Chapter 36

Sukuk: History and Development

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ABSTRACT

The chapter reviews and describes the history and development of Sukuk. It starts with the basic concept of Sukuk, its history and the basic foundations of Sukuk in Shari’ah. The chapter also outlines the sources of Shari’ah and the concept of Ijtihad. Basic principles of the Islamic financial system, and the concept of debt and equity in Islam are also discussed. Finally, the chapter continues with an outline of the development of the Sukuk market and the types of Sukuk structures.

THE DEFINITION OF SUKUK

There have been many definitions for Sukuk derived from previous studies and from recognized organizations globally and locally within Malaysian context (Ahmed, Islam, Alabdullah, & Amran, 2019; Ahmed, Islam, & Amran, 2019). According to Al-Jumuah (2000), Sukuk is a property certification. Sukuk is also sometimes referred as Islamic bonds or Sukuk sanadat (negotiable papers) and ownership (Al-Bastawaisi, 2006). In comparing Sukuk to bonds, Sukuk has a more generalized meaning than bonds (Ahmed, Islam, & Alabdullah, 2014). Furthermore, Sukuk refers to securities characterized as compliant with Islamic Shari’ah rules and with the principles of investment which prohibit and prevent dealings with interest charges (LMC, 2008). In addition, as mentioned by Al-Buolayan, (2006) and LMC (2008), Sukuk is represented by its stability, being asset-backed, compatible with Shari’ah rules and could be considered a trust certificate. The Accounting and Auditing Organization for Islamic Financial Institutions

DOI: 10.4018/978-1-7998-0218-1.ch036
Sukuk

(AAOFI, 2012) defines Sukuk as “Certificates of equal representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity.” There are several kinds of Sukuk. Nevertheless, the common ones, as mentioned by AAOFI, are: Musharakah Sukuk; the Ijarah Sukuk; Murabahah Sukuk; Mudarabah Sukuk; Istisna Sukuk; Salam Sukuk; and the Hybrids.

The Islamic Financial Services Board (IFSB) defines “Sukuk (plural of Sakk), frequently referred to as ‘Islamic bonds’, are certificates with each Sakk representing a proportional undivided ownership right in tangible assets, or a pool of predominantly tangible assets, or a business venture. These assets may be in a specific project or investment activity in accordance with Shari’ah rules and principles” (IFSB, 2009).

On the other hand, the Malaysian Debt Securities and Sukuk Market (BNM) (2009) provides another definition to explain Sukuk as follows: “Certificates of equal value that represent an undivided interest (proportional to the investor’s interest) in the ownership of an underlying asset (both tangible and intangible), usufruct, services or investments in particular projects or special investment activities.” Also, the Securities Commission (SC) Malaysia (2012) has defined Sukuk as “… any securities issued pursuant to any Shari’ah principles and concepts approved by the Shari’ah Advisory Council (“SAC”) of the SC as set out in Appendix 1 … (and subsequently) Appendix 1 (B): A document or certificate which represents the value of an asset” (SC, 2004 & SC, 2009).

Al-Buolayan (2006) stated that the Sukuk Security Model is derived from traditional securitization procedures that are based on a special purpose vehicle (SPV) which lies in gaining assets and issuing of financial compensation on these assets. Such assets represent appropriate aspects with beneficial ownership to the Sukuk investors.

The Sukuk issuance process lies in the following steps (LMC, 2008)

1. A feasibility study must be prepared in detail
2. A general framework is to be prepared in addition to setting up an organizational structure
3. The work should be in line with the structure and principles of Shari’ah
4. Conducted by a leading manager
5. Arrangement of agreed Islamic legal documentation;
6. Arrangement of special purpose vehicles (SPV) to represent Sukuk holders
7. Circulation of the Sukuk into the financial markets.

DIFFERENCE BETWEEN SUKUK AND DEBT BONDS

A Sukuk certificate duplicates some of the functions of the tradable bonds and conventional securities to inject liquidity into the reserves of government and corporations, to mobilize market resources and to provide a steady source of income for investors or Sukuk holders (LMC, 2008). However, there are number of distinctions between bond debts and Sukuk. Amongst these, the most significant is that for the creation of Sukuk, they are founded on an array of contracts to underpin the financial commitment between the investors and issuers. A lease (Ijarah) and others such as Musharakah (partnership) are such example whereas for debt bonds, these are issued based on loan contracts to secure the debt (Al-Amine, 2008).
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