

Understanding Sukuk

AAOIFI Shari'a Standard n°17



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AAOIFI Shari'a standard 17 provides rules for the issuance and trading of investment sukuk. Sukuk are financial securities that represent equal shares in ownership of tangible assets, usufruct, or services. They are issued by the asset owners, or by a financial intermediary acting on behalf of the asset owner. Sukuk issuances are always based on licit contracts and underlying assets that comply with Shari'a precepts. Assets must be capable of being owned and sold legally as well as in accordance with Shari'ah. Sukuk are issued through Special Purpose Vehicles (SPV).

1. Certificates of ownership in leased assets (sukuk al ijara)

The certificates are issued by the owner, or a financial intermediary acting on its behalf, of a leased asset, or a tangible asset intended to be leased. The proceeds correspond to the purchase price of the designated asset, of which the investors become owners. As owner of the leased asset, the Sukuk holders benefit from regular leasing revenues. Purchase undertaking by the issuer is frequent, but only valid if done at market value.

2. Certificates of ownership of usufruct (sukuk al manfa'a)

In this format, the underlying is not brick-and-mortar asset but the usufruct of existing or future tangible leased services or assets. This structure, often considered a subcategory of sukuk al ijara, is particularly suitable for issuers who do not hold transferable tangible assets, thus allowing issues based on intangible assets. The proceeds of the issuance represent the purchase price of the usufruct. The investor receives regular income linked to fees or rents related to the underlying assets.

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3. Certificates of ownership with deferred delivery (sukuk al salam)

These are investment certificates whose proceeds are used to pay for goods delivered at a later date. The funds raised through the issuance represent the purchase price of the future goods, which the investors own. Sukuk holders' profit is linked to the margin applicable upon resale. Sukuk al salam are not tradable, as they represent a debt.

4. Certificates of ownership in manufactured assets (sukuk al istisna')

In sukuk al istisna', the proceeds of the issuance are used to finance the manufacturing of an asset, which will become the property of the investors. The proceeds represent the cost of manufacturing, and the investors' remuneration is linked to the margin applicable upon resale. Istisna' sukuk are tradable once the funds provided have been converted into tangible and identifiable assets.

5. Certificates of purchase & resell (sukuk al murabaha)

Sukuk al murabaha issuances deploy the raised funds to buy an asset on behalf of investors, then resell it immediately at a disclosed markup. The proceeds of the issuance represent the acquisition cost of the asset and investors benefit from the profit margin applied upon resale. These certificates represent debt receivables and are thus not tradable.

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6. Certificates of partnership (sukuk al musharaka)

Musharaka certificates pool investor cash with the issuer's own capital, and the proceeds are used to co-finance a project or an asset, in which investors will be acting as partners alongside the issuer to the extent of their respective contributions. Investors and issuers share profit and losses, and sukuk remuneration is directly linked to the performance of the underlying asset.

7. Certificates of limited partnership (sukuk al mudaraba)

These are partnership certificates where the management of the funds is entrusted to the issuer. Investors are passive, and profit is shared based on a pre-agreed ratio between issuers and investors.

8. Certificates of investment agency (sukuk wakala bil Istithmar)

These are partnership certificates where the issuer is appointed as an agent, and is responsible for investing the proceeds of the issuance. Investors own the assets and benefit from the portfolio's performance, while the agent is entitled to a pre-agreed fee.

9. Sharecropping Certificates (sukuk al muzara'a)

Capital raised through muzara'a sukuk finances a share-cropping venture, and sukuk holders become entitled to a share in the crop. The issuance proceeds can be used to buy the land, or to finance the cultivation costs, depending on the role and needs of the issuer.

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10. Irrigation Certificates (sukuk al musaqaat)

With these certificates, the proceeds are used to finance the irrigation of fruit trees and ensure their maintenance. Investors become beneficiaries of a portion of the harvest.

11. Agricultural Certificates (sukuk al mugharasa)

These are investment certificates whose proceeds are used to finance the planting and maintenance of fruit trees. Investors become beneficiaries of a share of the land and plantations.

Fixed or floating profit rates?

When the underlying contract provides predictable income, it allows for the structuring of fixed profit rate sukuk. This is particularly the case with sukuk al ijara or murabaha. On the other hand, sukuk al mudaraba or wakala offer unpredictable, and therefore variable, returns.

Tradable Sukuk?

When sukuk represent ownership of tangible assets, usufruct, or services, the trading and redemption of certificates is permitted. Conversely, when they represent debt receivables, trading is forbidden. There is thus no secondary market for sukuk al murabaha for example.

