospectus and its documents may state that the sukuk manager is entitled to all or part of the profit that exceeds a certain level as an incentive for his good management, in addition to the fees or profit share he is originally entitled to.
- 5.2.2.** The sukuk manager's incentive is to be worked out for the sukuk term upon the maturity of the sukuk; however, it is permitted to advance to the sukuk manger some payments on the account of the incentive during the sukuk terms and prior to their maturity. These advanced payments shall be offset against the realized incentive upon the maturity of the sukuk. It is permitted, however, to finally calculate and pay the incentive for each profit distributing period after a constructive liquidation.

5.3. Giving Prizes on Investment Sukuk

- 5.3.1.** It is not permitted for the sukuk manager (as Mudareb, partner or investment agent) to distribute prizes on lot basis to the sukuk holders from the profit distributable to them, since they are partners and assigning some profit to some partners is against the very spirit of profit sharing.
- 5.3.2.** It is permitted, however, for the sukuk manger to distribute prizes from his own fund provided the distribution is on pure donation basis and it is not the primary objective of the sukuk issuance.

6. Sukuk Guarantees

6.1. General Rules

- 6.1.1.** Investment in sukuk is an investment in real ownership whereby sukuk holders bear the risk of the assets in which the subscription realized fund is invested, such as investment in stocks or funds. Thus, Sukuk do not represent debts liability upon their issuer towards their holders. This, in fact,

necessitates the following:

- 6.1.1.1. Sukuk holders bear the risk and reap the fruits of the assets in which the subscription proceeds are invested.
- 6.1.1.2. Neither the sukuk issuer, nor the sukuk manager or the user of the subscription proceeds through one of the investment contracts like Mudaraba, Musharaka or Wakala Bil Istithmar, is permitted to guarantee for the sukuk holders the face value of their sukuk or a certain return on their investment. Otherwise, the very issuance and its underlying contract become null and void.
- 6.1.2. The meaning of guarantee in this context is to guarantee the value of the sukuk assets when they get destroyed or damaged, or when they fully or partially lose their value, without any misconduct, negligence or breach of the issuance conditions on the part of the guarantor. Nevertheless, the sukuk manager shall be liable for the value of the sukuk assets in these cases unless he proves that their occurrence was for reasons beyond his control, and which he could neither anticipate nor avoid.
- 6.1.3. It is permitted for the sukuk manager to give an undertaking to buy the sukuk assets at any value except the face value. This undertaking, however, does not bind the undertaker in cases of full or partial damage. This is because the undertaker is bound by his purchase undertaking only if the assets remain in existence at the time of the purchase execution, while if the assets have been destroyed or damaged then the undertaking is not executable, because selling non-existing assets is invalid.
- 6.1.4. The investment Sukuk manager is obliged to physically or constructively liquidate the sukuk assets upon the maturity of the sukuk as per the market practice and to refund the capital as well as the realized profit, unless he proves that the sukuk assets have been damaged or have lost value for reasons beyond his control.
- 6.1.5. It is permitted for the holders of investment sukuk to obtain from a third party, by virtue of an independent document, a binding promise to purchase the sukuk assets on a certain time or upon the maturity of the sukuk. It is permitted as well for this promise to originate from the sukuk manager so that he undertakes to buy the sukuk assets described in the undertaking at one of the permitted values; the market value, the value agreed upon at the time of executing the purchase, the net assets value, a fair value or the value determined by the market experts at the time of executing the promise.

6.2. Guarantee in Finance and Ijarah Sukuk

- 6.2.1. The originator of finance sukuk (Murabaha, Istisna' and Salam sukuk) may guarantee the price in Murabaha and Istisna' sales and the very Salam commodity, because these represent a debt liability on his part so stipulating such guarantee is a confirmation of a legitimate right, and a third party may guarantee the sukuk originator in repaying the said debt.
- 6.2.2. The originator of Ijarah sukuk cannot guarantee the assets or usufructs he has sold to the sukuk holders then respectively leased or bought them back. Furthermore, he cannot assume responsibility of their total loss, damage or

value depreciation after delivering them to the sukuk holders or their representative, because liability shifts with transfer of ownership.

6.2.3. It is permitted to appoint the seller of the assets or the usufructs as a service agent for the sukuk holders against a fixed fee plus an incentive.

6.3. The promise to purchase in Murabaha and Istisna'

6.3.1. This promise binds the promising party and not the beneficiary; however, the promising party may not be forced to execute its promise, but the beneficiary has the right to demand indemnity for any actual harm resulting from the non-fulfillment of the promise. The actual harm shall correspond to the difference between the cost of acquiring the assets and their selling price when sold to a third party.

6.3.2. The promise shall not bind its giver unless it is given on something known by description, and which shall remain as per description until the time of executing the promise. If it was damaged or disposed of, then the promise would not bind its giver since purchase of non-existing assets is invalid.

6.4. Undertaking of Purchase at Price Equivalent to the Remaining Unpaid Fixed Rental (The Non-Managing Lessee's Undertaking)

The non-managing lessee may undertake to purchase the Ijarah Muntahia Bettamleek sukuk assets at a value equivalent to the remaining unpaid fixed rental (fixed rentals balance), regardless of whether the leased assets were originally bought from the same lessee or from a third party, and this does not amount to guaranteeing the capital or the profit to the sukuk holders (nor a non-independent third-party guarantee if the sukuk manager was the one who sold the leased assets to a third party).

6.5. Guarantees in Investment Sukuk

Manager of investment sukuk may guarantee the value of the sukuk assets in case of breach of the agreement (cases of breach of the requirements of trust, negligence or misconduct in respect to taking the appropriate investment decisions which should normally be expected of an investment expert) or the investment rules stipulated by the sukuk holders. The guarantee shall be of the capital alone and in accordance with the general rules of guarantees.

6.6. The Commitment to Liquidate the Sukuk Assets and Refund the Capital

The sukuk issuer, who utilizes the sukuk issuance proceeds, is obliged to liquidate the assets of Mudaraba, Musharaka or Wakala Bil Istithmar upon the maturity of the sukuk, and to refund the capital as well as the realized profit to the sukuk holders. If he claims damage, loss or impairment in the market value of the sukuk assets, the burden of proof shall lie on his shoulder to suggest that the occurrence of these incidents was not the result of his breach of the requirements of trust, negligence or misconduct in respect to taking the appropriate investment decisions which should normally be expected of an investment expert.

6.7. Lending Undertaking by the Investment Sukuk Manager

It is not permitted for the Sukuk manager (as Mudareb, partner or investment agent) to undertake to lend the Sukuk holders in case of shortfall in the sukuk assets expected returns, for this involves the prohibited combining of a commutative contract with a loan contract. It is permitted, however, for the sukuk manager to source a Shari'a compliant financing or an interest-free loan in order to cover the shortfall. In this case, the Sukuk manager shall claim the same amount from the future profit or the selling price of the Sukuk assets.

6.8. Lending undertaking by the Finance Sukuk Manager

The Sukuk manager or the sukuk issuer of finance sukuk (sukuk of assets, usufructs or rights of utilization) may give an undertaking independently of the contracts to offer an interest-free loan to the sukuk holders in case of shortfall in the sukuk assets expected returns, because in this case the sukuk manger can be deemed as a third party.

6.9. Guarantee of a Determined Profit for the Sukuk Holders by the Sukuk Manager

The manger of investment sukuk may not guarantee for the sukuk holders a certain profit as a fixed amount or as a percentage of the capital, because this guarantee nullifies profit sharing; the underlying principle of investment.

APPENDIX (1)

7. DETAILS OF SUKUK RULES

7.1. Ijarah Sukuk

7.1.1. It is permitted that the sukuk holders buy the sukuk leasable assets then lease them to their original seller on Ijarah Muntahia Bettamleek basis against fixed and variable rents. This practice cannot be deemed unlawful Eina or Wafa' sale should the following be observed:

7.1.1.1. The sale is genuine, and it transfers both title and liability.

7.1.1.2. The sukuk holders are liable for the ownership risks so that the Ijarah is terminated in case of total loss of the leased assets, and the lessee has the right to demand a reduction in the rent proportionate to the loss in case of a partial loss that impacts the intended usufruct, if not caused by the lessee.

7.1.1.3. The sukuk holders and not the lessee, whether directly or indirectly, are genuinely liable for the burdens and expenses that are associated with ownership, like payment of the insurance premiums, major maintenance and taxes.

7.1.1.4. The sukuk holders have the absolute legal right in the disposal of the Sukuk without any restrictions.

7.1.1.5. The sukuk assets are saleable according to the official laws.

7.1.1.6. The sale and lease contracts are not linked together, the lease is not stipulated in the sale contract and the payment of the price is not conditional on payment, or non default in payment, of the rent.

7.1.1.7. One year at least must have passed from the lease of the assets to their title transfer to the lessee.

7.2. Elements of Ownership

7.2.1. Shari'a recognizes the complete ownership that involves both title and usufruct of the asset as well as the incomplete one that involves either the usufruct or the title. Segregation between the title and the usufruct is feasible in contracts like sale and bequest. However, the subject matter of the sale contract corresponds to the complete ownership of both title and usufruct, while the subject matter of the lease contract corresponds to the incomplete ownership of the usufruct only and not the title.

7.2.2. Sukuk holders are liable and fully responsible for the leased assets in terms of both title and usufruct or usufruct only since they are the owners of these assets.

7.2.3. The objective of Ijarah sukuk is to convert the Ijarah underlying usufruct into securities (sukuk) so that they can be traded in the secondary market.

7.2.4. Each Ijarah sakk represents a common share in the ownership of the usufructs of the tangible assets before these usufructs are sold to a third party. However, after the sale of these usufructs the sakk represents the rent, which becomes a receivable payable by the lessee and thus, subject to Shari'a rules of sale of debt.

- 7.2.5.** Ijarah sakk does not represent a certain amount of money or a debt liability upon a particular party, but rather a security representing a common share in the ownership of the usufruct of a tangible asset, like a real estate property, a plane or a vessel.
- 7.2.6.** It is permitted to issue and trade in the sukuk that represent ownership of leased, or to be leased, tangible assets as long as these assets have fulfilled Shari'a conditions pertaining to the leasable assets, like a real estate property, a plane or a vessel and the like, and the sakk represents a genuine ownership in these income-generating assets.
- 7.2.7.** The owner of a sakk can sell it in or out of the secondary market to any buyer other than its issuer - notwithstanding the issuer's right to redeem it upon or before maturity as per Shari'a rules – at any agreed price, whether equal, higher or less than its issuing price, based on the market factors of demand and supply.
- 7.2.8.** The sakk owner is entitled to his share in the return, i.e. the rent, according to the rent payment schedule outlined in the Prospectus and the lease contract, (after deduction of the sakk's corresponding share in the applicable expenses as outlined in the Ijarah contract).
- 7.2.9.** Being the owners of the usufruct, the holders of assets sukuk and usufructs sukuk, may issue Ijarah sukuk representing undivided shares in the usufructs they came to own by virtue of owning the tangible assets or their usufructs for the purpose of subleasing the same with the permission of the original lessor. However, this is circumscribed with the issuance of the sukuk being prior to signing the lease agreements with the new lessees, whether the lease is for a rent equivalent, higher or less than the first rent. In case signing the lease agreements was prior to the sukuk issuance, the sukuk become then untradeable unless with observing the rules pertaining to sale of debt.
- 7.2.10.** The seller of the usufruct may not guarantee the face value of the sakk or its return. Moreover, the owners who lease their assets are liable in case of full or partial damage of their assets.
- 7.2.11.** The leased assets may be already owned by the sukuk originator at the time of issuance, or a liability on its part, i.e. he/she will come to own them based on a sale, Istisna' or any other contract. Nevertheless, sukuk holders own the usufruct of these assets once the lease contract is signed and thus, they become entitled to the rent payable in the sublease contract. However, these sukuk of assets leased on the basis of liability by description are not tradable unless the assets have been delivered.
- 7.2.12.** Sukuk of ownership of tangible assets and sukuk of ownership of usufructs of tangible assets are issued on the basis of a valid sale contract that transfers the ownership from both Shari'a and legal perspectives. However, in this sale contract it is a must that:
- 7.2.12.1.** The sale is genuine and genuinely transferring to the sukuk holders the complete or the incomplete ownership of the asset form both Shari'a and legal perspectives, and thus it bestows on the sukuk holders all privileges of ownership to conduct all legally valid acts on the asset itself or its usufruct with no restriction whatsoever.

- 7.2.12.2. The object of sale (the sukuk assets) is among the saleable assets, and its title can be transferred from both legal and Shari'a perspectives to the sukuk holders or the agent that represents them. As a result, the following shall take place:
- 7.2.12.2.1. The assets (sold) become no longer the property of the seller, and in his financial statement they appear off balance sheet.
- 7.2.12.2.2. The right of the sukuk holders attaches to the sukuk assets to which they hold title (the sukuk assets) and not the liability of the sukuk originator who sold the assets.
- 7.2.12.2.3. The sukuk holders shall have the right to exercise on the sukuk assets all the legally valid acts like sale, lease-back to the seller and the likes, with no restrictions.
- 7.2.12.2.4. The purchase undertaking given by the lessee of the sukuk assets shall bind the promising party only so that the sukuk holders are not obliged to sell to him these assets. Moreover, the giver of the purchase undertaking shall not be bound to pay the price when the purchase undertaking becomes no longer executable and for reasons not attributable to him. If, however, they are attributable to him, then he is liable for the actual loss if any.
- 7.2.12.2.5. The sale undertaking given by the sukuk holders as owners of the assets shall bind them to sell the assets to the lessee, but the later shall not be obliged to buy the assets from them. This sale undertaking, however, can be on the nominal value of the leased assets.
- 7.2.13.** It is not permitted to have bilateral promises from the lessee to buy and from the sukuk holders to sell if the object of promises, the time for their execution and the remaining conditions are the same.
- 7.2.14.** If the assets have already been leased, then they cannot be leased again unless the new lease contract will start upon the expiry of the current lease, and any payment made before the start of the lease will be deemed as payment on account. An arrangement however can be made to replace the lessor by cancelling the current lease contract, executing the new lease then reinstating the old lessee based on a new lease contract.

7.3. Sukuk of Ownership of Leased or to be Leased Assets

- 7.3.1.** The sukuk of ownership of the leased assets or the asset to be leased represent the right of their holders in the ownership of the assets. They grant them the right over the proceeds from the sale of these assets or the sale of their usufructs.
- 7.3.2.** The underlying assets of the sukuk of ownership of tangible assets must be owned by their seller when selling them to the sukuk holders. When selling them on Istisna or Salam basis, the assets must have been established as liability by description on the seller.
- 7.3.3.** The title to these assets must be transferred to the sukuk holders by virtue of a valid title-transferring sale, and the sukuk holders must come to possess them physically or constructively.

- 7.3.4.** The holders of these sukuk shall become liable for the assets represented by these sukuk (their damage and loss) each in proportion to the number of the sukuk he holds, and they shall enjoy their gains and privileges (proceeds, returns, rents and profits) according to the terms outlined in the Prospectus and the issuance contracts.
- 7.3.5.** The holders of these sukuk, with the observance of the above rules and conditions, may lease these assets after they come to own and possess them, or lease them on forward lease basis, i.e. before possessing them, regardless of whether the lease is to their original seller or to a third party, and whether it is operating lease or Ijarah Muntahia Bittamlik.
- 7.3.6.** The seller of the sukuk assets may be appointed as Mudareb against a share in the profit, or as an agent on behalf of the sukuk holders to manage these assets against fixed fees plus an incentive for good management.
- 7.3.7.** The seller of the assets, who then leases them on operating leases basis, may unilaterally undertake to redeem these assets sukuk upon their maturity through purchasing the assets (sukuk assets) on the price agreed upon at the time of executing the purchase. Alternatively, the price could be a market price, a fair price, or the net value of the assets or their face value. However, this undertaking binds him alone and not the sukuk holders, and it can be given by a third party on any price.
- 7.3.8.** It is permitted to trade these sukuk, for they represent claims to tangible assets (already leased or to be leased at a later stage). When traded, the title to these assets represented by the sukuk is transferred from the seller to the buyer along with their rights and obligations.
- 7.3.9.** As owners of the assets represented by the sukuk, the sukuk holders have the right to conduct on these assets all valid acts, in accordance with the Shari'a compliant issuance contracts and in ways that do not harm others' rights.
- 7.3.10.** The lessee of the assets represented by the sukuk may undertake in a separate document to purchase these assets in case he has defaulted on meeting his financial commitments toward the Ijarah agreement. The purchase price in this case could be any price agreed upon at the time of executing the purchase; the market price, a fair price or a price equivalent to the net assets value or the face value.

7.4. Sukuk of Usufructs

- 7.4.1.** These sukuk represent their holders' right in the ownership of the usufructs, and not the title, of the assets to be leased, and they entitle their holders to the proceeds realized from the sale of the assets' usufruct.
- 7.4.2.** The usufruct represented by the sukuk must be owned by its seller when it is sold to the sukuk holders, so that he/she either owns the asset whose usufruct is to be sold or the usufruct alone and not its underlying asset. If the usufruct is already sold to a third party then issuing sukuk against this usufruct is not allowed since the usufruct no longer belongs to its seller.
- 7.4.3.** The usufructs represented by the sukuk may be usufructs of assets that are established as a liability by description on the seller's part to deliver

them on the date determined in the lease contract.

- 7.4.4.** The ownership of the usufructs represented by the sukuk must be transferred from the seller of these usufructs to the sukuk holders, who buy them through a lease contract.
- 7.4.5.** The holders of these sukuk shall become solely liable for the damage or loss of these usufructs, each in proportion to his share in these usufructs, and they shall enjoy their gains and privileges (the rent) according to the terms outlined in the Prospectus and the relevant sukuk contracts.
- 7.4.6.** The sukuk holders may sell the whole usufruct represented by the sukuk (for its whole duration) through a usufruct-selling contract or only a part thereof (part of its duration).
- 7.4.7.** The seller of the assets' usufructs represented by the sukuk may be appointed as an agent on behalf of the sukuk holders to manage the usufructs against fixed fees plus an incentive corresponding to the amount in excess of a certain rent limit, or to appoint him as Mudareb against a share in the profit.
- 7.4.8.** The seller of the usufruct may unilaterally undertake to purchase at a determined price the remaining usufruct (the duration of the usufruct) upon the maturity of the sukuk.
- 7.4.9.** It is permitted to trade sukuk of usufructs of assets (for whatever price before selling the usufruct) for they represent the usufructs ownership. When traded, the title to these usufructs represented by the sukuk is transferred from the seller to the buyer along with their rights and obligations.
- 7.4.10.** The holders of sukuk of usufructs of assets have the right to sell or lease these usufructs. Restriction to this right is not permitted except in accordance with the issuance contracts and in ways that do not harm others' rights.
- 7.4.11.** The holders of these sukuk may undertake in a separate document to gift or sell on a determined price the assets' usufructs represented by the sukuk to the original seller of these usufructs or to a third party. The sale is executed then on the remaining duration of the usufruct. However, this sale is not permitted if the sukuk holders have already sold or leased the usufruct, because the seller must be the owner of what he sells and the sukuk would represent then the price of the usufruct or the rent, which is a debt liability upon the lessee so it is subject to the rules pertaining to sale of debt.

7.5. Sukuk of Ownership of Usufructs of Specified Assets

- 7.5.1.** They are the sukuk originated by the owner of a particular asset with the aim of leasing the asset or selling its usufruct for a specified period and receiving the rental from the subscription proceeds so that the ownership of the usufruct of the assets passes to the sukuk holders.
- 7.5.2.** They are also the sukuk originated by the owner of a usufruct of a specified asset (the lessee) who leases the asset with the aim of subleasing it and receiving the rental from the subscription proceeds so that the usufruct of the assets passes into the ownership of the holders of the Sukuk.

7.5.3. These sukuk are issued on the basis of a sale of the right to the usufruct, not the corpus of its underlying specified asset, for a specified period. This right attaches to the asset and not the liability of the seller who originates the sukuk, and it reflects an incomplete ownership for the sukuk holders.

7.5.4. All sale contracts transferring title to assets or assets' usufructs and all lease contracts which give sukuk holders the direct right of assets' utilization must fulfill the following conditions:

7.5.4.1. The contracts are genuine so that they transfer the ownership of the assets and the usufructs to the sukuk holders. They shall also give sukuk holders the right to conduct on them all the legally valid acts. They shall not include any conditions that contradict the nature of these contracts or their Shari'a objective, rendering otherwise the contracts fictitious or conducive to Reba or 'Eina.

7.5.4.2. The sale or lease contract is capable of producing its legal effect so that the object of the contract (the sold or the leased asset) admits all acts of disposal, including transferring its title from its seller to the sukuk holders from both legal and Shari'a perspectives.

7.5.5. Based on the above:

7.5.5.1. The ownership of the underlying sukuk assets and usufructs should be removed from the books of the seller so that on its financial statement they appear off balance sheet, and thus they become the property of the sukuk holders rendering them the right to conduct on them all valid acts.

7.5.5.2. The right of the sukuk holders in the assets or the assets' usufructs, which are acquired with the funds realized from subscription, attaches these very assets and not the liability of the sukuk issuer who sold or leased these assets.

7.6. Sukuk of Human Labor (Service Ijarah Sukuk)

Sukuk of service Ijarah give their holders the right to own a service provided by the sukuk originator (the service provider) against the sukuk issuance proceeds and to sell this service and claim its price from its buyer or final user. The services represented by these sukuk may be obtained from a specified service provider or from an unspecified one.

7.6.1. Sukuk of Services Supplied a Specific Provider

These sukuk are issued with the aim of purchasing a specific service from a particular provider, like the service of education from a particular university or medical treatment by a particular doctor and the price of the service is paid through the subscription proceeds. The services purchased become the property of the sukuk holders so they have the right to sell them to a third party (the service receiver) against an agreed-upon price or fee.

7.6.2. Sukuk of Services Supplied Unspecific Provider

7.6.2.1. These sukuk are issued with the aim of purchasing a service established as liability by description without specifying its provider, with its price being paid with the proceeds from subscription. The service purchased becomes the property of the sukuk holders so they have the right to sell a service of the same specifications through a parallel forward (Mawsufa Bithimma) lease to a third party (the service

- receiver) against an agreed-upon price or fee.
- 7.6.2.2. The ownership of these services is immediately transferred from their provider to the sukuk holders through a sale or lease contract. Alternatively, the owner of services, who has not utilized them yet, may sell them to the sukuk holders against a determined price or fee. However the services sale or lease contract must fulfil its all Shari'a rules and conditions.
- 7.6.2.3. Service sukuk holders shall alone bear their sukuk risks, each to the proportion of the number of sukuk he holds, and they shall also enjoy the sukuk gains and privileges according to the terms outlined in the prospectus and the issuance contracts.
- 7.6.2.4. The seller of the services may undertake in a separate document to purchase the unutilized services, or the remaining period of the services, at a fair price, market price, any price agreed upon at the time of executing the purchase or at the face value. Similarly, the sukuk holders may undertake in a separate document to sell at any of these prices the unutilized services or the remaining period of the services to the original seller of the services.
- 7.6.2.5. It is permitted to trade the sukuk service before and not after the sale or the full utilization of these services, for they represent title to these services. When traded, title to these services or the remaining period thereof is transferred from the seller to the buyer along with its rights and obligations. Sukuk of forward (Mawsufa Bithimma) services are also subject to the same rules.
- 7.6.2.6. If only part of the sukuk services has been sold or utilized, then the ratio of this part to the unsold one must be taken into consideration for the tradability of these sukuk, so that the selling price of the later part is not equivalent to the face value of the sukuk, since this may render the very transaction fictitious.
- 7.6.2.7. The holders of services sukuk have the right to dispose of the unutilized part of the services or their remaining period. Imposing any restriction to this right is not permitted.
- 7.6.2.8. The services sukuk holders may undertake to gift, sell or lease to the original seller the remaining unutilized services, or the remaining duration of the services, for the price referred to in clause (4). The sale, however, is not permitted if the services have already been utilized or sold to others, because the seller must be the owner of the what he sells, and Sukuk represent in this case the due price or fee of the service, which is a debt liability upon the other.
- 7.6.2.9. The seller of a service for a specific period of time may undertake in a separate document to buy the remaining period of the services at a price determined in the very sale undertaking, provided it is reasonable for such remaining period. This is in order for the sale not to be fictitious like when the service of a ten-year period is sold for one thousand, then bought when only one year is remaining for one thousand as well.

7.7. Participation Sukuk

7.7.1. Mudaraba Sukuk

- 7.7.1.1. Sukuk holders provide the capital to be invested by the Mudareb.
- 7.7.1.2. The Mudareb is responsible for returning the Mudaraba capital and the realized profit unless he proves that the Mudaraba assets have been damaged or lost for reasons beyond his control which he could neither anticipate nor avoid.
- 7.7.1.3. The realized profit shall be distributed between the sukuk holders and the Mudareb according to a ratio agreed upon in advance and stated in both the Prospectus and the Mudaraba contract.
- 7.7.1.4. The loss that is not attributable to the Mudareb shall be borne by the sukuk holders, while the Mudareb shall lose his efforts in this case.
- 7.7.1.5. If the Mudaraba is restricted and not absolute, then the Mudareb is bound by the restrictions incorporated in the Mudaraba contract, and breaching which amounts to transgression.
- 7.7.1.6. These sukuk are originated by the Mudareb for the purpose of utilizing the issuance realized fund in a particular project or activity. At issuance they represent undivided shares in the Mudaraba capital, after issuance they represent undivided shares in the Mudaraba assets purchased with the capital. However, they never represent a debt liability upon their issuer (Mudareb) for their holders (the capital providers).
- 7.7.1.7. These sukuk are issued on the basis of the Shari'a contract of Mudaraba, which must fulfil its relevant rules and conditions and produce its legal effects, and nothing that nullifies it can be stipulated in the contract.
- 7.7.1.8. The issuance prospectus and its underlying Mudaraba contract must determine the respective profit share of the Mudareb as well as the sukuk holders; nevertheless, upon the distribution of profit, each party may waive to the other its share in the profit or a part thereof. However a pre-agreement to this effect may not be made in the Mudaraba contract or the issuance prospectus.
- 7.7.1.9. The Mudareb invests the Mudaraba assets on a trust basis, in which case he is not liable for damage or losses of these assets except in cases of breach of the requirements of trust, negligence or misconduct in respect to taking the appropriate investment decisions, according to the standards of an experienced Mudareb in the respective Mudaraba activity. Liability, if applicable, involves delivering the same assets or payment of their value which shall not drop below the Mudaraba capital. In case of dispute between the sukuk holders and the Mudareb over the occurrence of misconduct, it is the responsibility of the Mudareb to prove that the occurrence of damage or loss was for reasons beyond his control, and which he could neither anticipate nor avoid; otherwise, he/she would be held liable for the Mudaraba capital and the profit realized prior to the damage or the loss.
- 7.7.1.10. The Mudareb may undertake in a separate document to purchase

the Mudaraba assets at the price that will be agreed upon at the time of executing the purchase, at the market price, a fair price or a net value of the Mudaraba assets, but not their nominal value. However, in cases where Mudareb is held liable for the loss, i.e. in cases of breach of the requirements of trust, negligence or misconduct in respect to taking the appropriate investment decisions, Mudareb may provide an undertaking to purchase the Mudaraba assets at their face value, for this price represents then the Mudaraba capital for which Mudareb becomes liable in the aforementioned cases.

7.7.1.11. Such undertaking binds the Mudareb only and not the sukuk holders. If the Mudareb does not execute his undertaking, the sukuk holders shall then have the right to sell the Mudaraba assets in the market and claim from the Mudareb the difference, if any, between the selling price and the Mudaraba capital. However, the sukuk holders shall not have the right to force the Mudareb to execute the purchase (the actual execution of the very purchase contract).

7.7.1.12. The Mudareb may undertake to purchase the Mudaraba assets upon the maturity of the Mudaraba, if the Mudaraba assets conditions remain the same as they were at the time of giving the undertaking apart from the change in their value, at the price that will be agreed upon at the time of executing the purchase, the market price, a fair price or the net value of the Mudaraba assets as will be agreed by the two parties or by an independent party determined mutually in the Mudaraba contract or the issuance prospectus. If, however, the Mudaraba assets suffer from a total or partial loss, or their conditions have changed and the change is that would impact their price, then the purchase undertaker is not bound to buy them.

7.7.1.13. The Mudareb is responsible for terminating the Mudaraba upon its maturity by selling the Mudaraba assets and then returning its capital, if remained intact, as well as the realized profit. Sukuk holders, being the owners of the Mudaraba assets, have also the right to dispose of the Mudaraba assets, but they have to pay the Mudareb his share in the realized profit.

7.7.1.14. All expenses and direct expenditures related to the Mudaraba business must be paid from the Mudaraba account so that the Mudareb cannot be made responsible for payment of taxes imposed on the Mudaraba business or on its returns, or be responsible for any price differences resulting from currencies exchange.

7.8. Sukuk of Partnership in Profit

7.8.1. Sukuk of Joint Ownership

7.8.1.1. It is permitted to issue sukuk for the purpose of acquiring a common share in the ownership of an asset or a usufruct so that the other partner remains the owner of the remaining share.

7.8.1.2. Sukuk holders and the other partner are like foreigners with respect to each other's share so that no party has the authority to act on behalf of the other unless with delegation of power and each party is

independently entitled to the return on his share.

7.8.1.3. It is permitted to appoint against a determined fee the other partner as an agent in acts like taking possession of assets or settling payments, but not in investment. However, the agent may be given as incentive what may exceed a certain return or a certain share in the return.

7.8.1.4. A partner to a joint ownership may undertake to buy his partner's share at whatever price, including the nominal value of that share.

7.8.2. Sukuk of Contractual Partnership

7.8.2.1. Contractual Musharaka Sukuk can be issued in two different structures:

7.8.2.1.1. **First**, they can be originated by the owner of an asset, a particular project or a specific venture regardless of its legal form, for the purpose of receiving the monetary contribution of the sukuk holders, as partners, to develop a project or furnish it with new equipments. The contribution of the sukuk originator shall be in the form of tangible assets of his project or venture calculated on the basis on their net asset value. The combination of the cash contributed and the value of the tangible assets contributed constitute the capital of this partnership, and the share of each partner, the sukuk originator and sukuk holders, shall be proportionate to the contribution.

7.8.2.1.2. **Second**, they can be originated by a party seeking a contribution to the Musharaka to invest it along with his cash contribution in a particular project or venture and he handles the management of this partnership. Alternatively, his contribution to the Musharaka can be through purchase of some of the issued sukuk.

7.8.2.2. Each Sakk represents a common share in the Musharaka assets, and each sukuk holder reaps the benefits and bears the liability of his corresponding share in the Musharaka.

7.8.2.3. Neither The Musharaka sukuk originator nor their manger can give a purchase undertaking to the sukuk holders to buy their share in the Musharaka assets at its face value. However, if the purchase undertaking was on the value that will be agreed upon at the time of executing the purchase, at a fair value or at the price that will be determined by an independent party, then it is permitted.

7.8.2.4. Contractual Musharaka sukuk are of two types:

7.8.2.4.1. **First**, Sukuk of Musharaka in a particular, existing, specific and Shari'a compliant project or venture. This project or venture is owned by the sukuk originator whose aim is to expand the venture or increase its capital.

7.8.2.4.1.1. The Sukuk holders' share in the specific project or venture is the sukuk issuance realized fund, while the sukuk originator's share is the net value of his project or venture based on a valuation conducted by a specialized

- independent party. However, all Shari'a rules and conditions must be fulfilled in this project or venture.
- 7.8.2.4.1.2. It is permitted to appoint the project owner (the sukuk originator) as the Musharaka manager against a specific fee based on a management contract which must be independent of the Musharaka contract. The Sukuk holders, through their representative, may be the party handling the management of the project against a specific fee. Similarly the management may be handled jointly by the sukuk holders' representative and the sukuk issuer or by an independent party appointed by them based on
- 7.8.2.4.1.3. a mutual agreement. In the latter case, the manager may handle the management as a Mudareb against a share in the profit or as an agent against a specific fee plus a percentage in the realized profit as incentive if applicable.
- 7.8.2.4.1.4. Both sukuk holders and sukuk originator (the sukuk holders' partner) are liable for loss in proportion to each partner's share in the specific project or venture. Profit shall be distributed as per their agreement.
- 7.8.2.4.1.5. The partner may give an independent undertaking to buy the sukuk holders' share in the project at a price that will be agreed upon at the time of executing the purchase, the market value, a fair value or the net asset value but not the nominal value.
- 7.8.2.4.1.6. The sukuk manager may give an undertaking to buy the sukuk assets at their nominal value in cases of misconduct or negligence with respect to the Musharaka assets or breach of the sukuk issuance contracts and prospectus. The purchase undertaking can however be at face value so long as the undertaker is not the sukuk manager.
- 7.8.2.4.1.7. In all cases, the project manager is deemed a trustee with respect to the Musharaka assets so that he cannot be liable for them in cases other than misconduct, negligence and breach of the contract conditions. If he, however, claims the loss or damage of these assets then he should provide a proof to the effect that the loss or damage has occurred for reasons beyond his control and neither predictable nor avoidable.
- 7.8.2.4.2. **Second**, Musharaka Sukuk that are aimed for financing a specific project or venture that will begin with the fund mobilized through the issuance of the sukuk, and the issuer is a partner in proportion to the number of sukuk he subscribes to.
- 7.8.2.4.2.1. These sukuk represent a common share in the ownership of the project, and thus the holder of these sukuk shares profit and loss in proportion to the number of sukuk he holds.
- 7.8.2.4.2.2. Whatever applies to the sukuk of Musharaka in existing

project in terms of appointment of the Musharaka manager and his undertaking to buy the sukuk holders' share in case of wrongful acts or on the maturity of the sukuk applies as well to this type of sukuk.

- 7.8.2.5. The sukuk originator may form a partnership with the sukuk holders whereby each partner makes a specific contribution to a specific capital; this contribution may be in form of cash money or some tangible assets. The sukuk originator who owns a specific project or venture may issue sukuk with the aim of using the sukuk issuance realized fund to increase the capital of the project and expand its activities. The partners' shares in this Musharaka shall be determined by measuring the ratio of the net value of the project assets to the fund realized from the issuance of the sukuk. The loss, if any, shall be borne by the two partners according to the said ratio, while the profit shall be distributed as per agreement.
- 7.8.2.6. The managing partner manages the project on trust basis so he is not liable for the damage or loss of the Musharaka assets unless in cases of misconduct, negligence or breach of the contract conditions. However, if a dispute arises between the sukuk holders and the managing partner over the occurrence of misconduct then it is the responsibility of the managing partner to prove that the occurrence of damage or loss was for reasons beyond his/her control, and which he could neither anticipate nor avoid; otherwise, he would be held liable for the Mudaraba capital and the realized profit.
- 7.8.2.7. Wakala Investment Sukuk: These are issued on the basis of Wakala investment contract, and their issuance proceeds form the capital which is paid to the investment agent to invest it against a predetermined fee. Every sakk represent a common share in the Wakala assets which may contain tangible assets, cash, debts and other financial rights; and it represents a common share in the price of the Wakala assets after they have been sold. The holders of the investment Wakala sukuk are entitled to the investment return and liable for the investment risk each in proportion to the number of the sukuk he holds. The investment agent, in return, is entitled to a guaranteed a predetermined fee payable by the sukuk holders, in addition to all or part of what may exceed a certain profit threshold as incentive, if applicable. Rules and conditions of the investment Wakala contract and the investment agent fees shall be determined in the subscription prospectus of these sukuk and their relevant contracts.

7.9. Finance Sukuk

7.9.1. Salam Sukuk

- 7.9.1.1. This sakk represents upon issuance a common share in the issuance proceeds which constitute the capital of Salam, and it represents after the purchase of the Salam commodity a common share in this commodity, which is considered a debt liability upon its seller. The holder of the Salam sukuk shares their gains and liabilities in

proportion to the number of the sukuk each holds.

- 7.9.1.2. Salam Sukuk can be redeemed before taking possession of the Salam commodity, provided it is not food in kind, for an amount that does not exceed their nominal value, and they can be traded at market value based on the opinion of the Maliki Fiqh school.

7.9.2. Murabaha and Bay' Bithaman Ajel Sukuk

- 7.9.2.1. This sakk represents upon issuance a common share in the issuance proceeds which constitute the price in Murabaha, and it represents after the purchase of the Murabaha commodity and before selling it to the party promising to buy it a common share in this commodity. After selling the commodity the sakk represents a common share in its selling price which has become a debt liability upon its buyer. The holder of the Murabaha sakk shares its gains and liabilities in proportion to the number of the sukuk he holds.
- 7.9.2.2. After selling the Murabaha commodity to the party promising to buy it, Murabaha sukuk become untradeable unless with two conditions: the selling is at the face value and for a spot price, because once the commodity has been sold sukuk would represent a debt liability upon the commodity buyer.
- 7.9.2.3. Both Murabaha sukuk and Bay' Bithaman Ajel sukuk cannot be traded for less or more than their face value, but if sold against some commodities then they can be traded.

7.9.3. Istisna' Sukuk

- 7.9.3.1. An Istisna' sakk represents upon issuance a common share in the issuance proceeds then in the manufactured asset or its raw materials, and after selling it to its buyer the sakk represents a common share in its selling price. The holder of the Istisna' sukuk shares their gains and liabilities in proportion to the number of the sukuk he holds. Istisna' sukuk can also be issued against assets already purchased through Istisna' so that the sukuk issuer may sell them to a third party through a parallel Istisna'.
- 7.9.3.2. Istisna' sukuk become untradeable after delivering the Istisna' commodity to its buyer unless for the face value and for a spot price.
- 7.9.3.3. Istisna' sukuk, without a prior condition, can be redeemed for lesser than their face value, for they represent in this case a debt liability upon the buyer.

7.9.4. Investment Portfolio Sukuk

- 7.9.4.1. It is permitted to issue sukuk for the purpose of utilizing their proceeds in the purchase of an investment portfolio of a legal entity and independent financial liability, which may be inclusive of tangible assets, usufructs, cash money, receivables and financial rights, on two conditions:
- 7.9.4.1.1. The ratio of cash, receivable or the two combined shall not exceed 90% of the total portfolio assets.

7.9.4.1.2. The purpose of creating this portfolio is not to go around the Shari'a rules pertaining to sale of debt or cash so that they can be traded without the observance of these Shari'a rules. Moreover, if the ratio of the tangible assets, the usufructs, the rights of personal utilization of assets and financial rights is below 10% then acquiring this portfolio is not permitted unless with observance of the Shari'a rules pertaining to sale of receivables, money or the two combined.

Appendix (2)

8. Definitions

8.1. Islamic Shari'a Rules

The rules derived from the Quran, The Sunnah and from the other Shari'a sources whose authority is derived from the Quran and the Sunnah.

8.2. Sukuk

Sukuk: Plural of 'sakk', lexically means a certificate, a deed or security⁴. In Islamic Finance terminology 'sukuk' refers to certificates or legal instruments (securities) of equal value, nominal or for-the-bearer certificates. They represent undivided shares in ownership of assets (the sukuk assets): tangible assets, usufructs, debts, money, services, financial rights or a mixture of some or all of these kinds, but subject to certain conditions upon issuance and after subscription.

Sukuk can be distinguished from bonds by the following characteristics:

- 8.2.1. Sukuk are tradable instruments so long as they do not represent debt or money alone.
- 8.2.2. They cannot be deemed as debt for their owners on their issuer at issuance stage;
- 8.2.3. Their issuance is based on one of the Shari'a contracts, and the rights and obligations of all contractual parties are well defined in the Prospectus and the sukuk contracts. Moreover, sukuk have the following features:
- 8.2.4. They are either nominal or for-the-bearer certificates, issued with equal value as evidence of ownership for their holders in the underlying assets.
- 8.2.5. The holder shares to proportion of the sukuk he holds the profit and the liquidation value of the assets they represent. In case of loss, he is also liable for loss to the proportion of the sukuk he holds based on the Fiqh maxim "liability is an obligation accompanying gain".
- 8.2.6. Sukuk ability for redemption and trading is subject to the conditions pertaining to the tradability of the assets they represent.
- 8.2.7. Sukuk can either be issued for a limited period during or after which they can be redeemed or for an unlimited period.

8.3. Bonds (for comparison with Sukuk)

- 8.3.1. A Bond is a certificate or a deed (security) that represents a guaranteed interest-bearing debt owed by its issuer (the debtor) to its bearer. A bond thus represents a financial right for its bearer (the lender). Its amount is guaranteed by the bond issuer (the borrower) to be repaid at a specific future time.
- 8.3.2. It is the reality of the financial papers that matters and not their terminology and therefore, terming bonds as 'investment certificates' does not change

⁴ From the word 'Sakk' were developed later the English word (check) and the French word (cheque) and their likes.

the prohibition of their acquisition and trading. Similarly, terming sukuk that have fulfilled all Shari'a conditions as 'Islamic bonds' does not render them prohibited, yet the name (Islamic bonds) itself is not accurate in economic terms.

8.4. Sukuk Shari'a Committee

The Shari'a committee selected by the sukuk issuer in order to supervise the issuance of sukuk and the utilization of the issuance proceeds.

8.5. Securities Commission

The governmental unit responsible for supervising the issuance of sukuk in any country.

8.6. Sukuk Manager

The Mudareb, the managing partner or the investment agent.

8.7. Issuance Prospectus

The Information document, which include all of the data, the terms and conditions and the provisions of the sukuk issuance and redemption.

8.8. Sukuk Assets

They are the sukuk issuance proceeds and what they may be converted into of tangible assets, usufructs, services, cash, debts or other financial rights.

8.9. Issuance Contract

The Shari'a contract on the basis of which sukuk are issued.

8.10. Trade of Sukuk

It is the sale of sukuk to parties other than their issuer at the agreed price.⁵ This sale is subject to the Shari'a rules pertaining to the tradability of sukuk underlying assets as outlined in the Prospectus.

8.11. Redemption

It is the sale of the sukuk to their originator, which is subject to the rules and conditions pertaining to the tradability of sukuk underlying assets as outlined in the Prospectus.

8.12. The Market

The authorized securities and commodities market in the Country.

8.13. Underwriting

It is the undertaking by some party to subscribe at a determined price to the sukuk not subscribed to, which binds the undertaking giver alone and not the sukuk originator.

⁵ Eina is the purchase of an asset for a cash price then selling the same to its original seller for a higher deferred price, or the purchase of an asset for a deferred price then selling the same to its original seller for a spot lesser price.

8.14. Sukuk Originator

It is the party seeking finance from the sukuk subscription proceeds, like the buyer in Murabaha or Istisna, the seller in Salam, the seller of the leasable assets and services and usufructs, the Mudareb or the partner or the investment agent and the owner of the land and trees.

8.15. The Issuer

Sukuk are issued by an qualified party to receive the issuance proceeds. They can be also issued by a Special Purpose Vehicle (SPV) whose legal entity and financial liability is independent of that of its creator and shareholders. The SPV acts as the sukuk holders' trustee in holding title of the sukuk assets and as their agent in directing the sukuk issuance realized funds towards what the sukuk were issued for.

8.16. Sukuk Owners (Sukuk Holders)

They are the sukuk subscribers and buyers who own the sukuk assets and reap their gains and bear their losses in proportion to the number of sukuk held by every one of them. They represent the seller in Murabaha or Istisna, the buyer in Salam, the buyer of the leasable assets or services or usufructs, the capital provider in Mudaraba, Musharaka or Wakala in investment.

8.17. Sukuk Holders' Association

It is an association whose purpose is to protect the common interests of its members. It has a legal representative who is appointed - or dismissed - by the sukuk holders to take actions that serve the best interests of the sukuk holders, whether against the SPV or any other party, possibly in the courts of law, in accordance with the association's resolutions made in its appropriate meetings as outlined in the Prospectus.

8.18. The Counter

The place designated for trading the sukuk.