



EXAMINING THE ADOPTION OF *SUKUK AL-IJARAH*
FOR ECONOMIC DEVELOPMENT IN LIBYA

BY

ABDULRAHMAN ATEEYAH SHARIF

A research paper submitted in fulfilment of the requirement
for the degree of Master of Science (Islamic Banking and
Finance)

IIUM Institute of Islamic Banking and Finance (IiBF)
International Islamic University Malaysia

2018

ABSTRACT

In today's global finance environment, *Sukuk* has been adopted by several governments as an alternative Islamic monetary policy tool other than bond that generate its profits from the imposition of interest. This study pinpoints financial issues faced by government of Libya and introduces *Ijarah Sukuk* as a solution. These issues can be summarised into two; the first issue is the non-interest-bearing certificates of deposits held by central bank and the second issue is the liquidity crisis. The study focuses on highlighting the availability of Shari'ah, legal and technical factors that serve as an infrastructure for the adoption of *Sukuk al-Ijarah* in Libya to tackle these issue. This case study adopts the problem-solving approach where primary data from different governmental sources is analysed using document analysis technique to firstly; explore the main issues and challenges that the country is currently suffering from and secondly; to introduce *Ijarah Sukuk* as an alternative monetary policy instrument. As a way of reference and guide, the study also presents *Ijarah Sukuk* issuance cases from other countries which were misapplied and contradictory to Shari'ah. The findings indicated acute lack of Islamic financial products and instruments innovation despite the availability of the Shari'ah, legal and environmental infrastructure. The findings also showed that Libyan legal environment is unique in the way it has only one financial system which is Islamic. This implies that the factor of competitiveness with the conventional industry is not considered in Libya, a thing that is not available in the other cases mentioned like Bahrain and Malaysia.

خلاصة البحث

في ظل ما تشهده بيئة الصناعة المالية في العالم بشقيها الإسلامي والتقليدي، ظهرت فكرة صكوك الاستثمار كإحدى أدوات السياسة النقدية الإسلامية البديلة والتي تبنّتها العديد من الدول الإسلامية منها وغير الإسلامية كبديل عن السندات المعتمدة في ربحيتها على الفائدة. هذا البحث هو دراسة حالة تركزت فيه الجهود على تحديد بعض المشكلات المالية التي تواجهها الحكومة الليبية وطرح صكوك الإجارة السيادية كحل لها. يمكن تلخيص هذه المشكلات في نقطتين: الأولى تكمن في شهادات الإيداع لدى مصرف ليبيا المركزي والتي لا تُدفع عليها الفائدة وظلت حبيسة المصرف دونما استثمار منذ بدء تنفيذ قانون حظر الربا عام 2015 والثانية هي مشكلة السيولة. من جانب آخر تساهم الدراسة في تسليط الضوء على إمكانية وجود العوامل التي تُعد البنية القانونية والشرعية لتطبيق فكرة صكوك الإجارة كحل لهذه المشكلات بديلا عن الفائدة التي يعتمد عليها الاقتصاد الرأسمالي كأحد العوامل الرئيسة للربحية. تتبنى هذه الدراسة المنهج التحليلي والذي يقوم على جمع البيانات من مصادرها المرجعية من تقارير رسمية صادرة عن المؤسسات الحكومية الليبية، كتب، مقالات، صحف، مجلات ومواقع إلكترونية سواءاً التي تصدر عن المؤسسات المالية في ليبيا أم خارجها. بالإضافة إلى ذلك فإن الدراسة تعرض بعض تجارب الدول السابقة في تبني فكرة صكوك الإجارة كالبحرين وماليزيا والتي—من خلال تحليل بياناتها—تبين أن فيها بعض الإشكالات الشرعية؛ الأمر الذي دعى الباحث إلى تسليط الضوء عليها من خلال عرضها في صورة مبسطة يسهل استيعابها. أظهرت النتائج أن البيئة القانونية والشرعية في ليبيا تُعد بيئة مميّزة في كونها تخضع لنظام مالي موحد يعمل تحت مظلة قانونية مصدرها التشريعي الوحيد هو القرآن الكريم. هذه الخاصية تميّز الحالة الليبية عن غيرها كالبحرين وماليزيا في كون الأولى لا يلعب فيها النظام المالي التقليدي دور المنافس؛ الأمر الذي يُفسح المجال أما الصناعة المصرفية الإسلامية لتقدم أفضل ما لديها.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science (Islamic Banking and Finance)

.....
Adam Abdullah
Supervisor

This research paper was submitted to IIUM Institute of Islamic Banking and Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science (Islamic Banking and Finance)

.....
Syed Musa Alhabshi
Dean, IIUM Institute of Islamic
Banking and Finance

DECLARATION

I hereby declare that this research paper is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Abdulrahman Ateeyah Miftah Sharif

Signature

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION OF
FAIR USE OF UNPUBLISHED RESEARCH**

**THE IMPACT OF MOBILE INTERFACE DESIGN ON
INFORMATION QUALITY OF M-GOVERNMENT SITES**

I declare that the copyright holders of this research paper are jointly owned by the student and IIUM.

Copyright © 2016 Abdulrahman Ateeyah Miftah Sharif and International Islamic University Malaysia.
All rights reserved.

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below

1. Any material contained in or derived from this unpublished research may be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieved system and supply copies of this unpublished research if requested by other universities and research libraries.

By signing this form, I acknowledged that I have read and understand the IIUM Intellectual Property Right and Commercialization policy.

Affirmed by Abdulrahman Ateeyah Miftah Sharif

.....
Signature

.....
Date

ACKNOWLEDGEMENTS

Firstly, it is my utmost pleasure to dedicate this work to my dear parents and my family, who granted me the gift of their unwavering belief in my ability to accomplish this goal: thank you for your support and patience.

I wish to express my appreciation and thanks to those who provided their time, effort and support for this project. To the members of my research paper committee, thank you for sticking with me.

Finally, a special thanks to Professor Dr. Adam Abdullah for his continuous support, encouragement and leadership, and for that, I will be forever grateful.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration.....	v
Copyright Page.....	vi
Acknowledgements.....	vii
List of Tables	x
List of Figures	xi
CHAPTER ONE: INTRODUCTION.....	1
1.1 Background of the Study	1
1.2 Statement of the Problem.....	2
1.3 Research Objectives.....	4
1.4 Research Questions.....	4
1.5 Significance	4
1.6 Organisation of the Study	6
1.7 Summary.....	6
CHAPTER TWO: LITERATURE REVIEW.....	8
2.1 Introduction.....	8
2.2 The Concept of <i>Sukuk</i>	8
2.3 <i>Sukuk</i> Structure	11
2.3.1 Classical <i>Shari'ah</i> Contracts embedded in <i>Sukuk</i> Structures	12
2.4 Time Value of Money as a Differentiator Between <i>Sukuk</i> and Bonds	14
2.5 <i>Sukuk al-Ijarah</i>	15
2.6 Pricing of <i>Sukuk</i>	17
2.6.1 On What Rate <i>Sukuk</i> Price to be Based?	17
2.6.2 Pricing Mechanism of <i>Sukuk al-Ijarah</i>	19
2.7 <i>Shari'ah</i> Characterization of <i>Sukuk al-Ijarah</i>	23
2.7.1 Sale with a Subsequent Lease that Ends with Ownership	25
2.8 Islamic Finance in Libya	26
2.8.1 Elimination of Interest (Riba)	28
2.8.2 <i>Shari'ah</i> Governance	31
2.8.3 Legal Infrastrucure for The Adoption of <i>Sukuk al-Ijarah</i>	33
2.9 Summary.....	34
CHAPTER THREE: RESEARCH METHODOLOGY.....	36
3.1 Introduction.....	36
3.2 Research Method	37
3.14 Research Design	38
CHAPTER FOUR: FINDINGS AND DISCUSSIONS.....	39
4.1 Introduction	39
4.2 Factors Behind the Adoption of Interest-based Benchmark	39

4.3 Lessons from Misapplied <i>Sukuk al-Ijarah</i> in Different Countries	40
4.3.1 The Case of Bahrain	41
4.3.2 The Case of Malaysia	42
4.4 Implications of Applying Genuine <i>Sukuk al-Ijarah</i>	45
4.5 Uniqueness and Gaps in <i>Sukuk</i> Law in Libya	46
4.6 Liquidity Crisis; Determinants & The Potential Role of Ijara Sukuk ...	48
4.6.1 Lack of Investment	49
4.6.2 Banks' Reserves	51
4.6.3 The Role of Investors	53
4.7 Summary	54
CHAPTER FIVE: CONCLUSION AND RECOMMENDATION	55
5.1 Conclusion	55
5.3 Recommendations	56
REFERENCES.....	57

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
2.1	Different Types of <i>Sukuk</i> Based on Different Types of Issuers	13
2.2	<i>Shari'ah</i> Characterization of <i>Sukuk al-Ijarah</i>	24
2.2	Uniqueness and Gaps in Libyan <i>Sukuk</i> Law	48

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
2.1	Classical <i>Shari'ah</i> Contracts Embedded in <i>Sukuk</i> Structure	12
2.2	Basic Structure of Sovereign <i>Sukuk al-Ijarah</i>	16
2.3	Bond Pricing Formula	21
2.4	<i>Sukuk</i> Pricing Formula	22
2.5	Royal Decree by Libyan Monarchy Prohibiting Riba	29
4.1	Financial Statement of the Islamic Branches of al-Jumhuriyah Bank	50
4.1	Financial Statement of al-Jumhuriyah Bank	51
4.1	Financial Statement of Central Bank of Libya	52

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Sukuk al-Ijarah are widely comprehended to mean a lease. It is the sale-and-lease back structure where its revenues are generated from the underlying asset. These revenues represent the payments for *Sukuk* holders as a rental or profit not an interest. Therefore, *Sukuk al-Ijarah* are dependent on the performance of the underlying asset. Accordingly, the issuer of this type of *Sukuk* which is often the government must identify a tangible asset to be sold to *Sukuk* holders then leased back to the seller (government) (Franklin Templeton Investments, 2013)

Sukuk al-Ijarah are one of the effective *Shari'ah* compliant products that are rapidly becoming an integral part of the world economy. This evolution can be observed in the Middle East region, South Asia as well as some European countries (Tomas, 2015). What captured the attention of investors, among these products, is the emergence of *Sukuk* which are considered as one of the fastest growing instruments of the Islamic capital market. It is an alternative to the conventional bonds that are simply interest-bearing loans. Although many people view *Sukuk* as a contemporary type of the Islamic financial operations, their origins, according to (Ibn Anas, 2013) can be found back in the 1st Century AH during the Caliphate of Umayyad1. (p. 491)

In the conventional market, the primary relationship between the investor and the investee is merely based on debts either by loans in banking market or bonds in the capital market, whereas in *Sukuk* (asset-backed), the relationship is associated with the underlying asset along with a commensurate cash flows and risk. Too,

classification of *Sukuk* is not bounded by the type of contract being entered into. For example, multiple choice of *Murabahah*, *Musharakah* or *Ijarah* contracts can be entered into under the convertible *Sukuk* category. In terms of the structure, some types of *Sukuk* have been a debatable issue among scholars due to the elements of *Riba* and *Gharar* in bay' al-dayn and bay' al-'inah that arise in *Sukuk Murabahah* structure. Moreover, emulating conventional bonds can be seen in the type of asset-based *Sukuk* where the underlying asset is only used seeking the fulfilment of the *Shari'ah* requirement, meaning that not a true sale is taken place between the investor and the issuer. Rather, a debt is created by using bay' al-'inah to avoid the conventional direct loan.

Unlike the other structures, *Sukuk al-Ijarah* have the advantage of the indisputable intrinsic values of the certificates whom investors hold, they represent real estate assets from which the income for the investors is generated, thus, the indicator of the income is based on the creditworthiness of the underlying asset, and in case of insufficiency, the investors' recourse would be to the underlying asset. Moreover, *Sukuk al-Ijarah* can be traded in the secondary market because of their representation of real estate assets, which allows the investor to trade at discount, at part or premium with no element of *Riba*.

1.2 STATEMENT OF THE PROBLEM

Due to the loss of trust in the banking industry in Libya, depositors started withdrawing their money from the banks causing inadequacy in the banks' capital. (Alwasat, 2017). This is known in the banking perspective as Tier 2 capital (Tier 3 in other jurisdictions)² that represents depositors' money which is no longer exist in the

² In some jurisdictions, the tiers are numerated differently namely: Tier 1, Tier 2 and Tier 3

Libyan commercial banks. Moreover, the country suffers from lack of security and an absence of the capital market meaning that banks do not perform investments which represent Additional Tier 1 (Tier 2 in other jurisdictions) (Sheikh Eldin, 2017). Additionally, Fractional Reserve Banking system is not applied in the country since 2013 where interest-based financing transactions were prohibited under Law No. 1. These fractional reserves were the sole profit that banks relied on because there are no other alternative sources of income.

Moreover, the country suffers from a recession at a time it is heavily dependent on the only utilized source of income which is oil. According to the Libyan Audit Bureau, revenues of oil in 2014 is 19.9 billion Libyan Dinars whom the government pays from it 21.6 BLD for salaries (Libyan Audit Bureau [LAB], 2014). This caused a financial deficit and exhausted the general budget of the country while, on the other hand, there is no economic development.

As Libya has many income-generating resources that have not been paid attention, liquidity crisis comes into picture again leading to lack of investments and, as a result, poor economic developments. The country has many state-owned properties located in the center, beaches and lands that are unutilized. The researcher believes that the adoption of *Sukuk al-Ijarah* concept would attract investors to cash in their money to circulate the wealth within the society and provide liquidity for the banks. On top of that, ordinary citizens with minimal amounts of money can subscribe to *Sukuk* pari passu with the investors since governmental assets will be divided into small proportions affordable to be subscribed by the public. Adopting a real Islamic instrument like *Sukuk al-Ijarah* would undoubtedly attract citizens in Libya as it is deemed a religious society.

1.3 RESEARCH OBJECTIVES

The study aimed to achieve the following objectives:

1. To present a genuine *Shari'ah* compliant structure of *Sukuk al-Ijarah* inspired by previous experiences of the successful issuances to be implemented in the case of Libya
2. To contribute to solving liquidity crisis in Libya by replacing treasury bonds that became useless since the initiative of the interest prohibition law
3. To empower Libyan Bursa via tradability of *Sukuk al-Ijarah* that differ from Salam and istisna' *Sukuk* in which the value of *Ijarah Sukuk* represent an ownership of a real asset not a debt.

1.4 RESEARCH QUESTIONS

- 1- What are the factors that effected the genuineness of the previously issued *Sukuk al-Ijarah*? And how would be the proper structure of it?
- 2- Why Libya is considered a suitable environment for the implementation of *Sukuk al-Ijarah*?
- 3- How can *Sukuk al-Ijarah* contribute to solving liquidity crisis in Libya?

1.5 SIGNIFICANCE OF THE STUDY

The importance of this study can be seen in highlighting the utilization mechanism of *Sukuk al-Ijarah* in Libya and showing the appropriateness of adopting this type of *Sukuk* in the Libyan market taking into consideration the applicable laws of the respective country.

Despite the significant development that *Sukuk* have contributed to the capital market, every country has its own political and legal environment which may or may not be suitable to adopt such newly-established instruments. However, the researcher

believes that Libya enjoys several merits reflecting its capability for the adoption of this type of *Sukuk* which will contribute in solving the liquidity crisis as well as the development of the country economy. These features can be summarised as follows:

1- Legal environment

In 2013, the General National Congress GNC that was elected by the Libyan citizens, initiated a new law prohibiting all forms of *Riba* as stated in clause 1 of the Libyan constitution " all forms of Riba, whether in civil or commercial dealings shall be banned, and therefore all barter trades resulting from Riba contracts is considered void" (Ministry of Justice, 2013, p. 241). The resolution took place after pressing demands by the Libyan nation who sought for a transfer from the conventional bank system to the Islamic system.

2- Society environment

By taking the aforementioned demand into consideration, it implies that Libyan people are fertile ground to plant the Islamic bonds concept. Recent researches showed significant percentage of Libyan citizens who support the complete transfer to the Islamic system. According to Dr Mustafa Ali Abu-hmaira, 76.6% of the sample he selected support the transfer to the Islamic banking system. (Abu-hmaira, 2013)

3- *Shari'ah* scholars

As a crucial leader in the Islamic banking industry, Libyan government represented in General National Congress (GNC) and supported by *Shari'ah* scholars from different Islamic financial and non-financial institutions have allowed the concept of *Sukuk* . Decree No (4/2016) of GNC states that *Sukuk* can be adopted in the market as it provides investment opportunities similar to the bonds in terms of its proportionately stable returns and its intrinsic values

that are guaranteed by owning proportions in real assets. It is also similar to the Hire Purchase agreement in terms of the origins of its values that are represented in real estate assets.

On top of that, the study also contributes to knowledge by discussing the most important difference between *Sukuk* and bonds with reference to the theory of time value of money whom bond market practitioners rely on, which is, to the best of the researcher's knowledge, has not been discussed as a distinguisher and a key feature between *Sukuk* and bonds, a matter that would enhance the approbation of Muslim investors to cash in their money and subscribe to *Sukuk*.

1.6 ORGANISATION OF THE STUDY

The research is organized into five chapters. The first chapter covers the background of the study, followed by the problem statement, research objectives, research questions and significance of the study. Chapter two provides a review of literature on *Sukuk* and focuses specifically on *Sukuk al-Ijarah* to analysis the experience of both successful and less successful cases. The third chapter presents the methodology adopted for this research as an academic tool to enlighten the reader on the data used in the research and the sources that were relied on to conduct the research and come up with a proper findings. Chapter four provides findings. Chapter five presents conclusion and recommendations.

1.7 SUMMARY

This chapter has presented and discussed the background of the study. It elaborated why *Sukuk* generally play a vital role in the development of the global Islamic finance with a specific reference to *Sukuk al-Ijarah*. In addition, the statement of the problem

was highlighted, as the study is conducted to highlight the applicability of *Sukuk al-Ijarah* in the Libyan market. Following this is the review of the literature on *Sukuk al-Ijarah* as well as the economic environment of the Libyan market and its applicability in adopting *Sukuk al-Ijarah*. Moreover, research objectives, research questions and significance were also presented in this chapter. Finally, the chapter was concluded by the organisation section where it presented the flow of the research.

CHAPTER TWO

LITERATURE REVIEW

PART ONE: THEORETICAL REVIEW

2.1 INTRODUCTION

As the study sought to highlight the viability and applicability of *Sukuk al-Ijarah* in the country of Libya, it is of importance to shed the light on what academicians, practitioners and market players said about *Sukuk* in general with specific reference to *Sukuk al-Ijarah* either the theoretical or technical parts of it. Since the study focuses on implementing the genuine module of this type of *Sukuk* , this chapter will emphasize on the differences that distinguishes the introduced *Sukuk* module from the bonds and also from other *Sukuk al-Ijarah* that were misapplied in other countries. Furthermore, the chapter will cover the current economic situation of the country of Libya highlighting the conducive environment for the implementation of *Sukuk al-Ijarah* as well as the challenges.

2.2 THE CONCEPT OF SUKUK

Although the term of *Sukuk* (Islamic bonds) is modern, the idea behind was implemented, with some basic differences, in 1862 during the American civil war. According to (Razaghian, 2005), he noted that the need of the American government at that period to cover the deficit spending led to the innovation of bond market. To cover the deficit, the American government issued bonds whom its interest is backed by cotton to attract foreign investors to subscribe.

The concept of *Sukuk* is similar to the previously mentioned idea with other basic *Shari'ah* principles that distinguish it from the bonds. Among these principles,

according to (Zolfaghari, 2017), is that *Sukuk* holders are owners of the underlying asset which is the cotton in the previous example. However, the very basic difference is that owners of the asset in *Sukuk* must bear an equity risk attached to the underlying asset, whereas in bonds no equity risk is borne.

From the economical perspective, *Sukuk* generally can be defined as certificates encompass rights or papers that represent rights³. *Sukuk* word is literally translated as ‘certificates’ representing undivided ownership of a tangible asset in the picture of documents or certificates that can be traded in the secondary market according to some jurisdictions⁴. *Sukuk* are also defined by (Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], 2015), ‘certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment.’ (p. 467) Whereas Security Commission Malaysia (SC) considers *Sukuk* as documents represent the value of an asset.

Generally, we can see that the crucial part of *Sukuk* concept is the representation of the assets in the picture of certificates or papers. This, as it will be discussed later, is the distinguisher between asset-based *Sukuk* and asset-backed *Sukuk*. Asset-based *Sukuk* was brought to the market seeking the guarantee on the capital, thus, the certificates are not backed by assets but debts.

Sukuk were adopted in the market to replace the conventional practice of bonds. A bond is a type of instrument offered for investors who do not want to bear risk. It is a mere loan provided by those investors to other banks or institutions to be paid back

³ Lisan al-Arab, ibn Manthor

⁴ Except for *Sukuk Murabahah* which cannot be traded in the secondary market: ‘It is not permissible to trade in *Murabahah* certificates after delivery of the *Murabahah* commodity to the buyer. However, trading of *Murabahah* certificates is permissible after purchasing the *Murabahah* commodity and before selling it to the buyer.’ AAOIFI *Shari’ah* Standard No.17

with either a monthly or quarterly cash flow that represent their profit along with the capital they initially paid to buy this bond. Arguably, the nature of people desires risk-free ventures to be, at the same time, income generating. However, this theory is totally against the principles of *Shari'ah* regarding the use of Money.

The mechanism of bonds applies the concept of time value of money. As it will be discussed later, the time value of money (TMV) is the differentiator between *Sukuk* and bonds and *Sukuk* is the optimal alternative of bonds provided that *Shari'ah* principles are applied. Investors in bonds use the money as a commodity that deserves a return by only lending it to another party with an interest. In contrary, *Shari'ah* considers money as a measure of value, like a mirror whose value is in the reflection of things' shapes and colors. Playing with this base would distort the measurer of things' values.

Imam Al-Ghazali notes that money that Allah S.W.T has created which is gold and silver is a blessing from Him as they have no intrinsic usufruct or utility but Allah S.W.T created human beings attached with the need of having gold and silver by using them as mediators to judge other subjects' values. In his book *Revival of Religious Sciences*, (Al-Ghazali, 2004) further states that ‘‘Allah has create them, so that they may be circulated between hands and act as a fair judge between different commodities and work as a medium to acquire other things. So, the one who owns them is as if he owns everything... A mirror, which has no color, but it reflects all colors. The same is the case of money. It is not an objective in itself. But it is an instrument to lead to all objectives... He who does an act with dirhams and dinars, which is opposed to the above plan of Allah, commits a sin and is ungrateful to the gifts of Allah.’’ (pp. 90-94)

2.3 SUKUK STRUCTURE

Before we present the structure of *Sukuk*, it is of importance to highlight the factors that influence the way *Sukuk* are structured and designed. These factors can be summarized as follows:

- 1- Compatibility with basic *Shari'ah* contracts
- 2- Attached risk profile
- 3- Market environment and its capability to accept *Sukuk*
- 4- The type of cash flow sought by both originator and investor (Mirakhor O. I., 2013).

With regards to No.1, *Sukuk* are structured based on the basic *Shari'ah* contracts that will be highlighted in the next section. For No.2, risk is the crucial part when it comes to structuring for *Sukuk* as it shapes the type of certificates that investors are going to subscribe to and whether or not they are secured from a potential loss. There are certain ways market players use to eliminate, in most cases, or mitigate the risk attached to the certificates.

From the issuer's side, there might be a call option embedded in *Sukuk* structure for early redemption. According to the *Sukuk* prospectus issued by Public Islamic Bank Berhad in Malaysia (SC, 2014), the structure encompassed a *call option* where the issuer

2.3.1 CLASSICAL *SHARI'AH* CONTRACTS EMBEDDED IN *SUKUK* STRUCTURES

Religiously, the products innovated by Islamic financial institutions have to be based on the *Shari'ah* contracts for that the major principles are taken from these classical Islamic contracts whereby contemporary contracts are put on the scale of these classical Islamic contracts that are shown in figure and characterized based on the latter's rules and regulations.

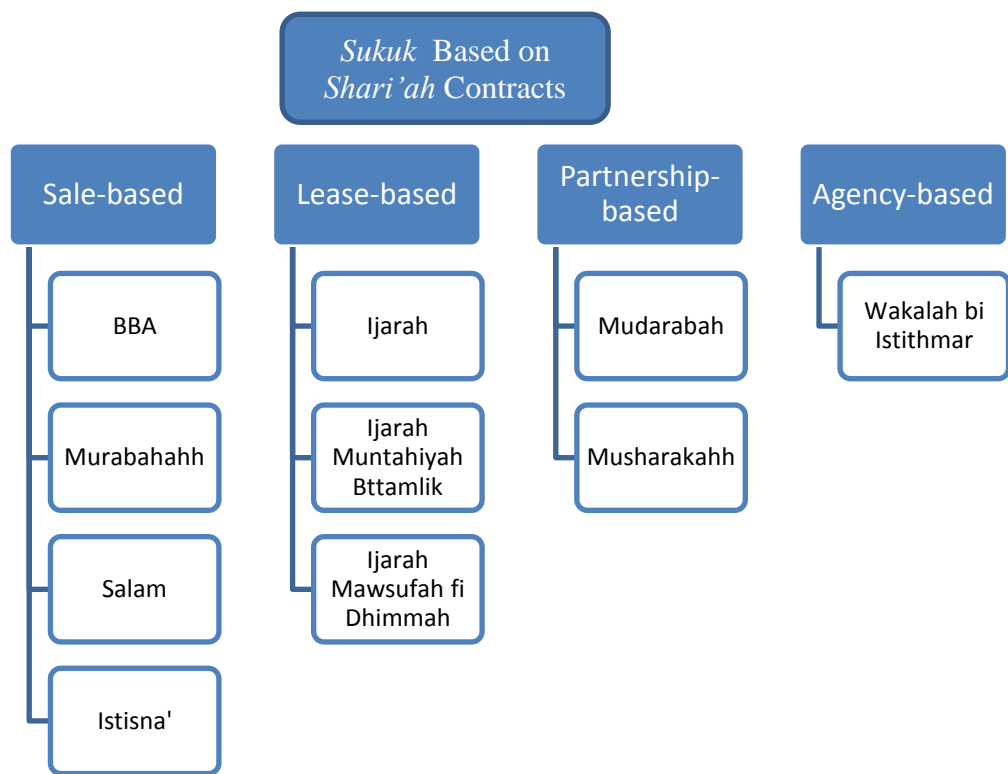


Figure 2.1 *Shari'ah* Contracts Embedded in *Sukuk* Structure

Source: (SC, 2009, p. 48)

However, classifying *Sukuk* based on the above mentioned contracts does not mean that *Sukuk* will be tied up with that particular contract for the whole process, there are other components that might be taken into consideration. For example, the issuer's

character whether it is a corporate or sovereign, also the underlying asset whether it is an asset-backed or asset-based *Sukuk*. In light of the previous considerations, for one particular type of *Sukuk*, there can be multiple *Shari'ah* contracts embedded (International Shari'ah Research Academy for Islamic Finance [ISRA], 2012).

From the commercial perspective, *Sukuk* are classified into several aspects. Table below shows, from different angles, classification of *Sukuk* structures.

Corporate	• Issuers are Incorporated companies which are non-government firms.
Sovereign	• Issuers are government of sovereign entities.
Exchangeable and Convertible	• <i>Sukuk</i> may be converted into shares (equity) at maturity or other trigger events.
Subordinated	• The repayment of the <i>Sukuk</i> is subordinated to the creditor or depositor.
Stapled	• Two instruments are attached together and cannot be traded separately.
Asset-Backed	• Securities backed by an income generating asset with stable cash flow. This involves true sale securitisation where the recourse is to the asset and not to the originator.
Project Financing	• Proceeds of <i>Sukuk</i> used to finance a project. Repayment to investors comes from cash flow generated from the project.

Table 2.1 Different Types of *Sukuk* Based on Different Types of Issuers

Source: (ISRA, 2012, p. 400)