THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

جامعة حمد بن خليفة
HAMAD BIN KHALIFA UNIVERSITY
كلية الدراسات الإسلامية
College of Islamic Studies

LSE–HBKU Workshop | February 13, 2015

Revisiting Islamic Securitization and Structured Products

Edited & Compiled
Wijdan Tariq
Senior Research Officer, Center for Islamic Economics and Finance (CIEF)
College of Islamic Studies, Hamad Bin Khalifa University

Center for Islamic Economics and Finance
College of Islamic Studies | Hamad Bin Khalifa University
P.O. Box 34110 Doha, Qatar

Cite this report as: Tariq, W. (2018), Summary report of the 'Revisiting Islamic Securitization and Structured Products An Economic, Shari'ah and Legal Analysis' hosted by the Center for Islamic Economics and Finance (CIEF), College of Islamic Studies, Hamad Bin Khalifa University at the London School of Economics on February 13, 2015.

Introduction[1]

The Center for Islamic Economics and Finance at the Qatar Faculty of Islamic Studies (QFIS), a college of Hamad bin Khalifa University (HBKU), organized a workshop on Islamic finance at the London School of Economics (LSE) on Friday, February 13, 2015. The workshop was on the theme of "Revisiting Islamic Securitization and Structured Products." This report is a summary of the workshop deliberations.

There is confusion in the *sukuk* markets about whether *sukuk* are securitizations.

The workshop began with participants claiming that the definitions of *sukuk* that the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB) have put forward are causing confusion in the markets.

AAOIFI defines *sukuk* as follows:

> "Investment sukuk are 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 activity…" (AAOIFI, 2010, p. 307). [2]

IFSB describes the process of issuing *sukuk* as follows:

> "Securitisation in *sukuk* is broadly referred to as a process of issuing *sukuk* involving the following steps:
>
> (a) origination of assets…
> (b) transfer of the assets to a special purpose entity (SPE) which acts as the issuer by packaging them into securities (*sukuk*); and
> (c) issuing the securities to investors." (IFSB, 2009, p. 3).

Some participants were of the view that the prevailing definitions and descriptions of *sukuk* given by AAOIFI and IFSB inaccurately represent *sukuk* as an asset-backed securitization. It was argued that the majority of *sukuk* are not true securitizations. From an English law perspective, most *sukuk* are unsecured bonds[3]. In the event of default, there is only the Purchase Undertaking Deed (PUD) whereby the originator promises to purchase back the assets at an agreed upon exercise price. Investors usually do not have recourse to the *sukuk* assets. In a true asset-backed securitization, the security-holders would have recourse to the underlying assets and not to the originator of the *sukuk*. In the vast majority of cases, s*ukuk*-holders do not have recourse to the *sukuk* assets—they have recourse to the originator. This raises many important concerns in the market especially with respect to the actual risks involved in investing in such products.

The sale of underlying assets in most *sukuk* issuances is not a true sale. Deviations from true sale are primarily due to the purchase undertaking and the absence of legal transfer of ownership of the assets sold from the buyer

[1] Acknowledgements**:** This roundtable was convened by S. Nazim Ali and moderated by Frank Vogel. The roundtable was organized by S. Nazim Ali, Hussam El-Khatib, Shariq Nisar, and Wijdan Tariq. This report is based on the excellent notes of Jennifer Schwalbenberg. The comments of Frank Vogel and other participants were also instrumental in preparing this report. The usual disclaimer applies. All errors that remain are the author's own.

[2] The standard definition continues "…however, this is true after receipt of the value of the sukuk, the closing of subscription and the employment of funds received for the purpose for which the sukuk were issued. Furthermore, AAOIFI also defines securitization as follows: "Securitisation is known in Arabic terminology as Taskeek (issues) and Tasneed (securities). Securitisation is a process of dividing ownership of tangible assets, usufructs or both into units of equal value and issue securities as per their value." (AAOIFI, 2010, p. 322)

[3] The Bank of England statement on sukuk supports this view.

to the purchaser. This view is problematic—if there is no true sale then there is no genuine ownership. In the absence of ownership of the assets, on what basis are the *sukuk*-holders generating their returns? If one accepts that there is no ownership of the assets by the *sukuk*-holders and/or there is no true sale, the *shariah*-compliancy of the product comes under serious doubt in the eyes of many of the participants.

It was suggested that the IFSB definition creates confusion especially if it were to go to an English court. A party could argue in court that this definition by IFSB meant that they had a legitimate expectation to have recourse to the assets. Widely accepted terms such as "securitization" have specific meanings, so the Islamic finance industry should not associate its own preferred definitions to the word "securitization". For instance, one participant stated that in Saudi Arabia, the term "securitization" is being used specifically to describe the discounting of receivables. Some participants were of the view to separate the word *sukuk* from the word "securitization" and accept that they are not the same thing—this would reduce legal uncertainties to an extent.

When questioned further to clarify the source of the confusion in the *sukuk* definitions, a participant stated that the definitions do not say where the recourse. To further elaborate on the concern, one practitioner described the practice of issuing *sukuk* in the Middle East and North Africa (MENA) region. Many transactions in MENA do not complete the registrations and lawyers in the Gulf Cooperation Council (GCC) countries—civil law jurisdictions—will issue the term "beneficial right" even though it is a common law concept. With beneficial rights, if the seller goes and sells that same asset to someone who perfects those assets, the first buyer will lose that beneficial claim on the asset. However, Western securitization is based on the true sale concept and the total transfer of assets. The investor relies on the fact that that asset cannot go back to the originator thereby securing the investors rights to enforce debt claims. The participant suggested that *sukuk* got off to a wrong start because it was poorly defined and the asset came into existence only to give the structure *shariah* credibility. The reality is that it is a temporary lending of the asset or temporary transfer of title and the asset will eventually go back to the originator. Very few issuers in Asia and the Middle East want to relinquish their assets. They do not want to diminish their balance sheets—they want the assets back. The participant argued that we need to redefine *sukuk* to show what it actually is.

One participant had a different opinion on the source of the confusion. The confusion does not stem from the definitions—the confusion comes from the fact that very few people actually read the *sukuk* prospectuses. The reality is that we have many different types of *sukuk*, and there is a degree of overlap between securitization and *sukuk*. Asset-backed *sukuk* involve true sale with recourse to the *sukuk* assets[4]. We also have subordinated securitizations and subordinated *sukuk*. The AAOIFI and IFSB standards do describe some of these alternative *sukuk* structures, although the basic descriptions provided by AAOIFI and IFSB do appear to describe the less common asset-backed structures. Nonetheless, the more pressing problem according to this view is that investors do not read the prospectuses. There are some people who claim that they do have a right to the underlying asset. But if you look at prospectuses, the documents are clear that you have no right to that asset and no right to enforce against the asset. Your only right as a *sukuk*-holder (in the vast majority of cases) is against the purchase undertaking. Therefore, you join other groups of unsecured creditors if you take that claim for payment to court. This is clearly detailed in prospectuses, so the key is to encourage stakeholders to read the prospectuses and allow them the time to understand the key aspects of these documents before making investment decisions.

One participant spoke briefly about the historical evolution of the *sukuk* markets as well as the *sukuk* standards from firsthand experience. The participant acknowledged that the confusion in the *sukuk* markets exists among all stakeholders, even the *sharia* scholars. The historical view may shed light on why *sukuk* in practice have not been asset-backed and how the AAOIFI standards came into being. *Sukuk* were initially issued because of idle assets of state-owned corporations. The state-owned corporations used to borrow conventionally through

[4] However, the participant agreed that we do not have many of these and there may be an opportunity for them to develop.

interest-based loans and bonds. Over time, pressure grew from the general public and from Islamic institutions that governments should not borrow using interest-based transactions because it was deemed *haram* (prohibited by *shariah*). The corporations were left with two options: either to continue to borrow on an interest-basis and obtain *fatwas* (legal opinions) on their permissibility due to lack of alternatives, or to issue "Islamicisized" versions of the conventional debt-based products in the form of *sukuk*. The corporations took the latter option. The *sukuk* market started small but proliferated quickly and the market was not ready for the tax, legal and regulatory implications. There was no real preparation for this market. Over time, many different professionals including lawyers became actively involved with the markets. When issues arose, AAOIFI was asked to prepare *sukuk* standards. The *sukuk* standard was one of the earliest AAOIFI standards. They attempted to control some of the issues that were occurring. In the view of this participant, the IFSB/AAOIFI standards should not be viewed as perfect and do need to be refined.

On the issue of securitization and *sukuk*, the participant went on to state that in the Middle East it was not known what the term "securitization" meant in practice. Islamic finance, he argued, should be credited for bringing some sort of securitization to the region through *sukuk*. Islamic banks introduced securitization to the Muslim world and this is their invention and contribution. *Sukuk* should be viewed as a hybrid between conventional bonds and conventional securitizations. In the *Shariah*, purchase and sale undertakings within a sales contract is a matter of debate. Some scholars are of the view that such a sale is a true sale with certain obligations that come into effect under certain conditions such as default. These purchase and sales undertakings have a history as well. Lawyers have always demanded for Islamic finance to be *pari-passu* with conventional finance. It is in the interest of *sukuk*-holders to be *pari-passu* with other creditors otherwise all other creditors will want to be secured as well. In a nutshell, this is the historical background on the complications of the *sukuk* market and its relationship to securitization.

It was disclosed during the discussions that AAOIFI in their last *shariah* board meeting decided that they plan to re-visit the *sukuk* standards and to include recent issues such as asset-backed, asset-based, tier 1, tier 2, perpetual *sukuk*, etc., in the revised standards[5]. A team of seven experts has been formed that includes four shariah scholars, an expert from Malaysia, an accountant and a lawyer working in the field. The *shariah*, tax, and legal aspects of *sukuk* will be considered when drafting the new standard. Roundtable workshops similar to this one are being planned by AAOIFI and all the comments (including from this workshop) would be beneficial for AAOIFI. It appears that one of the additional objectives of the new standard would be to encourage moving beyond *shariah*-compliance and to consider the *maqasid-al-shariah* as well. In other words, the standard may address questions about the use of *sukuk* proceeds and about the overall objectives and aims of financing. Accordingly, the assumption according to this view is that the problem with *sukuk* structures does not stem from a lack of disclosures or from people not reading prospectuses; the main source of problems in the first place is the motivation for issuing *sukuk*—this is what results in controversial structures. For example, do issuers want to create these instruments to get rid of assets permanently, or is it just for a temporary period by informing investors that they do not have claim to the assets? The new AAOIFI standard might attempt to address such questions relating to incentives.

Another important source of confusion according to a participant is the gap between the interpretation of sale from a *shariah* perspective and from a legal perspective. In the *shariah* point of view, the participant claimed that there is no difference between true and beneficial ownership. In *shariah*, there is offer and acceptance, and the contract is valid as long as risk and liability are transferred and as long as the subject of sale is free from *shariah* prohibitions (e.g. *gharar*, banned goods, *riba*, etc.). There are instances where the *shariah* scholars have regarded transactions as true sales, but the court of law does not recognize it as a true sale. Definitions of true

[5] This was also reported in a Reuters article dated 19 November 2014 titled "Islamic finance body AAOIFI to revise four standards, eyes sukuk".

sale vary between common law and civil law jurisdictions. Thus, this is an important source of uncertainty and confusion: the difference in secular legal interpretations and the *shariah* interpretation of a true sale.

At the same time, within the *shariah* differences of opinions do occur on issues related to *sukuk*, structured products and true sales. One must acknowledge this as a source of confusion as well[6]. For instance, how does the non-recourse condition in *sukuk* affect its compliance with the *shariah*? Is the contract void? Is the condition void? There are instances in *sukuk* issuances where buyers (investors) have no right to conduct due diligence on the underlying assets. Would this be considered as a true transfer of ownership from a *shariah* perspective? These questions were posed a number of times throughout the discussion without a conclusion or a clear consensus reached. With such differences of opinions among *shariah* experts, confusion in the markets is inevitable.

According to a lawyer, there is a gap between the expectations of some *shariah* scholars in the industry and the effective legal regime in those jurisdictions. In addition, the products were placed in the market before the availability of an appropriate legal and regulatory environment. This is a problem of *sequencing*. How can we issue *sukuk*—regardless of whether it is asset-backed or asset-based—in countries that do not recognize any securities other than a conventional bond? We need to create the enabling environment in order to reduce the significant gap between what we want these instruments to be and what the jurisdiction enables.

One participant argued that in a market economy, it is supply and demand that determines which products are offered and available. No one is preventing industry players to undertake full-fledged asset-backed securitizations. However, this is not what is being demand by industry, government, and large enterprises. In addition, under the new Basel committee rules, asset-backed instruments have higher capital requirements than before. So the market demand for securitization is just not there, according to this participant.

The capital markets view of *sukuk* instruments is to assess what recourse is available in the event of a default. With the prevalent asset-based *sukuk*, the rating agencies treat them in the exact same way as bonds. For bonds, the rating is based on the entity responsible for repayment and in *sukuk* the rating is based on the entity that has the obligation under the purchase undertaking. A true asset-backed *sukuk* can achieve a better rating than the entity obliged under the purchase undertaking—usually the originator itself—if the quality of underlying assets is higher than the quality of the originator. This is one of the key motivations for issuing true asset-backed securities. If *sukuk* issuers understand these benefits more fully, the markets might move towards asset-backed structures.

The discussion then moved on to discuss the content of the *sukuk* prospectus. Some participants suggested that the legal regime governing the prospectus should be clarified and that *sukuk*-holders are not told what the law of the land is in the countries where the underlying assets are located. In particular, recent experiences with *sukuk* prospectuses have shown the difficulties of having two legal regimes (e.g. *shariah* and English law) in the same contract. In fact, from an English law perspective, you cannot introduce two competing regimes within the contract. Some participants made normative claims that if a party to a contract is "Islamically-minded", then they should abide by the contract of the *sukuk* irrespective of the law of the land that gives them recourse to the assets of the originator. The fact remains, however, that such normative opinions are difficult to enforce without the appropriate legal incentives and framework. One potential solution to these problems is that *sukuk* prospectuses can specify that disputes will be resolved by arbitration. Each party selects an arbitrator and both parties select a third arbitrator. One *shariah* scholar agreed that if the parties do not go to court and instead appoint arbitrators that will uphold *shariah* law, then most of the concerns raised in this discussion could be solved. Arbitration tribunal could potentially solve some of the issues because it could recognize the *fiqh*

[6] Statements on *sukuk* by a board member of AAOIFI in 2007 and the OIC Fiqh Academy in 2012 (published in English in 2014 in IRTI's *Islamic Economic Studies*) are examples of ongoing debates from within the *shariah* on some of these issues.

nuances where an English court would not. However, another participant questioned the relevancy of arbitration—when a contract says that you have no recourse, this is a serious issue. *Sukuk* documents do increasingly contain arbitration provisions. In bilateral contracts, you would have more flexibility. In the case of *sukuk* where an offer is being made to anonymous group of investors and who are trading all the time, you may still have arbitration; however, it needs to be clarified whether there is recourse to the assets or not because the ratings agencies, the exchanges and the investors need to know the rights of the parties. Simply having an arbitration provision does not satisfy the needs of these stakeholders.

The discussion went back towards whether a real sale is intended in the first place. Lawyers are saying that there is no true sale in most *sukuk*. Both parties do not want a real sale, so the intention to sell does not exist. *Sukuk*-holders do not have full ownership rights, but only the right to take value from the assets. In many jurisdictions, the parties do not want to pay sales taxes. Governments and companies do not want to give up their assets for economic, political, or strategic reasons. If there is no intention to sell, then perhaps we need to find a new solution.

One of the *shariah* scholars criticized what he called the "anti-*sukuk* school" and he described the views of critics as a minority view. He claims that true asset-backed securitizations are difficult and highly risky due to their volatile characteristics. These kinds of structures need a much higher level of due diligence and other factors also mean more complications—especially in the developing markets where there are no standards. Leaving *sukuk* and moving towards securitization will not happen according to this *shariah* scholar. He is critical of those that demand full ownership. According to him, ownership has two sides: full ownership and full liability. For example, imagine an oil & gas company issues a true asset-backed *sukuk* and subsequently there is a large oil spill involving the company—in the case of true sale, all the *sukuk* investors (as owners of the assets) may be liable. The *shariah* scholar claims that the critics do not realize both these sides of ownership, and that once they do realize this, they will appreciate the difficulty and unattractiveness of true asset-backed *sukuk* for the market.

Participants did not agree with the assessment of the *shariah* scholar that the critical view of *sukuk* is a minority view. Many participants agreed that it is in fact the *majority* view both inside and outside of the roundtable discussion. Many technical and non-technical people argue that Islamic finance uses legal devices to give veneer of compliance. They are suspicious of Islamic finance, and they see it as nothing more than a series of legal devices. Some participants agreed that securitization is a gradual process and that we cannot switch overnight, but we cannot ignore the critical views because this is in fact the majority view.

One of the participants was critical of finance lawyers. He claimed that lawyers are not making it clear to the *shariah* scholars that there are different set up of basis on which you can form *sukuk*. Lawyers are advising clients to go for beneficial ownership only. It is upon the lawyers to advise what can be done to have recourse to the asset and to be in line with the existing legal system. At the same time, *shariah* scholars need to emphasize more during their interactions with lawyers on what needs to be developed. Another participant added that while this is true, we must keep in mind that the sector is dominated by conventional players who are not as concerned with the *shariah* issues as much.

The question was asked whether the issue of sale in AAOIFI resolution is clear. Most of the discussants agreed. One *shariah* practitioner suggested that AAOIFI needs to review the standards and make the true sale part of the standards itself. Lawyers cautioned against this because there is no jurisdiction in the Middle East where you can do that—where you can perfect the transfer of title. There are no insolvency laws in some of these countries. If the jurisdiction does not guarantee recourse to the assets, no one will give a legal opinion without major qualifications. And you cannot just say this to retail investors. It would be disastrous if it goes wrong.

One London-based participant commented that assets (to be the basis of securitization) are available but no one wants to buy or sell them. Pre-2008, *sukuk al-mudharaba* with fixed price undertaking was available to the market—this gave the market the benefit of having a product that is a credit claim without the need for assets. This kind of structure was acceptable for a long time. After the well-known AAOIFI pronouncement in 2008 prohibiting any structure which implies the guarantee of principal in a profit-sharing structure such as *sukuk al-mudharaba*, those types of structures witnessed a marked decline. However, the structures that we have now are still economically similar; returns are not really linked to the asset—they are predetermined. According to this participant, the market still demands a product which allows *sukuk* holders to invest in a business and to get a return fixed up-front and have a right to get principal back in a debt-like way. Is there any way to recreate the economic reality of a debt claim and a minimal return without the need for assets? The market demands instruments that look like conventional bonds but have a *shariah* justification and analysis applied to them. They can then be easily explained to the different stakeholders such as the exchanges and ratings agency which will allow the investors to easily conduct their risk analysis. Essentially, the market wants to reverse engineer a conventional bond to make it *shariah*-compliant.

In response to the above comment, another London-based participant gave the example of a German insurance company that issued a *wakala sukuk* that was backed by insurance policies. It acted more like a covered bond.[7] He said that although the assets were ring-fenced, they remained on the balance sheet of the originator and did not need to be transferred across. The previous commenter remarked that assets were still needed for that structure and that this would not meet the demand for structures that do not require for there to be underlying assets.

Other *shariah* experts warned that without having underlying assets, the link to the real economy is broken. They also acknowledged, however, that many companies are coming forward with these requests. The only way this can be permissible is to make it similar to *mudaraba*, *musharaka*, or *wakala*—share the profits that are generated and follow the guidelines of the perpetual *sukuk*. The market is already moving towards such structures with the introduction of perpetual *sukuk*. More innovation would be required and it was recognized as an area of ongoing concern.

Perpetual *sukuk*, however, do not meet the market demand for bond equivalents. The reason is that perpetual *sukuk* are highly subordinated debt and they are priced that way. There is a strong market demand for Islamic debt instruments that are pari passu with conventional debt and with a similar pricing. We need to acknowledge that *sukuk* are treated—in the wider financial system outside of the realm of *shariah*—as a loan with interest. If you look at pricing from the investor's perspective, the pricing is similar in good conditions. In other words, the presence of underlying assets is irrelevant when it comes down to the final economic/financial analysis.

The *shariah* scholars took strong objection to the desire of the industry to create bond-like instruments with no underlying asset and to try to pass them off as Islamic. The desire to create the risk profile of a bond with no underlying asset and to make it Islamic is, according to one participant, like "trying to sell milk in the wine market." The scholars expressed strong disapproval of the conventional finance market to solely insist on the one contract—that is, the interest-based loan. This unidimensional reliance of mainstream financial players on the interest-based loan contract stifles innovation in finance, according to the Islamic finance scholars.

The question was asked whether it would be ok to relax the *shariah* rules for a period of time to allow the industry to reach a degree of economies of scale. The benefit of this could potentially be a larger, deeper market with an avenue to finance the necessary innovative (and more genuinely Islamic) structures in the future. This

[7] Although the participant did not mention the name of the issuer, it is likely that he was referring to the $US 100m *sukuk* programme that the European insurance group, FWU issued in October 2013. The European Islamic Investment Bank was one of the arrangers of this deal.

may sound something similar to the Malaysian model where the trading of debt (*bay' al-dayn*) was allowed which helped the market to grow very large and become efficient over time. Should we encourage this approach? One *shariah* scholar admitted that there are glaring *shariah* issues ("violations") in the way that many aspects of Islamic finance are practiced, not just *sukuk*[8]. At the same time, he said, we have to be fair regarding the reality of being able to address these issues and solving them in the real market. We must recognize that we do not have any sovereign sponsor or patron and that we are operating at the periphery and "swimming against the current". The size of the industry is too small and costs of addressing the *shariah* violations will be much higher proportionally. The fact that we are not addressing the issues head on—the *ulema*, the *fiqh* and regulatory bodies are turning a blind eye because of the necessities of the market—does not make all of this right; they are just postponing the issues for another time. What remains to be seen is whether this postponement would be for the benefit or the detriment of the industry. It is not being addressed because it is working and the issues have not yet rocked the boat. Just because we have not been able to address these concerns does not make them acceptable. But at the same time our hands are tied. There is a big gaping hole in the Islamic compliance requirement, but it is beyond our means to control it at this point in time.

Others commented that relaxing the rules even further would be detrimental. The public—and especially the youth—are already losing trust in Islamic finance, it was claimed. So these kinds of proposed plans would have to be considered with extreme caution, carefully assessing the costs and benefits of such a strategic approach. At the same time, another participant argued that the main attraction of Islamic finance for the wider audience—including conventional mainstream economists—is the emphasis on risk-sharing and equity-like financing arrangements. According to this view, there is a need for Islamic finance to reconsider this approach and emphasize risk-sharing and equity-financing more than debt. This is where Islamic finance can potentially add value. If Islamic finance cannot add value, it will continue to face questions about its existence. The problem, commented another participant, is that it is not attractive to engage in equity financing due to the favorable tax benefits that debt arrangements receive. Furthermore, the risk weighting that Basel attributes to equity financing makes it very unattractive for the financier. There needs to be top-down strategic thinking to enable the shift from debt to equity-like arrangements.

A *shariah* scholar commented that sometimes when scholars declare an instrument as non-compliant with *shariah*, innovation follows. For instance, when conventional insurance was declared non-compliant over many years, we saw the development of cooperative insurance.

The Basel approach to regulation is relevant for the regulation of *shariah* in the Islamic finance market as well. The Basel Committee on Banking Supervision changes their standards and imposes them on the industry and the industry is compelled to comply, even if it is not binding. However, in Islamic finance we observe that standard-setting boards do not want to revise standards in order not to hurt the market. This defensive approach to standard-setting must change. At the same time, participants expressed concern that pronouncements from AAOIFI members in the past have negatively affected the industry, and there was a worry that if AAOIFI came out and suddenly announced that, for example, hybrid *sukuk* are wrong, that it would damage the industry. Other participants assured that in the future, AAOIFI will not make statements and will only issue standards. However, there is a need for the industry to adopt the standards just as banks adopt Basel standards.

A discussion ensued about the means through which innovation in *sukuk* can be achieved. It was suggested that for innovation to occur, we need to look at the business model of the issuing firms—what is their business all about? Based on this, we can create constructs that have enough tangibility and assets that are defined in a legally certain way. For instance, with an airline company we can identify that the right of passengers to fly is

[8] The *shariah* scholar went on to mention that there are problems in the other practices of Islamic banking, such as the treatment of *mudaraba* investment accounts. In response to this, the participants were notified that on 28 December 2014, AAOIFI had issued new standards on investment accounts.

something that can potentially be securitized. Ironically, airline industries are asset-intensive, yet you can innovate to create a *sukuk* based on an underlying intangible concept. The same principle, therefore, can be applied to industries that are asset-light. If we can find ways of looking at different industries and find out what they do, and create guidance around how from a *Shariah* perspective you should look at how to do it[9], this may be the way forward towards innovative Islamic financial engineering. The challenge is that some entity has to pay for this extra work. If you innovate and bring a new instrument to the market, it might not be accepted and issuers are not willing to take the risk.

One participant lamented at the fact that no one has collected and documented all the innovative *sukuk* that have been structured over the years. He stated that there are many examples of innovations in *sukuk*, such as in the airlines industry, the SABIC *sukuk*, and the UAE national bond program[10].

It was suggested that some *sukuk* structures were justified and allowed by *shariah* scholars as exceptional cases, in which case the *shariah* scholars usually will qualify it by, say, allowing it for one year and then reviewing the situation thereafter to see if the same circumstances exist. Another *shariah* scholar provided an alternative view to this. When *shariah* scholars decided that asset-based *sukuk* were permissible, they were not saying it was exceptional. Based on the advice from the lawyers, the understanding was that it is not exceptional. If from the beginning it was made clear to the scholars that *sukuk*-holders have no rights to the asset, i.e., that there is no link to the asset, asset, no link with asset. If this was made clear to the scholars at the onset, they would at least have made it exceptional. But this was not done, maybe because of the lawyers were not clear enough or maybe because the scholars could have done more due diligence. But today, we are clear that this condition is wrong. The scholar asked whether we going to continue to declare asset-based *sukuk* as *shariah*-compliant or not? One way to clarify this issue is for AAOIFI to discuss with lawyers what are criteria for the beneficial ownership existing now. Without settling this, we will have so many opinions from scholars saying that beneficial ownership is right or wrong.

One *shariah* expert took the view that there is a problem in the way that *fatwas* are reached, even at the level of *fiqh* academies. He argued that there should be a broader kind of consultation. Particularly, practitioners need to be involved in the process in order to provide the informative role of explaining how products are structured in practice, the considerations of the different parties to the financing, and the challenges on the ground. *Shariah* scholars need to ensure that they have developed the correct perception of the ground realities. These practical issues on the ground are sometimes neglected by the *fiqh* academies and *shariah* scholars. It is important to have this broader consultation with practitioners without compromising the *shariah*-compliancy aspect.

Conclusions and unanswered questions

One thing that was striking was the disconnect between the scholars and the lawyers. The scholars showed a certain amount of disagreement on asset-based sukuk. There seemed to be two perspectives on the purchase undertaking. One view from shariah scholars is that this is a true sale with two purchase undertakings on each side, but others are saying—with a degree of surprise—that if this is what the prospectuses really say, with all those exceptions to the rights of an actual owner, how can we say this is a sale? In 2008 with the resolution clarifying AAOIFI's standard on sukuk, it is clear some kind of true sale is expected, and a view was expressed during the roundtable that if scholars knew what prospectuses now would be saying, they would not have approved sukuk at the time.

But now the sukuk are out of the bag and are a huge part of the Islamic finance industry and reputationally we are committed. So should this be an exception or accepted? If this is an exception, then it was expressed that

[9] The concept of a *salam* sale may be relevant here.
[10] The participant referred to the UAE national bond program as a kind of an "Islamic lottery".

there should be a time limit or some kind of future state when it will stop. Why is this disagreement amongst the scholars, that there are some who support the existing sukuk apparently and some who do not, not better understood? How many people are labouring under the idea that this is a sale, but with the purchase undertaking cloaking it? How far is this obscurity experienced? Is it only amongst the scholars?

On the disconnect between the scholars and the lawyers, the lawyers claim that they have been making it totally clear that if this is a sale it is a very shaky, uncertain kind of a sale. You cannot sell the assets and cannot do due diligence. How can the industry continue without some kind of property? And some lawyers say that even if you wanted to do true sales, you cannot do it in a MENA jurisdiction, not without such heavily caveated opinions that only the bold will willingly dare to tread. Some specialised asset-backed securities have been issued, but with people closing their eyes to the risks. And practically speaking there was no sense of what shariah has been calling for all along, and now there is reputational risk. Participants felt that there is a need to look at how the industry has reached this state of affairs.

There are some scholars who do know the situation and accept it, their views have perhaps evolved, and they have considered other interpretations of these contracts and feel they are justified. Now this particular thing is valid as to the purchase undertaking—maybe beneficial ownership is what makes it valid, perhaps there is some confusion there, but they have accepted it. But how can these sukuk keep being issued if scholars are not approving them? Are the lawyers intimidated by the scholars, or maybe the scholars do not want to hear? What can be done to improve this exchange of views? To understand what the law actually means and what are the complexities of ratings—should the scholars be engaging on all those levels? It has impact on what Muslims are doing. One scholar did accept that they need to know more about this and take it into account. Perhaps there is a lack of follow-up, even though the scholars have always said they have an obligation to follow-up after they have given the fatwa.

Outside of fiqh, is there another explanation for how this disconnect happened? Maybe the market is not taking its cue from the scholars anyway and goes where it wants—the prevalence of the commodity murabaha in hybrid sukuk suggests that this may be the case. Then the question is, what other measures does this fact call for? First, that asset-based sukuk should explicitly be declared an exception, accepted by some scholars but an exception to most. These asset-based sukuk are out there in the market—this view suggests that let us keep them but impose a time limit. The other view is simply to stop sukuk issuances. This view suggests that such a strict measure of declaring the asset-based sukuk as noncompliant with shariah would foster and simulate the desired innovation. In either case whether it is an exception or halted, there should be an urgent effort to develop in the Gulf and elsewhere the infrastructure that is needed to do asset-backed *sukuk*, and there should be innovation to create new assets that can be securitized. The market needs this supporting infrastructure and innovation.

What alternative structures are there for Islamic structured products? And where do the incentives come from? The market appears to want bonds. In Islamic finance, the struggle typically is to go against the corporate market's demand (for bond-like instruments) and to create a new financial structure for the Muslim world and other markets. For this, the industry needs an entity to drive that effort, create the incentives and provide the institutions that will allow it to happen. Are there institutions now that will push for greater compliance rather than less?

One of the objectives of such roundtables is to uncover questions that remain to be answered with the hope of motivating researchers to undertake research projects in these areas. In addition to the preceding discussion, questions uncovered by this workshop included:

- What are the different types of transfer of assets and how do the different types of asset transfers affect the condition of recourse to assets?

- What are the different legal refinements of ownership and does the *shariah* recognize these different types of legal ownership?
- Is there a difference between the *shariah* definition of a true sale as compared to the legal definition?
- Is there a need to accept that *sukuk* are not securitizations and accept that they are not the same? Or do *sukuk* structures have to be reformed to be in line with definitions of AAOIFI and IFSB and hence meet the definition of a true asset-backed securitization?
- What are the different analogies that come to mind when thinking about *sukuk*? Are they similar to shares in terms of legal right vs ownership perspective? Is consistency of AAOIFI in question when we think about similar structures such as *ijarah muntahia bittamleek*—why allow one and discourage the other if they are similar?
- Should *shariah* scholars reach a consensus on these issues? If so, how?
- Markets normally dictate the *shariah* standards. How can *shariah* scholars ensure that markets abide by their principles, rather than the other way around?
- What would happen if AAOIFI declares most *sukuk* as non-compliant? How do similar resolutions such as the 2012 OIC Fiqh Academy resolution affect *sukuk* markets? Can they ever be binding? How can we reduce these related tensions?
- What does the future hold? Is there a need to move towards asset-backed securitizations (ABS)? How can we foster more innovative structures? Do fees of registration, title transfer, etc., need to be reduced—is this main obstacle to ABS? Does the entire approach to Islamic securitization and Islamic financial engineering need to be re-considered? And finally, how do we address the prevailing market needs for bonds without assets?[11]

[11] Readers would find more questions related to *sukuk* from economic and legal perspectives in Mahmoud El-Gamal's *Islamic Finance: Law, Economics and Practice* (2006, p. 22, e-book version). The questions that he poses on the economics of *sukuk* are still relevant today.

PARTIAL LIST OF PARTICIPANTS

Moderator: Frank VOGEL, Founder, Harvard Law School's Islamic Legal Studies Program
Convener: S. Nazim ALI, Director, Center for Islamic Economics and Finance, QFIS, HBKU, Qatar
Essam ISHAQ, Shari'ah Scholar, Manama, Kingdom of Bahrain
Farmida BI, Head of Islamic Finance-Europe, Norton Rose Fulbright, London, U.K.
Hamed Hassan MERAH, Secretary-General, AAOIFI, Manama, Bahrain
Harris IRFAN, Managing Director, European Islamic Investment Bank, London, U.K.
Haytham TAMIM, Director and Founder of Shariah Solutions Ltd, London, U.K.
Huma SODHER, Ph.D. Candidate, Bangor University, Wales, U.K.
Husam EL-KHATIB, DLA Piper, Riyadh, Saudi Arabia
Ijlal A ALVI, Chief Executive Officer, International Islamic Market, Manama, Bahrain
Issam AL TAWARI, Chairman & Managing Director, Rasameel Structured Finance Co. Kuwait
Jennifer SCHWALBENBERG, Associate, Reed Smith, London, U.K.
M. Iqbal ASARIA, Chief Executive Officer, Afkar Consulting Ltd. London, U.K.
Michael GASSNER, IslamicFinance.de, Geneva, Switzerland
Mohamad Akram LALDIN, Executive Director ISRA Malaysia
Mufti BARKATULLA, London, United Kingdom
Muhammad Al-Bashir AL-AMINE, Bank Al Khair, Manama, Bahrain
Neil D. MILLER, Global Head of Islamic Finance, Linklaters LLP, Dubai, United Arab Emirates
Nishith DESAI, Nishith Deasai Associates, Mumbai, India
Nizam YAQUBY, Senior Shari'ahh Scholar, Manama, Kingdom of Bahrain
Shariq NISAR, Director, TASIS, Mumbai, India
Syed Salman ALI, Economist, Islamic Research and Training Institute, Islamic Development
Usman HAYAT, Content Director, CFA Institute, London, United Kingdom
Volker NIENHAUS, Professor, University of Reading, Reading, United Kingdom
Wijdan TARIQ, Center for Islamic Economics and Finance, QFIS, HBKU