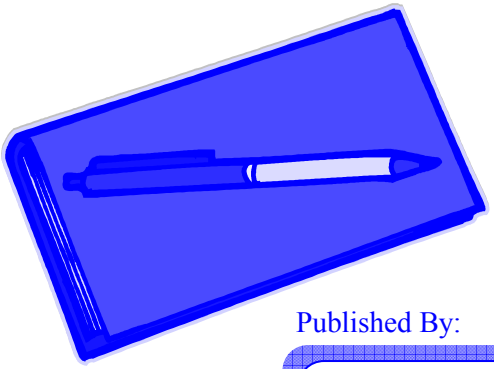
Sukuk and their Contemporary Applications

By Mufti Muhammad Taqi Usmani



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INTRODUCTION

Sukuk and their Contemporary Applications, is an article written by Mufti Muhammad Taqi Usmani in which he criticizes the interest-based transactions of the Islamic banks which he has championed for decades. However, even after an existence of several decades, the 'Islamic' banks, far from rising to Mufti Taqi's expectations, have degenerated into the capitalist rut. Today they are no different from their kuffaar counterparts, just as they were no different from their very inception.

Mufti Taqi Sahib, in his article, points out the conflicts between the dealings of the so-called 'Islamic' banks and the Shariah. Although Mufti Taqi Sahib has great hopes in these 'Islamic' banks, we believe that his hope of these banks becoming true institutions operating in full compliance with the Shariah is a barren dream.

The owners of these banks are hardened capitalists who believe that financial institutions cannot function without interest, insurance and the other concomitant corrupt dealings which form integral constituents of the kuffaar capitalist riba banking structures. With interest indoctrinated in every capilliary of their body, and driven on by inordinate lust for the accumulation of wealth without active participation in trade enterprises of risk, there is no hope for the Muslim capitalist evolving a banking structure to comply with the Shariah.

Just as Mufti Taqi's criticism of the un-Islamic 'Sukuk' practices of the 'Islamic' banks is not interpreted as opposition to Islamic banking, so too should our criticism not be misinterpreted. If a bank functions in accordance with the Shariah, no one will have any objections against it. But, the haraam riba transactions of all the current so-called 'Islamic' banks render them all haraam financial institutions. As long as these banks refuse to submit to

the Shariah, they will remain haraam, and it will be haraam for Muslims to invest with them.

Mufti Taqi's criticism is an acknowledgement of the haraam status of the 'Islamic' banks, and no amount of interpretation will salvage the haraam image which these banks have carved out for themselves with their haraam transactions deceptively marketed 'halaal' under a variety of misleading Islamic terminology. Only a total transformation from the system of deceptive stratagems and full compliance with the unadulterated Shariah can bail these riba banks out from their morass of interest dealings.

The liberal Ulama's policy of granting these capitalist banks licence for employment of deceptive stratagems – tricks and stunts – which only hoodwink the Ummah, has proven to be a dismal failure. Even after decades of support by the pro-bank Ulama, these 'Islamic' banks, instead of coming nearer to the Shariah, have drifted far, very far from the Shariah, marooned in the quagmire of Riba.

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Sukuk and their Contemporary Applications

By Muhammad Taqi Usmani
President of the AAOIFI Shariah Council

In the name of Allah, the Merciful and Mercy-Giving

Introduction

Praise to Allah and only to Him!
And blessings on those of His Servants He has chosen!

As to what follows:

Among the duties of the Shariah Council, as stated in the statutes of the Accounting and Auditing Organization for Islamic Financial Institutions is the following:

> To bring about mutual conformity or approximation between the conceptualizations and the practical applications of Shariah supervisory boards of Islamic financial institutions so as to avoid inconsistencies and contradictions between the *fatawa* and the implementations of these institutions in ways that lead to the effectiveness of the role of Shariah supervisory boards in Islamic financial institutions and central banks.

Investment Sukuk worth enormous amounts have appeared in our times, and have been widely subscribed to by many Islamic banks. At the same time, many scholars have expressed their opinions in relation to the compliance of Sukuk with the precepts of the Shariah. Therefore, the Shariah Council in its prior meeting at al-Madina al-Munawwarah decided to study the subject at its next annual meeting in Makkah al-Mukarramah. As the responsibility to prepare a concise report of the issues requiring further study and debate was given to me, I have therefore prepared this modest brief as a working paper for discussion of the subject at the coming meeting, Allah willing.

Muhammad Taqi Usmani
Chairman of the Shariah Council

In the name of Allah, the Merciful and Mercy-Giving

Sukuk and their Contemporary Applications

All praise to Allah, Lord of All the Worlds!
Peace and Blessings upon our Leader and our Prophet, Muhammad, the Finest of the Prophets, and upon his family and Companions, and upon everyone who follows them in righteousness until the Day of Judgment!

As to what follows: The issuance of Sukuk on the basis of the rules of the Shining Shariah of Islam is among the objectives of Islamic banking, and is also one of the greatest means of establishing Islamic economies in society. This, however, is on condition that the tools used to develop and structure Sukuk are in consonance with the fundamental principles which distinguish Islamic economic systems from others. The interest-based system prevalent in the world today regularly issues bonds that yield interest from capital-intensive enterprises that bring great profits and regular revenues. Yet, the holders of such certificates are no more than lenders to the sponsors of such enterprises; and their earnings come from the interest on their loans in a percentage that accords with the price of interest in the marketplace. The profits of these enterprises after costs, including interest payments[1], return exclusively to the sponsors. The basic concept behind issuing Islamic Sukuk, however, is for the holders of the Sukuk to share in the profits of large enterprises or in their revenues. If Sukuk are issued on this basis they will play a major role in the development of the Islamic banking business and thereby contribute significantly to the achievement of the noble objectives sought by the Shariah. Among the benefits of Sukuk are the following:

[1] To bond holders. YTD

1. Sukuk are among the best ways of financing large enterprises that are beyond the ability of a single party to finance.
2. Sukuk provide an ideal means for investors seeking to deploy streams of capital and who require, at the same time, the ability to liquidate their positions with ease whenever the need should arise. This is because it is envisioned that a secondary market for the trading of Sukuk will develop. Thus, whenever investors require cash from their investments, or from a part of the same, it will be possible for them to sell their Sukuk holdings, or a part thereof, and receive their value from their original investment plus earnings, if the enterprise is profitable, in cash.
3. Sukuk represent an excellent way of managing liquidity for banks and Islamic financial institutions. When these are in need of disposing of excess liquidity they may purchase Sukuk; and when they are in need of liquidity, they may sell their Sukuk into the secondary market.
4. Sukuk are a means for the equitable distribution of wealth as they allow all investors to benefit from the true profits resulting from the enterprise in equal shares. In this way, wealth may circulate on a broad scale without remaining the exclusive domain of a handful of wealthy persons.[2] This is clearly among the most important of all the higher purposes sought by an Islamic economic system.

Today, there are many Sukuk in the market, all claiming to be Islamic Sukuk. In this brief study, I mean to shed light on the mechanisms they use and on the extent to which these comply with the precepts of Islamic jurisprudence, and its principles, and its higher purposes. The issuers of these Sukuk have expended a great deal of effort to make them competitive with the conventional bonds prevalent in today's capital markets. By

[2] See al-Qur'an at VII:59. YTD

endowing these Sukuk with the same characteristics of bonds, they have attempted to facilitate their acceptance in both Islamic and conventional markets.

The most prominent characteristics of conventional bonds may be summarized as follows:

1. Bonds do not represent ownership on the part of the bond holders in the commercial or industrial enterprises for which the bonds were issued. Rather, they document the interest-bearing debt owed to the holders of the bonds by the issuer, the owner of the enterprise.
2. Regular interest payments are made to the bond holders. The amount of interest is determined as a percentage of the capital and not as a percentage of actual profits. Sometimes the interest is fixed, while oftentimes in bonds with longer tenors the rate of interest is allowed to float.
3. Bonds guarantee the return of principal when redeemed at maturity, regardless of whether the enterprise was profitable or otherwise.

The issuer of such bonds is not required to return more than the principal and the agreed amount of interest. Whatever profits may have been earned by the enterprise accrue entirely and exclusively to the issuer. So the bond holders have no right to seek a share in the profits beyond the interest.

These characteristics are not to be found in Islamic Sukuk, at least not directly. Even so, the issuers of Islamic Sukuk today have attempted to distinguish their Sukuk, however indirectly, with many of these same characteristics. For this reason they have developed a variety of mechanisms. Let us now study these mechanisms in the light of the following three points.

1. Bond Holders' Ownership of Enterprise Assets

The first point, or the bond owners' ownership of enterprise assets, is that the majority of Sukuk are clearly different in this respect

from interest-based bonds. Generally, Sukuk represent ownership shares in assets that bring profits or revenues, like leased assets, or commercial or industrial enterprises, or investment vehicles that may include a number of projects. This is the one characteristic that distinguishes Sukuk from conventional bonds. However, quite recently, the market has witnessed a number of Sukuk in which there is doubt regarding their representation of ownership. For example, the assets in the Sukuk may be shares of companies that do not confer true ownership but which merely offer Sukuk holders a right to returns. Such Sukuk are no more than the purchase of returns from shares; and this is not lawful from a Shariah perspective. Likewise, there has been a proliferation of certain Sukuk that are based on a mix of ijarah, istisna' and murabahah contracts undertaken by Islamic banks or institutions such that these are packaged and sold to Sukuk holders who hope to obtain the returns from these operations. The inclusion of murabahah contracts into such Sukuk, however, cannot but bring into question the issue of the sale of debt,[3] even if the percentage of the murabahah contracts may be considerably less than that of the ijarah, musharakah and istisna' contracts. All of this requires careful review.

2. Regular Distributions to Sukuk Holders

In reference to the second point, most of the Sukuk that have been issued are identical to conventional bonds with regard to the distribution of profits from their enterprises at fixed percentages based on interest rates (LIBOR). In order to justify this practice, the issuers include a paragraph in the contract which states that if the actual profits from the enterprise exceed the percentage based on interest rates, then that amount of excess shall be paid in its entirety to the enterprise manager (whether a *mudarib*, or a partner, or an investment agent) as an incentive for the manager to manage effectively. I have even seen in the structure of certain Sukuk that they do not state that such excess will become the right

[3] Generally speaking, the sale of debt is prohibited by Shariah law. YTD

of the manager as an incentive but, instead, they state no more than that the holders of the Sukuk will be entitled to a fixed percentage based upon the rate of interest at the time of regular distributions (as if the excess as an incentive was established by estimation or by exigency). If the actual profits are less than the prescribed percentage based on interest rates, then the manager may take it upon himself to pay out the difference (between the actual profits and the prescribed percentage) to the Sukuk holders, as an interest free loan to the Sukuk holders. Then, that loan will be recovered by the lending manager either from the amounts in excess of the interest rate during subsequent periods, or from lowering the cost of repurchasing assets at the time the Sukuk are redeemed as will be explained in detail in the third point, below, Allah willing.

3. Guaranteeing the Return of Principal

As to the third point, virtually all of the Sukuk issued today guarantee the return of principal to the Sukuk holders at maturity, in exactly the same way as conventional bonds. This is accomplished by means of a binding promise from either the issuer or the manager to repurchase the assets represented by the Sukuk at the stated price at which these were originally purchased by the Sukuk holders at the beginning of the process, regardless of their true or market value at maturity.

Then, by these complex mechanisms, Sukuk are able to take on the same characteristics as conventional, interest-bearing bonds since they do not return to investors more than a fixed percentage of the principal, based on interest rates, while guaranteeing the return of investors' principal at maturity.

We will now speak about these mechanisms firstly from the perspective of Islamic jurisprudence and secondly from the perspective of the higher purposes of Islamic finance and economics.

From the Shariah perspective, there are three questions:

First: Stipulating the amount in excess of the price of interest for the manager of the enterprise under the pretense that this is an incentive for good management.

Second: The manager's commitment, if the actual profits are less than the yield from the fixed rate of interest during any of the times for distribution, to lend the amount of the shortfall to the holders of the Sukuk. Thereafter the amounts of such loans will be recovered either through the actual profits of the enterprise at the times of following distributions or through the sale of the enterprise's assets at maturity.

Third: The binding promise by the manager that he will purchase the assets represented by the Sukuk at their face value, and not at their market value on the day they are redeemed.

One: Stipulating an Incentive for the Manager

With regard to the stipulation of an incentive for the manager of the enterprise, its justification may be found in what certain jurists have mentioned in regard to the lawfulness of offering incentives in contracts of *wakalah* or in brokerage. Al-Imam al-Bukhari mentioned the same on the authority of the Companion Ibn `Abbas and Ibn Sirin:

> Said Ibn `Abbas:"There is no impediment to one's saying, 'Sell this cloth and whatever is in excess of this or that[4] will be yours.'" Said Ibn Sirin: "When someone says, 'Sell it for this much and whatever profits are realized beyond that will be yours, or will be shared between us,' then there is no problem with that."

This opinion was adopted by the Hanbali school of jurisprudence.

In *Al-Kafi* by Ibn Qudama it is written:

> If someone says, "Sell this for ten, and whatever you receive in excess will be yours," then that excess will be lawful for the

[4] naming an actual price, or a margin. YTD

seller because Ibn `Abbas did not see any impediment to doing so.[5]

This opinion is recorded by Ibn Abi Shaybah in his *Al-Musannaf* from Ibn `Abbas, Ibn Sirin, Shurayh, `Amir al-Sha`bi, al-Zuhri, and al-Hakam. `Abd al-Razzaq added Qatada and Ayyub to those who agreed. The arrangement, however, was considered *makruh* (undesirable) by Ibrahim al-Nakha`i and Hammad, as related by `Abd al-Razzaq, and by al-Hasan al-Basri and Tawus ibn Kaysan as related by Ibn Abi Shaybah.[6] This is the opinion of the majority, other than the Hanbali scholars. Al-Hafidh Ibn Hajr commented on the opinion of Ibn `Abbas mentioned by al-Bukhari:

> This, too, refers to the wages of a broker. But, as these are unknown[7], the majority of jurists have not allowed the arrangement, saying if the broker sells the item for the owner on this basis, he will be entitled to no more than the fee customarily awarded for similar sales. Some jurists have interpreted the statement by Ibn `Abbas to mean that he saw the situation as analogous to that of a partnership. The same interpretation was given by Ahmad ibn Hanbal and Ishaq. Ibn al-Tin recorded that some jurists stipulated, for its acceptance as lawful, that people at the time understand the price of the goods to equal more than what was stated; but his opinion was challenged on the grounds that ignorance of the actual amount of the fee still remains.[8]

Badr al-Din al-`Ayni wrote:

> As to the opinion of Ibn `Abbas and Ibn Sirin, well, the majority of scholars do not allow such a sale. Among those who disliked it are Sufyan al-Thawri and the jurists from Kufa.

[5] Ibn Qudamah, *Al-Kafi*, vol. 2, p. 253.
[6] Ibn Abi Shaybah, *Al-Musannaf*, vol. 6, pp. 107-108.
[7] at the time of the agreement between the owner and the broker. YTD
[8] Ibn Hajr, *Fath al-Bari*, vol. 4, p. 451.

> Likewise, al-Shafi`i and Malik did not allow it. If someone sells on this basis he will be entitled to a fee equal to what is customary for such a sale. Ahmad and Ishaq, however, have allowed the sale, saying, "This is actually a partnership, for at times a partner will not profit."[9]

Of course, all of this is said in relation to the fees of a broker if other than the excess over the stated original price of the sale is not specified. However, if the broker's fee is stated as a determined amount, and then the broker is told, 'If you sell this for more than this, the excess will be yours in addition to your predetermined fee,' then it should be clear that the majority will not oppose it. This is because the ignorance with regard to the fee is lifted when it is determined in advance. Then, if the broker sells the item for more than a certain amount, the excess will be his as an incentive for better management.

On this basis, the Standard for Mudarabah approved by the Shariah Council reads as follows:

> If one of the two parties should stipulate for itself a specific amount (of profit), the mudarabah will be void. This prohibition, however, is not inclusive of an agreement by the two parties that if the profits exceed a certain percentage then one of those two parties will receive the excess exclusively such that the distribution will be according to what the two have agreed.[10]

The operations manager in a Sukuk will manage on the basis either of its being a wage-earning employee (*ajir*) or an investment agent (*wakil*), thus resembling a broker, or on the basis of its being an investment manager (*mudarib*), or a working partner (*sharik `amil*). All of these possibilities are covered by the Standard. However, when the jurists gave permission for this

[9] Badr al-Din al-`Ayni, *`Umdah al-Qari*, vol. 12, p.133.
[10] AAOIFI Standard 13, para 8.5

arrangement, they did not consider that it would be used to carry out operations on the basis of interest rates or to maintain the status quo of the conventional, riba-based market. The right of the manager to an amount in excess of the prescribed percentage has been called an incentive for better management of the assets.[11] Such an incentive, however, may only be understood as an incentive if it is linked to what exceeds the minimum amount of expected profits from the commercial or industrial enterprise for which the Sukuk were issued. For example: if the minimum amount of expected profits is 15%, then it may be said that the actual profits in excess of that percentage may be paid to the manager as an incentive. This is because that excess amount may logically be ascribed to good management. The problem is that the prescribed percentage in these Sukuk is not linked to the expected profits from the enterprise, but to the costs of financing or to the prevalent rates of interest in the market; rates that vary every day, or every hour of the day. Obviously, there is no connection between these and the profitability of the commercial or industrial enterprise. Oftentimes, this rate will be considerably lower than the expected rate of return from the enterprise. Thus, for example, if the expected rate of return from the enterprise is 15%, the interest rate at the same time may be no more than 5%. If, owing to poor management, the actual rate of return from the enterprise falls to 10%, then how may what is in excess of 5% be given to the manager as a reward for "good management"?[12] How can this be, even when poor management resulted in profits dipping from [an expected] 15% to only 10%? It should therefore be clear that what is being called an "incentive" in these Sukuk is not truly an incentive but rather a method for marketing these Sukuk on the basis of interest rates. It should also be clear that this aspect is not free of legal repugnance (*karahah*), even if we do not declare it prohibited (*haram*) outright.

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[11] Or the enterprise in general. YTD

[12] i.e., assuming that the incentive is linked to the 5% rate in the market for interest. YTD

The foregoing is from the perspective of Islamic jurisprudence only. From the perspective of the higher purposes of Islamic economics, such "incentives" in today's Sukuk actually defeat the purpose of an Islamic economic system in which wealth is equitably distributed among investors. Sukuk that are based on such "incentives" distribute profits to investors on the basis of prevalent interest rates, and not on the basis of actual returns from an enterprise.

If Shariah supervisory boards have tolerated such irregularities (*mafasid*) when Sukuk began to be issued, and at a time when Islamic financial institutions were few in number, the time has now come to revisit the matter… and to rid Sukuk from now on from such blemishes. Either Sukuk should be free of all such "incentives" or these should be based the enterprise's expected profits. These should certainly not be based on prevalent interest rates. This will then become a truly distinguishing characteristic of Islamic financial institutions, and one that sets them apart from their conventional, interest-based counterparts.

Two: Stipulating Loans when Profits Fall Below Prescribed Percentages

There is absolutely nothing in the Shariah to justify a loan when actual profits are less than the prescribed percentages. The one undertaking the loan is the operations manager, and the manager is the one that sells the assets to the Sukuk holders at the beginning of operations. If it is then stipulated that the manager will make loans to the Sukuk holders at times (for distribution) when actual returns fall below the (promised) rate of return, the transaction will come under the heading of a sale with a credit. It is well known that the Prophet, upon him be peace, prohibited sales linked to credits. The same was related by Malik in his *al-Muwatta* on the authority of trusted narrators (*balaghan*), and by Abu Dawud and al-Tirmidhi whose version reads, "A sale and a credit are not lawful." Al-Tirmidhi added, "This is a good and a

sound hadith." In his commentary on this narration, Ibn `Abd al-Barr wrote:

> This hadith is recorded on the authority of `Amr ibn Shu`ayb, from his father, from his grandfather, from the Prophet, upon him be peace. It is a sound hadith that has been related by many reliable narrators on the authority of `Amr ibn Shu`ayb; and `Amr ibn Shu`ayb is a reliable narrator (i.e., his narrations are reliable) when those who relate his narrations are themselves reliable.[13]

The entire community of scholars is agreed on this (prohibition) and no one is known to have held a dissenting opinion. Ibn Qudamah wrote:

> If someone sells on condition that the purchaser give credit (to the seller), or advance him a loan, or if the buyer stipulates the same, that will be unlawful and the sale will be void. This is the opinion of Malik and al-Shafi`i, and I know of no dissenting opinion.[14]

At another place, he wrote:

> If he stipulates that he lease his house to him at a rate lower than the market rate, or that he take a lease on the lender's house at a rate higher than the market rate, then this will be even more unlawful.[15]

With regard to the mechanism used in the Sukuk, the manager is not willing to offer the loan unless he receives more than his due share of the actual profits by means of the "incentive" which is stipulated for him when the percentage of actual profits exceeds the percentage based on the prevalent interest rate of interest.

[13] Ibn `Abd al-Barr, *al-Tamhid*, vol. 24, p.284.
[14] Ibn Qudamah, op. cit., vol. 4, p. 162.
[15] Ibn Qudaman, op. cit., vol. 4, p. 211.

Therefore, such a loan, in view of the opinion voiced by Ibn Qudamah, is emphatically all the more unlawful.

At times, the manager who undertakes the loan may be a partner in the enterprise, or a *mudarib*. Such an undertaking [on his part], too, is in opposition to the requirements of the contract and falls under the same prohibition as that against a sale linked to a credit (or a loan) in exactly the same way. Thus, it is not lawful.

Three: The Manager's Promise to Repurchase Assets at Face Value

The third issue is that in true commercial enterprises, where the Shariah is concerned, the return of investors' capital cannot be guaranteed. In Shariah compliant dealings, reward always follows after risk. The legal presumption with regard to Sukuk is that there can be no guarantee that capital will be returned to investors. Instead, they have a right to the true value of the [Sukuk] assets, regardless of whether their value exceeds that of their face value or not. All of today's Sukuk, however, guarantee by indirect means Sukuk holders' principal. The manager pledges to the Sukuk holders that he will purchase Sukuk assets at face value upon maturity, regardless of their true value on that day. What this means is that the principal paid originally by the Sukuk holders will be returned to them at maturity. There is no other significance to such a commitment. If the enterprise is not profitable, the losses will be borne by the manager. If it is profitable, however, the profits will accrue to the manager, regardless of how great the amount. The Sukuk holders have no right to other than the return of their principal, as is the case in conventional bonds.

In considering the lawfulness of this commitment, we note that the manager of the Sukuk may act in his capacity as an investment manager, *mudarib*, for the Sukuk holders, or as a partner, *sharik*, or as an investment agent, *wakil*, for them.

A Commitment by a *Mudarib*

That such a commitment to investors on the part of a *mudarib* is void should be obvious because it is a capital guarantee by the *mudarib* to the investors, and no jurist has ever averred that such an arrangement is lawful. The Standard on Mudarabah approved by the Shariah Council states:

> If the loss at the time of closing operations is greater than the earnings, the losses will be deducted from the capital and the manager, in his capacity as a trust holder, *amin*, will not bear any of the loss as long as there is no negligence or mala fides on his part. If the costs are equal to the earnings, the investors will receive their capital back, and the *mudarib* will earn nothing. When profits are earned, these will be distributed among the two parties (investor and manager) in accordance with what the two have decided.[16]

Thus, I can see no possible justification for such a commitment by a *mudarib*. It is, however, mentioned in some Sukuk that the manager does not make this commitment in his capacity as a *mudarib*, but in another capacity. This is clearly illogical because the *mudarib* has no other capacity in this deal.

A Commitment by a *Sharik*

The manager may also act as the partner of the Sukuk holders. Then, in the same way that it is unlawful for a *mudarib* to guarantee the return of capital to investors, it is also unlawful for one partner to guarantee the return of capital to the other partner or partners. This is because to do so would effectively interrupt the partnership in the event of losses; and that is something that no jurist has ever allowed. The Standard on Musharakah approved by the Shariah Council states:

> It is unlawful for the conditions of partnership or for the basis of profit distribution to include any text or condition that leads

[16] AAOIFI Standard 13, 7.8.

> to the possibility that the sharing of profits will be interrupted. If this happens, the partnership will be void.[17]

The Standard specifically mentions the unlawfulness of such a commitment in one of the following paragraphs, where it states:

It is lawful for one of the parties to the partnership to issue a binding promise to purchase the assets of the partnership during the period of partnership or at the time of dissolution at market value or at an agreed price at the time of purchase. A promise to purchase the assets at face value, however, is unlawful.[18]

In the Basis for Conclusions for the Standard it is stated:

> The justification for the ruling of "unlawful" with regard to the binding promise by one of the partners to purchase the assets of the partnership at face value is that this is the same as a capital guarantee, which is unlawful. The justification for a ruling of "lawful" for repurchase at market value comes from the fact that there is nothing in this arrangement that guarantees anything to the partners.[19]

Certain contemporary scholars have attempted to justify a commitment that implies a capital guarantee by saying that while it may be prohibited in a partnership of contract, *shirkah `aqd*, it is not prohibited in a partnership of property, *shirkah milk*. They then claim that the sort of partnership that occurs in Sukuk (especially Sukuk with leased assets) is a partnership of property and not a partnership of contract. However, when we consider the reality of these two types of partnership, it is clear that the type of partnership that occurs in Sukuk is a partnership of contract and not a partnership of property. This is because the purpose of the partnership [in these Sukuk] is not merely to own physical assets for the purpose of consumption or personal benefit but for the

[17] AAOIFI Standard 12, 3.1.5.7
[18] AAOIFI Standard 12, paragraph 3.1.6.2
[19] AAOIFI Standards, p. 230

purpose of joint investment. This is the fundamental difference between a partnership of property and a partnership of contract.

To be more specific, when we consider what the classical jurists have mentioned regarding the reality of a partnership of contract, it should be clear to us that a partnership of contract may be distinguished from a partnership of property in three ways:

1. The purpose of the partnership of contract is to jointly seek profits; whereas the purpose of the partnership of property is no more than to have possession of something and make use of it.
2. A partnership of contract makes each partner the agent of the other in investment enterprises, whereas partners in a partnership of property are entitled to dispose of their own share [of the jointly owned property] as they wish; while they are absolute strangers with regard to the shares of the other partner or partners.
3. The partners in a partnership of contract are free to distribute profits among themselves in whatever proportion they agree among themselves. A partnership of property is different. In it, each partner is entitled only to the profits earned by his own share. So, when each partner puts his share to work separately, each partner will profit solely from the returns earned by his own share.

Each of the characteristics [of a partnership of contract] described above is to be found in Sukuk.

Shaykh Mustafa al-Zarqa', may Allah bless him, wrote clearly and concisely of the difference between the two types of partnership in what follows:

> Joint ownership always occurs in things that are shared. Such a partnership, if it occurs in physical wealth only, with no agreement as to its investment by means of a collective effort, will be called a partnership of property. This is countered by the partnership of contract in which two or more persons contract among themselves to invest wealth or labor and then

to share the profits, as occurs in commercial and industrial partnerships.[20]

At another place, the Shaykh spoke of the difference between the two types:

> The partnership of contract: This is a contract between two parties or more to cooperate on a profitable activity and to share in its profits. Partnership, in its essence, can be either a partnership of property shared between a number of persons as a result of some natural reason, such as inheritance, or it can be a partnership of contract in which a group agrees to undertake an investment activity in which they assist one another with capital or labor and then share in the results of the same. Thus, a partnership of property is a sort of joint ownership rather than anything contractual, even if the reason for the partnership may be traced back to a contract; as in the case of two people who purchase something together, so that they share its ownership. This is a partnership of property (joint ownership). There is no contract between the owners, however, to put the property to use, or to invest it through commerce or leasing or by any other means of earning profits. A partnership of contract, on the other hand, has investment and the earning of profits as its objective. This is the partnership that it intended here, and this is the partnership that is numbered among the nominate contracts, *al-`uqud al-musammah*.[21]

Thus, the Shaykh explained that whenever the purpose of a partnership is investment or earning, regardless of whether that is to take place by means of commerce, or by means of leasing, the partnership will be a partnership of contract. Since it is obvious that the purpose of Sukuk is investment or earning by means of leasing assets, it is impossible to call Sukuk a partnership of property. Therefore, it is not lawful for one partner to guarantee

[20] Mustafa al-Zarqa', *al-Madkhal al-Fiqhi al-`Amm*, Vol. 1, p. 263.
[21] Mustafa al-Zarqa', op. cit., vol. 1, p. 551.

the capital of another partner either directly or indirectly.

In fact, that it is unlawful for a partner or a *mudarib* to make such a commitment is a matter that requires very little in the way of justification because it is an established fact of Islamic jurisprudence that has been emphasized by fiqh academies, and at specialized seminars, and by the Shariah Council itself. If we were to open this door, the managers of Islamic banks would then be able to guarantee the capital of depositors by committing to purchase shares in investment accounts at their face value; thus negating the single difference between conventional deposits and deposits in Islamic banks.

A Commitment by an Investment Agent

In some Sukuk, the manager is neither a *mudarib* nor a partner but an agent for the Sukuk holders whose function is to invest the assets represented by the Sukuk. Then, is it lawful [for the agent/manager] to promise the Sukuk holders that he will purchase the assets at maturity for their face value? The answer is that such a commitment by an investment agent, even if it is less egregious than a commitment by a partner or a *mudarib*, it too is unlawful. This is because agency, *wakalah*, is a contract of trust, *amanah*; and there can be no guarantees except as regards negligence or mala fides. The aforementioned commitment is tantamount to a guarantee and is therefore unlawful. This point is mentioned in para 1/2/2 of the Standard for Guarantees, issued by the Shariah Council, as follows:

> It is not lawful to stipulate a guarantee from a *mudarib*, or an investment agent, or a partner among partners, regardless of whether the guarantee is for the principal or for the profits. Likewise, an operation may not be marketed on the basis that investor capital is guaranteed.

In the following para it is written:

> It is unlawful to combine agency with a guarantee in a single transaction because to do so is contrary to the requirements of

> both. This is because to stipulate a guarantee by an investment agent transforms the operation into a loan with *ribawi* interest, guaranteeing [the return of] principal while offering returns from the investment.

It might, however, be imagined possible to justify such a commitment from an investment agent on the basis of an issue that was established by the Standard in the same para, where it is stated:

> However, if the agency is not encumbered by a stipulation of guarantee [or surety], and a guarantee for the agent was given in a separate agreement by another, the agent will be a guarantor, but not in his capacity as agent, such that if the agency were withdrawn he would remain a guarantor.[22]

Then it might be said that the investment agent, though not originally a guarantor, became a guarantor as a result of the commitment which is conducted separate from the contract of agency.

The answer to this is that the proposed analogy contains a false comparison because the agent described in the Standard acts as a guarantor under a separate agreement for a debtor in the enterprise, such that the agent will not be responsible [as guarantor] unless the debtor fails to make a required payment. The agent therefore does not guarantee for the seller that his sale will be profitable under all circumstances. In the case of the Sukuk, the investment agent does not guarantee for a specific debtor, but rather against the failure of the enterprise, such that his guarantee remains valid even after every debtor has performed its obligations and the enterprise suffers losses as a result of falling prices in the market, or for any other reason. So, how can the first instance be compared to this?

Then, adding to the confusion in regard to this commitment is that the manager is the seller of the assets to the Sukuk holders, as is

[22] AAOIFI Standard 5: para 2.2.1 and 2.2.2

the case in most Sukuk, so that the commitment leads to a sale of *`iynah*.[23] This is because he commits to buy what those to whom he has committed are selling; unless the *`iynah* is negated by means of the conditions which are well known in Islamic jurisprudence.

The Higher Purposes of Islamic Economics

To this point, this entire study has been conducted from the perspective of Islamic jurisprudence. However, if we consider the matter from the perspective of the higher purposes of Islamic law or the objectives of Islamic economics, then Sukuk in which are to be found nearly all of the characteristics of conventional bonds are inimical in every way to these higher purposes and objectives. The noble objective for which riba was prohibited is the equitable distribution among partners of revenues from commercial and industrial enterprises. The mechanisms used in Sukuk today, however, strike at the foundations of these objectives and render the Sukuk exactly the same as conventional bonds in terms of their economic results. Islamic banks were not established so that they could offer the same products, and engage in the same operations, as conventional banks in the prevalent interest-based banking system. Instead, the purpose was to gradually open up new horizons for business, commerce, and banking that would be guided by social justice in accordance with the principles established by the Shariah of Islam. Undoubtedly, such an ambitious undertaking requires a gradual approach; and a gradual approach may be imagined with a careful and detailed plan that outlines all of its various stages. Likewise, if the undertaking is to advance it will require continual follow up throughout each of its

[23] This is a sale of appearances or of assistance, depending on the root of the word in Arabic; though, in fact, both derivations are accurate portrayals of the transaction. This is because it is essentially a loan in the form of a sale; so that it is a sale in appearance only and a means of offering assistance. This is accomplished by one's buying back what one has sold for a lower price than that for which one originally sold it. The difference, ostensibly profit, is actually a loan. YTD.

stages. A gradual approach does not mean that its progress will depend on a single step for an undetermined period of time.

Undoubtedly, Shariah supervisory boards, academic councils, and legal seminars have given permission to Islamic banks to carry out certain operations that more closely resemble stratagems than actual transactions. Such permission, however, was granted in order to facilitate, under difficult circumstances, the figurative turning of the wheels for those institutions when they were few in number [and short of capital and human resources]. It was expected that Islamic banks would progress in time to genuine operations based on the objectives of an Islamic economic system and that they would distance themselves, even step by step, from what resembled interest-based enterprises. What is happening at the present time, however, is the opposite. Islamic financial institutions have now begun competing to present themselves with all of the same characteristics of the conventional, interest-based marketplace, and to offer new products that march backwards towards interest-based enterprises rather than away from these. Oftentimes these products are rushed to market using ploys that sound minds reject and bring laughter to enemies.

In order to promote Sukuk, the justification given is that international ratings agencies will not grant the desired, investor-grade ratings unless these mechanisms are used to guarantee the return of principal to investors, and to distribute profits from capital at specified rates. Without these mechanisms, so they say, it will not be possible to market Sukuk widely. The answer to this objection is that if we are to continue to run behind the international ratings agencies, agencies that do not distinguish between halal and haram, it will never be possible for us to move forward with authentic Islamic products which actually serve the purposes of Islamic economics. This is because these agencies have matured in an interest-based atmosphere that is unable to acknowledge the quality of an investment unless its capital is guaranteed and its returns are distributed on the basis of interest. At the same time, the quality of a product from a Shariah perspective depends upon the sharing of risk and the equitable

distribution of profits between investors. Thus, the Islamic mentality is diametrically opposed to the mentality of those institutions.

As a result, Islamic Sukuk were introduced for Islamic banks and financial institutions which aim to move beyond riba. Therefore, Sukuk should be circulated among these banks on that basis. For the same reason, Sukuk should be acceptable between them so that they have no need of conventional ratings. Recently, an Islamic ratings agency was established. Islamic banks and financial institutions should strive to support that agency so that they no longer have a need for conventional ratings agencies.

Actually, the number of Islamic banks and financial institutions today is not to be overlooked, and thank God! The numbers increase day after day; and the growth of Islamic banks in many countries is greater than that of conventional banks. It is now incumbent upon these Islamic banks and financial institutions to cooperate among themselves for the purpose of developing authentic products that are far removed from empty stratagems, free from all association with riba, and that aim to serve the higher purposes of Islamic law in the spheres of economics, development, and social justice. None of this will come about without the guidance and encouragement of Shariah supervisory boards. If these boards continue with their present policies, however, Islamic banks will stumble on the road, and there is a danger, God forbid, that this virtuous movement will fail. It is time for Shariah supervisory boards to review their policies, and to moderate the license [they have granted] until now to benefit Islamic financial institutions. Instead, the Shariah supervisory boards need to apply themselves to upholding the Shariah Standards issued by the Shariah Council, standards which are not insensitive to the real needs of these institutions. Personally, I am certain that if Shariah supervisory boards uphold these Standards, the exceptional professional qualifications found in today's Islamic financial institutions will have no difficulty in developing viable alternatives to these dubious products… Allah willing.

Summary and Recommendations

1. Sukuk should be issued for new commercial and industrial ventures. If they are issued for established businesses, then the Sukuk must ensure that Sukuk holders have complete ownership in real assets.
2. The returns of enterprises should be returned to Sukuk holders regardless of what amounts they reach after costs, including the manager's fees, or the share of the *mudarib* in profits. If there is to be an incentive for a manager, then let it be based on the profits expected from the enterprise and not on the basis of an interest rate.
3. It is unlawful for a manager to lend money when actual profits are less than expected.
4. It is unlawful for a manager, whether a *mudarib* or a partner or an agent, to commit to repurchase of assets at face value. Instead, their resale must be undertaken on the basis of the net value of the assets, or at a price that is agreed upon at the time of purchase.
5. Shariah supervisory boards must abide by the Shariah Standards issued by the Shariah Council.

Finally, all praise is due to Allah, Lord of All the Worlds!

THE HARAAM 'ISLAMIC' BANKS

A rightly-irritated Brother, taking up issue with a body called Darul Ihsaan which koshers haraam riba banks, wrote the following letter to this miscreant organization:

"Al Baraka Shariah Board / Darul Ihsan

Re: Shariah Compliancy of Albaraka

I am extremely disturbed, perturbed, furious and disheartened at the double standards policy of Albaraka Bank. On the one hand the Bank very boldly brags and shows off that it is "very very" Shariah compliant in all its transactions. To legitimize its Shariah compliance, the bank proudly advertises your names as being part and parcel of them; that you are "experts" in the field of Shariah finance and economics.

On the other hand when it comes to the intermingling of the male and female staff there is no Shariah Compliancy. What is your fatwa in this regard? What about the female staff travelling to Durban / Johannesburg without a Wali (mahram male guardian)? What is your ruling on this matter? Are you afraid that by making a bold and clear statement in this regard you may be offending those holding the cheque book?

What does the Shariah Board say about Albaraka's "Eid Supper" – sorry "Eid Parade" for the staff? Is the fancy dress parade and intermingling party permissible according to the Board?

Has the Shariah board become like the people of the book who believe / accept some parts of the book and reject the other? What does the Board say concerning the command of Allah: "O you who believe come into Islam completely"? No picking and choosing." – Yunus Ismail

"KHANAAZEER"

One is not in need of an excess of intelligence to understand that Albaraka Bank and all other so-called 'Islamic' banks are haraam riba banks. They are inwardly and outwardly haraam institutions operating 100% in accordance with the riba capitalist system. The 'shariah compliancy' slogan is a massive deception – a deliberate shaitaani ruse to beguile ignorant and unwary Muslims to invest their money. The 'profit' they pay is pure riba, no difference from kuffaar conventional bank-interest.

The 'shariah boards' are the deceptive 'deeni' veneer to present a kosher front. The molvis manning such evil 'shariah' boards and bodies such as Darul Ihsan' paid to legalize the haraam riba and zina wares of these banks are about the worst specimens of the ulama-e-soo' fraternity. They legalize all the haraam activities of the haraam riba banks. They legalize the riba transactions and the zina affairs which stem from the intermingling of sexes and employment of female staff. These satanic 'shariah' boards and evil organizations such as Darul Ihsaan which issue licences for riba and zina, are, in the words of Rasulullah (sallallahu alayhi wasallam), like *"swines around whose necks are strung garlands of pearls, diamonds and gold"*. In another Hadith, Rasulullah (sallallahu alayhi wasallam) describing these ulama-e-soo'

said: *"Their ulama will be the worst under the canopy of the sky. From them will emerge fitnah, and the fitnah will rebound on them."*

There are no viler so-called 'scholars' in this era than the shaitaani molvis and sheikhs who sit on these so-called 'shariah' boards of the capitalist riba banks. They are lucratively remunerated to fabricate and fraud 'fatwas' to halaalize every riba product produced by the capitalist owners of the banks.

The condonation of the zina parties and parades with their female staff and even the participation of the evil molvis in these functions of zina portray their true filthy colours of *shaitaaniyat*. For them riba depicted with Islamic nomenclature is 'shariah compliant'. Zina of varying degrees with the female staff is 'shariah compliant' because they are cogs in the so-called satanic 'shariah compliant' riba banks.

These 'shariah boards' of the haraam riba banks and supporting satanic organizations such as Darul Ihsaan are treacherous institutions which commit high treason against Allah Ta'ala. They have degenerated to a lower level of corruption than even the Ulama of Bani Israeel of bygone times. They are infinitely worse and more dangerous for Imaan than the Qabar Pujaari molvis whose fitnah is not as lethal for Imaan as the evil machinations of these humbug molvis who pillage and prostitute Muslim females with their 'halaal' licences, and who paint riba as trade in exactly the same way as the Mushrikeen of the era of Rasulullah (sallallahu alayhi wasallam) had done. Describing the evil of the Mushrikeen, the Qur'aan Majeed says: **"And trade is like riba."** This is precisely the profession of the vile 'shariah' boards and Darul Ihsaan type bodies who have the dexterity to halaalize any riba transaction in lieu of the boodle they lap up from their paymasters. Money is their criterion.

The 'Eid' zina parade speaks volumes for the villainy of these shayaateen in human bodies. About these devils of the 'shariah' boards and miscreant bodies such as Darul Ihsaan, Rasulullah (sallallahu alayhi wasallam) said: "Verily, I fear for my Ummah the aimmah-e-mudhilleen." (i.e. those money-mad molvis and sheikhs who halaalize riba, zina and carrion.).