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Islamic Şukūk

Juristic Fundamental Study

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Islamic Şukūk Juristic Fundamental Study

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Abstract:

Şukūk are leading financial instruments that held the concern of the investors, institutions and governments globally. Due to the increased turnouts of *şukūk* issuance worldwide, these turnouts increase the need to fundamental research effort that is sharpening this financial instrument and clarifying its characteristics, features, and general rulings of *Sharī'ah* regarding it. To meet these objectives, this research aims to provide a sample-rating index that rates the *Sharī'ah* compliance through the issuance process of *şukūk*. In this research, the descriptive methodology is followed in order to give details about *şukūk* stands from the definition and ends with the application. The historical methodology is also followed, from pre-Islam era to the modern time to present an inclusive picture of the development of this tool, and the analytical fundamental methodology to provide the detailed study about the *Sharī'ah* requirements, which are applied within the sample rating index. *Şukūk* play significant role in developing the countries' economy and the institutions' financial situation and position; moreover, *şukūk* have proven its economical viable. This thesis ends up by providing a sample of *Sharī'ah* rating index, to rate the compliance of *Sharī'ah* and fulfillment of the *Sharī'ah* requirements to ensure correct, adjusted, and smooth application.

Keywords: *şukūk*, Islamic Bonds, Rating Index, *Sharī'ah* Compliance, Stock, Shares.

الصكوك الإسلامية

دراسة فقهية أصولية

إبراهيم نبيل إبراهيم

قسم الدراسات الإسلامية باللغات الأجنبية (اللغة الإنجليزية)، كلية اللغات والترجمة، جامعة الأزهر، القاهرة، مصر.

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الملخص:

تناول هذا البحث تعريفات الصكوك لغوياً واصطلاحياً، من خلال تناول العريفات اللغوية والقاموسية والمنقولة عن استخدامات العرب، والتعريفات الاصطلاحية من خلال عرض تعريفات الهيئات والمنظمات والهيئات الرقابية الرئيسية، وأيضاً تعريف الخبراء في الشريعة والمتخصصين في الاقتصاد والمالية وقوانين سوق المال، وقد خلُصت إلى جمع كل تلك التعريفات لإخراج تعريف موحد شامل يغطي كامل الجوانب الأساسية. ثم تناولت خصائصها وأهميتها ودورها في أسواق المال. وهو: أن الصكوك هي وثائق متساوية القيمة وأوراق مالية تتوافق مع أحكام ومبادئ الشريعة الإسلامية وأحكام الفقه الإسلامي، تمثل ملكية شائعة لحاملها في أصول ومنافع وخدمات أو ملكية في أصل حقيقي وموجودات مشروع بعينه أو نشاط استثماري خاص، ويستحق حملة الصكوك عوائد وتدفعات نقدية متولدة عن النشاط استثماري حقيقي وجائز مرتبط بشكل مباشر بأصول الصكوك.

الكلمات المفتاحية: الصكوك، السندات الإسلامية، مؤشر التصنيف، الالتزام بالشريعة، البورصة، الأسهم.

NOTED ON TRANSLATION AND TRANSLITERATION SYSTEM

The translation of the Quranic Verses is copied from the translation of Muhammad Habib Shakir.

Brill's simple Arabic transliteration system

Version 1.0, 14 December 2010 / By Pim Rietbroek

Arabic	Symbol	Arabic	Symbol	Arabic	Symbol
ا	a, ā	ط	ṭ	ى	ā
ب	b	ظ	ẓ	ي	ī
ت	t	ع	‘, ’	و	ū
ث	ṭ	غ	ġ	َ	a
ج	ġ	ف	f	ِ	i
ح	ḥ	ق	q	ُ	u
خ	ḫ	ك	k	أ	ai
د	d	ل	l	ؤ	au
ذ	ḏ	م	m	آ	īy
ر	r	ن	n	ؤ	ūw
ز	z	هـ	h	ة	a, ah, āh, at, āt
س	s	و	w, ū	ال	‘al, al
ش	š	ي	y, ī		
ص	ṣ	ء	’		
ض	ḏ				

INTRODUCTION

One of the most significant financial features nowadays is asset securitization. Transformation of the assets into tradable certificates that present an ownership of financial papers, stocks, securities and Islamic instruments (Şukūk) becomes one of the financial solutions that open the opportunities in market. Securitization has many shapes and kinds; Şukūk are the most famous of these kinds. Şukūk are widely popular. Mostly known in the financial local, regional and international markets are floating Şukūk for trade in large quantities and in large numbers values, especially in the witnessed economic revival, which we see in Islamic banking solutions.

In spite of the Şukūk high demand which is increasing every day and the large amounts of money which are specialized and allocated to fund and support this idea, and the international turnout in issuing, structuring, and investing in şukūk, the disagreement among scholars and economists according to the legal ruling, evidences and mechanism are still running and escalating. Among them, we can find supporters and refusers, while everyone has his reasons and proofs. Therefore, scholars, researchers and jurists have to work on clearing this issue and pay a lot of attention to it to disclose the details, tips and tricks of these Şukūk.

The term "*Şākk*" has multi uses according to time and place. In the first days of Islam, the word *Şākk* refers to certificate that guarantee a right and ownership. Nowadays, the word "*Şākk*", financially, refers to a document representing common shares that verify the ownership of their holder of assets (goods, benefits, rights, or mix of all of that) which already existed, under existence or will be existed by proceeds of subscription; it is issued under a Shari'ah compliance contract and takes its rules.

Şukūk and contracts are strongly connected. The contract represents the agreement document, while the *Şākk* represents the ownership. The trade and financial benefits are common and popular in every society and group of people. For example, in Hammurabi laws in Mesopotamia, which are considered as the oldest and one of the first written laws on the Earth. We can find many articles that arrange transactions, contracts and agreements between labors and owners. In the prophet Muhammad –blessings and peace be upon him- time, the commerce and trade were very active. The prophet reached Madinah and its people was used to make forward buying agreements, *salam*, for one year and two years. *Mudārabah* (Speculation) was also will be known in the time of *Umar Ibn Al-Ḥattab* – May Allah be pleased with him-.

In this research, real current issue will be presented. Hence, In March / 2018, Egypt, Şukūk law first draft was issued and published. Therefore, the historical background of Şukūk will be introduced. It will be followed by the development of this product through different eras and geographical regions until reaching its current presented deal by studying the linguistic, fundamental, and juristic areas.

Objectives of the Study:

- Studying economic issues from Islamic perspective and codifying them with laws that agree with Islamic jurisprudence.
- Clarify the meaning of the term "*Şākk*" in transaction and commerce in different languages, eras, and lands.
- Covering historical, juristic, and linguistic categories, and the disagreement among scholars and economists relating Şukūk
- In addition to cover şukūk benefits, characteristics, features and types that agree with Sharī'ah rules and principles, plus its relation with securitization.
- Raise the level of awareness of the *Sharī'ah* limits in transactions related to şukūk.
- Provision of a scientific material that aims to teach people the types and kinds of şukūk; in addition, the way to have benefits of it and invest their savings by this tool.
- Increasing Access to material that combines between the historical foundation and the legal rulings of şukūk, from the starting points until the present time throw different eras and lands.

Research problem:

Today, şukūk have a high share in capital markets in the whole world. They usually take the title "Islamic". They get different types, mechanisms and names. Şukūk are the Islamic substitution of conventional bonds that are well known. In this research, the most known kinds of şukūk will be handled. The research investigates the meaning, mechanism, applying, legal ruling, and finally the ruling of Zakat.

Research Methodology:

- 1- Descriptive methodology: the research handles the topic of şukūk in details starting from their foundation to the present time. It also tackles the types, mechanisms and forms of şukūk.
- 2- Analytical methodology: the research is analyzing şukūk definitions, characteristics, features and shari'ah rulings. Finally, it will be examined to show about the *Zakat* and its obligation on şukūk. By the end of this research I will reflect the shari'ah requirements in the international standards and Islamic fiqh bodies resolutions and acts of law.
- 3- Historical methodology: It over-views the history of şukūk and their development throw history eras, since the first stage of Islamic State until the present forms of şukūk.

Research Questions:

- What are the semantics of the term "*Şākk*" in transactions in different languages, eras, and lands?
- There is disagreement among scholars, jurists, and economists according the legal ruling, therefore, what are the general Sharī'ah rulings of şukūk issuance, regarding every phase, to avoid ambiguity and instability?
- What are the Problems that Şukūk are facing in the markets from Sharī'ah perspective?
- What is the relation between şukūk and the process of issuing şukūk (Taşkeek)?
- What are the differences between şukūk and conventional bonds and shares?
- Can we develop a Sharī'ah-rating index, which concerns to rating the level of Sharī'ah compliance performance?

Literally review:

Since the Islamic finance industry is developing rapidly, and since it is an infant industry, hence studying the related subjects and areas of interests become an obligation. The Islamic finance Industry is a leading experience in the whole world economics. Şukūk is one of the significant tools that comply with Sharī'ah rules and principles. It is a flexible tool, which plays significant role on different scales, i.e. governments, sovereigns, and corporates. Because of the growth of the projects that depend and issue şukūk for the financing purposes, this tool captures the world and

markets attention. Occasionally, everyday there is new markets that adopt şukūk and use it as an investment tool from all around the world.

Şukūk is a tool with special characteristics and features that give it superiority that cause this worldwide diffusion. Şukūk is a financial tools, the majority of studies describe the financial, accounting, pricing, listing, trading and maturity aspects of şukūk from the market practices scoop. Because of the paucity of the resources that cover the Sharī'ah aspects and Sharī'ah compliance role during the şukūk issuance process, the research to cover these aspects is introduced. The Sharī'ah requirements and fiqhi rulings related to şukūk will be focused on. In addition, the application of these requirements and the precautionary measures to prevent non-compliance general and in every detail in particular.

1. The Definition of Şukūk:

The term şukūk is the plural form of *Şākk*. This term *Şākk* can be examined from different perspectives; linguistic, from lexical and traditions, and idiomatic, from the perspectives of economists, jurists, and the capital market laws and practices.

1.1. The linguistic definition:

The origins of term *Şākk* go to the Persian language (چك) (*Al-Zabīdī*, 1993), which means, *Şākk*, transfer, and the banking cheque (*Hassaneen*, 1982). In Arabic Language, the term *Şākk* is to 'severe beating in a wide object' (*Omar*, 2008), 'hit', 'strike', or 'close' (*Al-Zabīdī*, 1993). It also refers to 'book which is written for escrow' (*Al-Zabīdī*, 1993), 'contract', or 'livelihood' because it was get paid in written way (*Ibn Manzūr*, 1300H). The term *Şākk* may refer to a document that proofs an amount of money for its holder (*Al Mu'jam Al Waseet*, 2004). It may also mean the book that is written in transactions (*Omar*, 2009).

1.1.1. Şukūk in Arab's Traditions:

In traditions, the term *Şākk* used to refer to contract or document the proofs a right, title, or ownership. This meaning starts in the *Uthmani* State, where the state used to allocate lands for the citizens by writing a document of title assigned to them. Sakk in this meaning is still in use until today, especially in bedouin districts in Saudi Arabia and United Arab Emirates.

1.2. The Idiomatic Definitions of şukūk:

The term *Şākk* can be examined idiomatically through there different perspective; jurisprudence, economy, and capital market.

1.2.1. From Shari'ah scholars perspective:

From jurist point of view, şukūk can be defined as been published by The International Sharī'ah Research Academy for Islamic Finance (ISRA) in 2012, it was reported that scholars used the term *Şākk* for a written document that confirms a transaction, stipulating the rights and conditions of the contracting parties (*Sairally*, 2017).

1.2.2. From Economists and Islamic finance professionals perspective:

Economists and Islamic finance professionals give different definitions of şukūk from their specialisation perspective. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), one of Islamic finance key organizations, allocates a special Sharī'ah and accounting standards for şukūk. The Sharī'ah standard is standard number (17), named "investment şukūk". In this standard şukūk is defined as Investment şukūk are certificates of equal value presenting undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity, however, this is true after receipt of the employment of funds received for the purpose for which the şukūk were issued (AAOIFI, 2010).

1.2.3. From Capital Market Laws perspective:

Jordanian Capital Market Law defines şukūk as following: "documents of equal value presenting common ownership shares of the project, issued in the names of their owners in return for funds they provide to finance, implement, and utilize the project and achieve a yield for a period set in the issuance prospectus, in accordance with the principles of Islamic Sharia and its provisions." (SDC, 2012).

Şukūk, in the Egyptian Capital Market Law, are defined as: securities at a nominal value certificates of equal values, issued for limited period less than thirty (30) years. It is presenting, common title to shares (ownership) and rights in tangible assets, usufructs and services, equity of a given project, or cash flow that has been specified in the general memorandum or the information note, depending on conditions (Act 17, 2018).

1.3. The inclusive Definition of Şukūk:

To conclude, we can make an overall definition that combines all previous perspectives. However, Şukūk are financial certificates, that comply with *Sharī'ah* and *Fiqh* rules and principles, present a partial ownership to Şukūkholders in tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity. Şukūkholders accrue returns and cash flows of the financing generated from real and permissible investments, linked directly to the assets of Şukūk.

1.4. The Definition of *Taskeek* or Securitization:

The process of issuing certificates that present debts and loans (generally any type of obligations). The issued certificates (or securities) can be traded in financial markets like stocks and bonds. In this sense, the underlying debts and loans are actually traded as assets. The securitization process need not be limited to debts, but rather it can be undertaken to divide ownership of tangible assets, usufruct (*manfa'ah*) or both into units of equal value, and then to issue securities presenting their values, (*The Financial Encyclopedia*).

The term *taşkeek* comes from şukūk and refers to the process of issuing şukūk to be sold to public. Professionals may define it as dividing the ownership of assets, usufruct or both of them into equal value units, then issue şukūk by the total value of it, (Mirah, 2008).

The term securitization is more like the term *taşkeek*. However it relates more to issuance of bonds that present load or debt. It is defines in Cambridge Dictionary as to borrow money in the form of bonds which can then be traded on financial markets, (Cambridge).

1.5. Features of Şukūk, (Sairally, 2017):

- **Sharī'ah compliant contract:**

Issuance of şukūk must be structured under Sharī'ah compliant contract. The Sharī'ah Standard by AAOIFI that entitles "Investment Şukūk" states: Investments şukūk are issued on the basis of Sharī'ah-nominated contract in accordance with the rules Sharī'ah that govern their issuance and training, (AAOIFI, 2010).

Şukūk use Sharī'ah contracts such as sale, lease, agency and partnership as the underlying relationship between the issuer and the investors to enable the latter to enjoy *halāl* (permissible) returns on their investment.

- **Common Share:**

Şukūk presents a common share in the ownership of the underlying assets of the investment şukūk and not a debt that the certificate holder owes to the issuer. The assets underlying the issuance of şukūk can be in the form of non-monetary assets, usufructs, services or a mixture of these along with intangible rights, debts and monetary assets, (AAOIFI, 2010).

- **Economic Activities:**

Şukūk should be linked with real sector activities where the funding raised is invested in. Examples include infrastructure financing such as water, power, telecommunications, transportation and public works; project financing such as real estate development and business expansion; asset acquisition such as equipment, airplanes, ships and buildings; and social investments such as social welfare projects, financial and social inclusion initiatives, and education and health projects.

- **Sharī'ah Compliance:**

The investment activities that are run by the outcome fund of şukūk initial public offering (IPO) or the prospectus, must comply with Sharī'ah rules and requirements:

- **Result Profits, Returns, or Rents:**

The investment activities would result profits, returns, or rents periodically. These returns are distinguished to the şukūk-holders regularly.

The Sharī'ah standard by AAOIFI state in this respect: (şukūk) entitles the owners to a share of returns as stated in the subscription prospectus. In the case of loss, it also requires that the owners bear the losses in proportion to the certificates owned by them.

- **Sharing Returns and Bearing Losses:**

As all the products of Islamic finance that are established and build on the basis of profit and risk sharing, şukūkholders share in the return and outcome of the investment activities and practices as been presented in the IPO or the prospectus. On the other hand, şukūkholders also share any losses according to their held shares.

- **Tradability of Şukūk:**

In the case of negotiable şukūk, it is permissible for the issuer to undertake, through the prospectus of issue, to purchase at market value, after the completion of the process of issue, any certificate that may be offered to him, however, it is not permissible for the issuer to undertake to purchase the şukūk at their nominal value.

The certificates may be traded through any known means, that do not contravene the rules of the Sharī'ah, such as registration, electronic, means or actual transmission by the bearer to the purchaser.

The matter of şukūk will be discussed in details in the third section based on its connection to the Sharī'ah rules and requirements.

- **Şukūk presents varying tenures:**

Şukūk can be of various tenures, structured as short-, medium-, long-term and even perpetual instruments. In most jurisdictions, it is common to structure şukūk with medium- to long-term tenures.

2. The development of Şukūk:

2.1. The History of sukūk:

2.1.1. The Islamic Era, pre-1979:

Şukūk, in its linguistic prospective as a financial document, were used from the prophet Muhammad –Peace be upon him- era and even before. In Hammurabi laws which were written in Mesopotamia to take the function of constitutions nowadays. These laws were written by the Iraqi King Hammurabi (1750-1793 B.C) to create for his people and country a frame of laws and uniform legislations. There are two main chapters in these laws organize the sales, investment, and financial relations and right between the money owner and the speculator; these articles, number (100-107), presents the rights of each party and guaranteed these rights by some procedures.

In the era of Prophet Muhammad –blessings and peace be upon him-, the financial instruments got more advanced frames. During this time the bills of exchange, cheque, and assignments were founded for the needs of society. Dealing with bill of exchange is known since the time of companions of the Prophet –peace be upon him. There is a narration which stated that *'ataa' ibn Al-zūbayr* –May Allah bless him- used to receive silver from the merchants of Makkah, then he would give them in exchange a document by which they can exchange in *Al-Kūfah* and *Al-Başrah*, the Iraqi cities. Also, *Ibn 'abbas* –May Allah bless him- used to do the same, to get silver in Makkah and give them a redeemable documents to be exchanged in *Al-Kūfah*, (Siraj, 1988).

There was another form of şukūk that was well-known during the time of Prophet Muhammad -peace be upon Him-, the food vouchers, (*Al-āuwada*, 2011). These vouchers were given to workers and employees to deserve their salaries from merchants of the state treasury. *Yahya* related to me from *Mālik* that he had heard that receipts (şukūk) were given to people in the time of *Marwān* ibn al-Hakam for the produce of the market at *al-Jār*. People bought and sold the receipts (şukūk) among themselves before they took delivery of the goods. *Zayd ibn Thabit* and one of the Companions of the Messenger of Allah (May Allah bless him and grant him peace), went to *Marwān ibn al-Hakam* and said, *Marwān!* Do you make usury *halāl?*" He said, I seek refuge with Allah! What is that?' He said, These receipts (şukūk) which people buy and sell before they take delivery of the goods. *Marwān* therefore sent a guard to follow them and to take them from people's hands and return them to their owners, (Muwaţţā', 1985).

There is a piece of sample on the display at the British Museum on a shape of obelisk returns to 1140. In which the following words are written: "By the Name of You *Raḥim*. Please, *Al-'akbar Abu 'al-kḥier* pay for the holder of this (form) a hundred *dinar* (gold) for the treasury of the country (AB. 1451 – July/August. 1140", (Mufeed 'al-raḥman, 2006).

2.1.2. The modern period, after-1980:

Şukūk development in its financial present form, stated in 1980 in Pakistan. There was an experience of issuing interest-free, negotiable, corporate financing in the form of Participation Term Certificates. There şukūk was carrying the partnership form şukūk, based on *mudārabah* structure. It enables investors to partake in the profits of the investee business for specified term of the certificate.

There was calls tell that Malaysia is the first country that tries to issue şukūk in its modern and financial developed essence, which is known in the capital markets now. In 1983, The Government of Malaysia (GOM) had an early experience in issuing short-term instrument for Islamic liquidity management for Islamic financial institutions as well as for long-term investment purposes. The maturities of these instruments tend to range between one to 10 years.

Jordan also had an early experience. It was in 1988. It was following the issuance of muqāradah bond Title Act in 1981, in addition to the resolution of General *Iftaa'* Department (GID) in 1988. This Title Act was considered as the first specialized law about şukūk, (Miş'al, 2015).

2.1.3. Sukūk from 1990:

During the period 1990-2000, the overall şukūk market was at its nascent stage. According to RAM Ratings (2013), this period was characterized as the awareness-building phase by stakeholders, including potential issuers and investors. In Malaysia, much attention was given at that time to the introduction of the şukūk market, the players, the concept, the mechanism, as well as the structures of şukūk.

Another type of şukūk issued in Sudan comprised the Government Investment Certificates (GIC) which are medium-term securities whereby the Ministry of Finance acts as the originator and the money raised is invested in specific projects financed by the government. The Central Bank of Sudan also issues Central Bank Ijara Certificates (CIC) which are backed by the buildings it owns.

2.1.4. Sukūk after 2001 up to present:

The period from 2001 to the present state of the şukūk market marked its actual emergence, with Malaysia taking the lead in market developments. The period can be further sub-divided into segments to present the evolution in the market:

2001-2004: When there have been several government issuances, a rise in Ijarah sukūk, a move from asset-backed to asset-based sukūk, development of blended assets sukūk, and a shift from local issuances to international, rated and listed sukūk.

2005-2007: When there has been acceleration in the growth of the market size, greater innovation in contracts utilised and an increase in the number of players joining the sukūk market; and

2008-2015: When the market initially recorded a slump during the financial crisis but later accelerated in growth, moving towards globally accepted, highly competitive and innovative structures.

2.2. Classifications of Şukūk:

Şukūk can be classified in various manners. The bases for şukūk classification can either be the contracts underlying the şukūk structures, the nature and type of asset presented by the şukūk, or the şukūk's technical and commercial features. The first method is to look into the underlying contracts used in transactions, (Dusuki and Mokhtar, 2010).

There is a classification based on the function of the contract upon which the şukūk are issued. It can be classified under sale-based şukūk, participation-based şukūk, leasing-based şukūk, and agency-based şukūk.

2.2.1. Asset-based Şukūk:

That is raising finance where the principal is covered by the capital value of the asset but the returns and re-payments to şukūk holders are not directly financed by these assets. Asset-based structures in Islamic finance are found in cases where, given the applicable legal environment, the ownership rights over the underlying asset may not reliably result in an effective right of possession in case of default, and in consequence, the şukūk holders need to have a right of recourse to the originator in case of default, (IFSB, 2009).

2.2.2. Asset- backed Şukūk:

That is raising finance where the principal is covered by the capital value of the asset but these assets directly finance the returns and re-payments to şukūk holders. According to being asset backed or asset based, şukūk can be more similar to bonds or shares so we explain the structure of both of them. Asset-backed structures involve ownership rights in the underlying assets (either physical or the usufruct of such assets, excluding all types of receivables or debts except where these form a minority part of a pool of assets), whereas in conventional asset-backed structures the asset backing takes the form of collateral rights, not ownership rights, (IFSB, 2009).

2.3. Difference between şukūk, conventional bonds, and shares from firms prospective and clients prospective:

Element	Şukūk	Bond	Share
Ownership	ownership in Sharī'ah-compliant assets, usufructs, service, intangible assets	Debt - No assets required	Ownership in a corporation - No assets required
The relation between issuer and investor	based on Sharī'ah-compliant and investment contract	based on lending relationship	based on ownership rights
Returns	- Periodic payment present a percentage of actual profits (generated from real investment activities) - Not guaranteed	- fixed interest and returns - guaranteed	- These returns are not guaranteed by the firm - Not guaranteed
Risk	Bearing risk of losses	Not bearing any risks	Bearing risk of losses
Investment activities	finance Sharī'ah-compliant activities	no need for investment activities	It is all about financing needs
Security	Secured by the ownership rights on the underlying assets	Generally unsecured, there are exceptions	Unsecured
Tradability in secondary market	can be traded	selling bonds can be traded in the second market as sale of debt	can be traded
Şukūk holders In the General Assembly	cannot have a chair in the firm or institution General Assembly	cannot have a chair in the firm or institution General Assembly	can have a chair in the firm or corporation General Assembly

Responsibilities of the şukūk- holders	Defining duties related to the underlying assets	No responsibility	Company affairs, limited to the extent of holding in the company
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2.4. Types of şukūk Regarding the contract:

Şukūk are varied, based on the type of contract and the financing formula. In the next part, all types of şukūk will be reviewed in brief.

Şukūk Al-Ijarah (Leasing şukūk): certificates with equal value upon issuance, indivisible, and tradable with the commercial and trade routes. It presents a common share in an ownership of leased assets, usufruct, or services of defined or described assets. (Mirah, 2008).

Şukūk Al-murābahah: certificates with equal value, indivisible, and tradable in the stock market. It is issued for financing the *murābahah* goods and products. Under this issuance, the ownership of the asset is to be transferred to the şukūkholders.

Şukūk Al-Musharakah (Partnership Şukūk): certificates with equal value, indivisible, and tradable in the stock market. It is issued for financing establishing a project, developing an existed project, or financing an activity. The project or the asset of the activities are owned by the şukūkholders each within the limits of the share. These şukūk are managed under the concept of partnership.

Sukūk Al-Mudārabah or Muqaradah (Spectulation Sukūk): certificates with equal value, indivisible, and tradable in the stock market. It is issued for financing establishing a project, developing an existed project, or financing an activity. The project or the asset of the activities are owned by the şukūkholders each within the limits of the share. These şukūk are managed under the concept of *muḍārabah*.

Sukūk Al-Salam (Forward-sale Sukūk): certificates with equal value and indivisible. It is issued to collect the capital of the sale. The product or the commodities are owned by

the şukūkholders. So that, the şukūkholders are the buyer (*Muslem*), thus, the issuer is the seller (*Muslem 'alāyih*).

Sukūk Al-'istisna' (Manufacturing Sukūk): certificates with equal value and indivisible. It is issued to use the underwriting outcomes to financing manufacturing a commodity, which is owned by the şukūkholders.

Sukūk Al-wakalah bi al'istithmar (investment agency sukūk): partnership certificates that represent projects or investments are managed under agency, by appointing and agent on behalf of şukūkholders.

Sukūk Al-Muzara'ah (Planting Sukūk): certificates with equal value and indivisible. It is issued to use the underwriting outcomes to financing a planting based project. Şukūk holders owns part of the harvest.

3. The Sharī'ah Requirements:

The Sharī'ah requirements will be touch upon in this chapter. This chapter will initiate with general Sharī'ah requirement for financial and related to financial transactions all. This part will address the prohibition of Ribā, Ġharar, and Maysir generally. Then it will express their relevance to şukūk particularly.

Further, the şukūk special Sharī'ah requirements will be took up, through five areas by presenting the general rulings related to each area. I mean by general rulings, which are applicable on every type of şukūk without giving certain reference to certain type, only when necessary. It will be started with the general Sharī'ah ruling on şukūk issuance, by mentioning what is related to the contracts, the relation between the contractual parties, sharing rule, the prospectus, and risk.

Then the general rulings that are related to the profit distributions, losses and returns will be expressed. After though the rulings of şukūk tradability will be stated.

By the end of this chapter, the roles of zakat on şukūk will be recited by presenting the general rulings, roles of the institution, and the şukūk-holder in this regard after classifying şukūk based on the purpose of it. This part will be ended by giving a clue about zakat calculation treatment.

3.1. General Sharī'ah requirements for Şukūk in particular and for Transactions in general:

The main reason behind all the incorporated forms of prohibitions in Islamic law of contracts is the prevalence of justice and parity. Basically, the illicit forms of exchange encumber the triumph of the *maqāsid al-Sharī'ah* (objectives of Islamic law); that is why different types of unmerited and exploitative commercial practices are proscribed in Sharī'ah. The prohibitions are generally based on the purpose of levelling the playing field to protect the interests of weaker parties; establishing justice and fairness; ensuring mutual benefit for the parties involved and for society in general; and promoting social harmony. Based on these reasons, the prohibitions of *ribā* (interest), *ġharar* (uncertainty), *maysir* (gambling), and other practices, like *safqatayn fi safqah* or *bay'atayn fi bayah* (combination of two transactions in one) have been enacted by Islamic law on contracts. They are discussed as follows.

3.1.1. Prohibition of Ribā, (Sairally, 2017):

Ribā is one of the important elements that would render a şukūk transaction void. This concept is identical to the concept of usury or interest, which includes any percentage of excess over the principal amount, whether high or low, due to the extension of repayment time.

Ribā is an Arabic word that technically refers to "an increase of money without an exchange for. Which means a *Mu'awada* (barter) money for money". (*Al-Nasafi*, 1997). *Ribā* occurs in both debt transactions (*ribā al- duyoun*) and sale contracts (*ribā al-buyū*), which are explained in Exhibit 4.2.

3.1.1.1. Categories and Types of Ribā:

Scholars categorize *ribā* based on its sources into two main types (see figure no.1 below), namely, (*Al-Deeban*, 2011):

- i. *Ribā al-* (*ribā* in debts): *Al- duyoun* are delineated as the sum accumulated in compensation for deferment in the repayment of a debt. This is exactly the essence of interest or usury. The definition means that a loan or debt should be repaid in precisely the same amount, and there should not be any compensation for the time factor arising from delay in its repayment. Since this type of *ribā* is explicitly mentioned and prohibited in the Qur'ān, it is also called *ribā al-Qur'an*. Some scholars further divide *ribā al-duyoun* into two categories:
 - a. *Al-qard* (loan): An increment in lending or borrowing over and above the principal amount that is agreed between the contracting parties. This type of *ribā* occurs when a lender lends USD 100 to a borrower for one year on the condition that the borrower would repay USD 110.
 - b. *Ribā al-jahiliyyah* (*ribā* of the era of ignorance, pre Islamic era): An increment over and above the principal amount due to deferment in paying the debt. Which arises from either a loan or deferred sale contract. This is the practice of pre-Islamic Arabs, where the creditor increases the debt amount if the debtor is unable to make settlement on the maturity date.
- ii. *Ribā al-Buyū*: *Ribā al-buyū'* occurs in sale or exchange contracts where a commodity--from the six *ribawi* items mentioned by Prophet Muhammad (SAW), that is, gold, silver, wheat, barley, dates and salt-is being exchanged for the same commodity in an unequal amount and/or with delayed delivery. The well known hadith of the Prophet (SAW) which prohibits the excess

and/or deferment in sales involving ribā items is the one reported by 'Ubadah ibn al-Şamit, as follows:

«الدَّهَبُ بِالذَّهَبِ وَالْفِضَّةُ بِالْفِضَّةِ وَالْبُرُّ بِالْبُرِّ وَالشَّعِيرُ بِالشَّعِيرِ وَالتَّمْرُ بِالتَّمْرِ وَالْمِلْحُ بِالْمِلْحِ مِثْلًا بِمِثْلِ سِوَاءٍ بِسِوَاءٍ يَدًا بِيَدٍ فَإِذَا اخْتَلَفَتْ هَذِهِ الْأَصْنَافُ فَبِيعُوا كَيْفَ شِئْتُمْ إِذَا كَانَ يَدًا بِيَدٍ»

“Gold [is to be paid) for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt, like for like, and equal for equal, (payment should be made) hand to hand. And when these species are (exchanged with different [species) then exchange in any manner you like as long as it (the delivery) is on spot” (*Muslim, hadith no. 1587*).

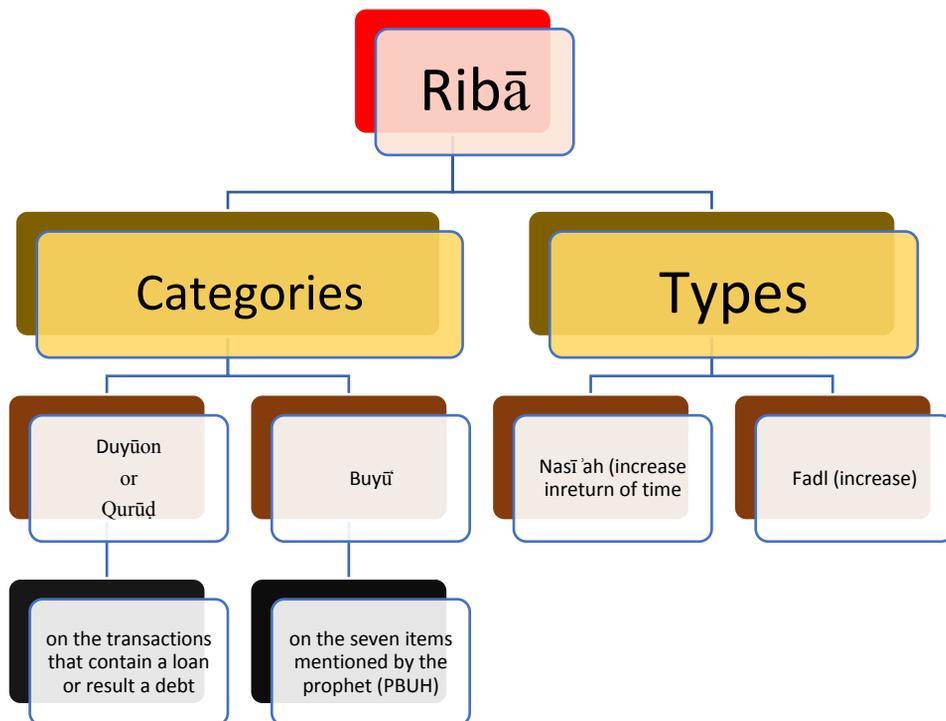


Figure 1: Ribā

3.1.1.2. Relevance of Ribā in Şukūk:

As discussed above, receiving or paying interest on a debt falls under ribā, and thus, is categorically prohibited under Islamic law. A conventional bond is a certificate representing liability of its issuer to pay the principal amount of loan along with interest to the bondholders. In view of that, the IFA-OIC in its Resolution No. 60 (11/6 dated March 1990 resolved that conventional bonds and

other interest-bearing securities are impermissible instruments. Their issuance purchase and trading are accordingly not allowed.

Extending the analogy to şukūk, if şukūk are structured in a way similar to conventional bond, then it would also be declared as impermissible. That why the IFA-OIC in its Resolution No. 178 (4/19) dated April 2009 resolved: that it is not allowed in an investment şukūk (mushārkah or mudārabah) for şukūk manager to pre-assure or to have a preunderstanding that he would go loans or donations to the şukūk holders if the actual profit was short of the expected profit. Allowing this would make the profit fixed and guaranteed, without exposing the şukūk holders to the liability or risk of the investment. Hence, their profit would become an increase in the investment (principal amount without any compensation, which is tantamount to ribā. Similarly, AAOIFI (2015) in Sharī'ah Standard No. 17 (5/2/2) mentions that the issuer of şukūk can redeem negotiable şukūk at market value or at any agreed price on the date of redemption; however, redemption of şukūk at the nominal value is not allowed. The Standard (5/1/8/7) iterates that the issuer of şukūk cannot assume any obligation to compensate the şukūk holders up to the nominal value of şukūk, nor can he guarantee a certain percentage of profit. It is due to the fact that this will cause the profit to be fixed and guaranteed, thus the profit would become an increase in the principal amount (investment) without any compensation, which resembles an interest-based transaction.

Moreover, the proceeds of şukūk should not be utilised in ribā-based activities. AAOIFI (2015) Sharī'ah Standard No. 17 (5/1/8/4 & 5/1/8/5) and Part 3, Chapter 2 of the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework (2015) require that the proceeds raised through the şukūk issuance be utilised in Sharī'ah-compliant investments or projects.

3.1.2. Prohibition of Ġharar (Uncertainty):

Ġharar is another prohibition in a şukūk transaction that is categorically proscribed in Sharī'ah. It literally means danger, uncertainty, fraud, deception, delusiveness, peril and fallaciousness. Although Ġharar has been technically defined in many ways, they can all be summarized by three concepts:

- 1- Uncertainty;
- 2- Ignorance;
- 3- Being unknown.

In the context of şukūk, Ġharar can be understood as the uncertainty in the nature, the object or the characteristics of subject matter of the transaction which

affects the outcome of that transaction. *Ġharar* is an element of risk or hazard arising from information asymmetry that could render a şukūk transaction void. It can basically lead to deception, fraud, dispute and conflict of interest among parties of the şukūk transaction. *Ġharar* may arise in a variety of forms, which are listed below:

- Uncertainty related to a contract or a structure of a şukūk transaction;
- Uncertainty in the underlying asset of şukūk; or
- Uncertainty in price.

3.1.2.1. Types of Ġharar:

The difficulty of completely removing Ġharar from a contract has been acknowledged by Sharī'ah scholars. By nature, Ġharar may exist in any contract, hence they opine that only excessive Ġharar should be prohibited. Based on this fact, they have accordingly further discussed and classified Ġharar into three categories: Ġharar yasīr (trivial uncertainty), Ġharar mutawassit (average uncertainty), and *Ġharar fāhish* (excessive uncertainty). The prohibition of Ġharar is mentioned in a ḥadīth that says:

نهى رسول الله ﷺ عن بيع الحصاة، وعن بيع الغرر

The Messenger of Allah (peace be upon him forbade sale by throwing stones and Ġharar transactions (Muslim, ḥadīth no. 1513).

3.1.2.2. Relevance of Ġharar in Şukūk:

In the context of şukūk, any kind of ambiguity and lack of transparency in documentation that may lead to a dispute among the contracting parties can be considered as uncertainty in the şukūk transaction. For instance, an issuer of sale-based şukūk offers a third-party guarantor for the payment of price of the underlying asset of şukūk to the şukūk holders, but it does not specify any certain person or entity to provide the guarantee within the şukūk prospectus this would cause Ġharar that would invalidate the transaction.

Moreover, *Ġharar* may exist in the structure of şukūk, its underlying assets, and price. That is why, in order to ensure that şukūk are free from any impermissible *Ġharar*, many standards and resolutions have been proposed, and rules have been enacted. For instance, AAOFI (2015) in Sharī'ah Standard No. 17 (5/1/8) emphasizes that the prospectus of şukūk should offer full disclosure of necessary information and that the transaction is transparent. It requires that the prospectus include all contractual conditions, rights, obligations and statuses of

parties involved in şukūk issuance and structuring It should also explicitly mention the Sharī'ah contract used in the structure of şukūk and the commitment of all the parties involved to follow rules and principles of Sharī'ah in the issuance of şukūk and implementation of the project throughout the investment period. It should additionally disclose information about the underlying assets and utilization of şukūk proceeds.

3.1.3. Prohibition of *Maysir* (gambling):

Maysir is another prohibition in şukūk transactions imposed by the Sharī'ah. It is a type of *Qimar* (gambling). However, in Sharī'ah, the term *maysir* is used for all kinds of gambling activities. Technically, it can be defined as a competition or game where a bet is placed such that the loser has to pay something to the winner. It is considered a zero-sum game in that one party's gain is equivalent to another's loss.

It is also defined as betting on pure uncertainty, or carrying out a transaction where gain is conditional upon risk or chance from both sides of the exchange.

Maysir is explicitly denounced by the Sharī'ah as Allah says in the Qur'ān:

قال الله تعالى: (يَا أَيُّهَا الَّذِينَ آمَنُوا إِنَّمَا الْخَمْرُ وَالْمَيْسِرُ وَالْأَنْصَابُ وَالْأَسْرَارُ أَمْثَلُ الشَّيْطَانِ فَاجْتَنِبُوهُ لَعَلَّكُمْ تُفْلِحُونَ (90) إِنَّمَا يُرِيدُ الشَّيْطَانُ أَنْ يُوقِعَ بَيْنَكُمُ الْعَدَاوَةَ وَالْبَغْضَاءَ فِي الْخَمْرِ وَالْمَيْسِرِ وَيَصُدَّكُمْ عَنْ ذِكْرِ اللَّهِ وَعَنِ الصَّلَاةِ ۗ فَهَلْ أَنْتُمْ مُنْتَهُونَ (91)) [المائدة: ٩٠-٩١]

Allah says: "Oh, you who have believed, indeed, intoxicants, gambling, [sacrificing on] stone altars [to other than Allah], and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful. Satan only wants to cause between you animosity and hatred through intoxicants and gambling and to avert you from the remembrance of Allah and from prayer. So will you not desist? (Qur'an, 5: 90-91).

Transaction that involves *maysir* usually exhibits some characteristics that are less immoral and unethical. For example, it allows wealth transfer through all means, without the consent of all the contracting parties. It contributes generating new risk. It facilitates earning at the expense of others. It is a sum game. It facilitates earning without justified efforts and appropriate efforts. It inculcates enmity and jealousy among the contracting parties. In addition, conclusion of this type of contract is reliant on highly uncertain factors that are entirely out of the contracting parties' control.

3.1.3.1. Relevance of Maysir in Sukūk:

From the above discussion, it can be construed that any transaction that involves excessive ġharar and gaining at the expense of others falls under the scope of maysir. If these two elements are found in a şukūk transaction, then it would become a gambling instrument. That is why it is vital to ascertain that any şukūk transaction is free of those two elements. For example, if şukūk are structured in a way that they resemble a game of chance or even to replicate conventional financial derivatives, they would not be allowed to be issued and traded.

3.2. The Şukūk Specific Sharī'ah Requirements:

Defining the related Sharī'ah requirements and controls is significant. Since şukūk are new and innovated Islamic financial instrument in the market, due to, it needs to identify the Sharī'ah controls to ensure harmonization and standardization of the transactions and conducts. However, şukūk is a significant tool that attracts the attention of a wide segment of society; therefore, determination of Sharī'ah limits and controls becomes as priority.

Due to the diversity of şukūk and the types of şukūk and its transactions, adjusting the legal rulings and Sharī'ah principles. However, setting the disciplines of dealing in is critical. For all mentioned previously reasons, the Jurisprudential (*Fiqhi*) Academies and bodies, Fatwa regulators, and Sharī'ah supervisory boards of the Islamic financial institutions and the supporting institutions of the Islamic Finance Industry, attempt to issue resolutions, pronouncements, and recommendations and develop standards to govern this matter.

3.2.1. The Zakat on the Investment Şukūk:

3.2.1.1. Proofs on the obligation of Zakat on şukūk:

Zakat is an obligation on the invested money on general. However, şukūk is a kind of invested money that Zakat is an obligation on, as been presented in the following:

From Qur'an: The lawfully acquired funds are subject to Zakat, if it meets the conditions of Zakat that are stated by scholars of Sharī'ah, Fiqh, and Islamic finance.

Allah says: "Take alms out of their property, you would cleanse them and purify them thereby, and pray for them; surely your prayer is a relief to them; and Allah is Hearing, Knowing." (9: 103).

قال الله تعالى: ((حُذُّ مِنْ أَمْوَالِهِمْ صَدَقَةٌ تُطَهِّرُهُمْ وَتُزَكِّيهِمْ بِهَا وَصَلَّ عَلَيْهِمْ إِنَّ صَلَاتَكَ سَكَنٌ لَهُمْ)) [التوبة: ١٠٣]

Allah says: "And those in whose wealth there is a fixed portion (24) For him who begs and for him who is denied (good) (25)" (70: 24-25).

قال الله تعالى: ((وَالَّذِينَ فِي أَمْوَالِهِمْ حَقٌّ مَعْلُومٌ (24) لِلسَّائِلِ وَالْمَحْرُومِ (25))) [المعارج: ٢٤ - ٢٥]

From Sunnah: There are many texts and aḥadith that been reported and narrated by the prophet of Allah –Allah's blessings and peace be upon him-.

In the narration of Ibn `Abbas he said: When Allah's Messenger (ﷺ) (Allah's blessings and peace be upon him) sent Mu`adh to Yemen, he said (to him), "YOU are going to people of a (Divine) Book. First of all invite them to worship Allah (alone) and when they come to know Allah, inform them that Allah has enjoined on them, five prayers in every day and night; and if they start offering these prayers, inform them that Allah has enjoined on them, the Zakat. And it is to be taken from the rich amongst them and given to the poor amongst them; and if they obey you in that, take Zakat from them and avoid (don't take) the best property of the people as Zakat."

عَنْ ابْنِ عَبَّاسٍ - رَضِيَ اللَّهُ عَنْهُمَا أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ لَمَّا بَعَثَ مُعَاذًا - رَضِيَ اللَّهُ عَنْهُ - عَلَى الْيَمَنِ قَالَ: «إِنَّكَ تَقْدُمُ عَلَى قَوْمٍ أَهْلُ كِتَابٍ، فَلْيَكُنْ أَوَّلَ مَا تَدْعُوهُمْ إِلَيْهِ عِبَادَةَ اللَّهِ، فَإِذَا عَرَفُوا اللَّهَ فَأَخْبِرْهُمْ أَنَّ اللَّهَ قَدْ فَرَضَ عَلَيْهِمْ خَمْسَ صَلَوَاتٍ فِي يَوْمِهِمْ وَلَيْلَتِهِمْ، فَإِذَا فَعَلُوا، فَأَخْبِرْهُمْ أَنَّ اللَّهَ فَرَضَ عَلَيْهِمْ زَكَاةً {تُؤْخَذُ} مِنْ أَمْوَالِهِمْ وَتُرَدُّ عَلَى فُقَرَائِهِمْ، فَإِذَا أَطَاعُوا بِهَا فُحِّدْ مِنْهُمْ، وَتَوَقَّ كِرَائِمَ أَمْوَالِ النَّاسِ». (صحيح البخاري).

From Fiqh: There is an Conon sum of opinions among scholars on the obligation of paying zakat if it meets the conditions of zakat.

According to the first conference that been held by Zakat House in the Ministry of *Awqaf*, Kuwait, It states the rules of Zakat that are obligated on the shares and bonds that are subject to Zakat.

This resolution is applied very much on şukūk. Scholars of Sharī'ah has divided the şukūk zakat calculation from one time to another according to the intention of the holder and its kind. To the following:

First: if the şukūk-holder is investing in şukūk for short-term investment and trading, buying and selling for the profit. The zakat is obligated as subject to Zakat as commercial goods

Second: if the şukūk-holder is investing in şukūk for making profits and gains, it would subject to Zakat of durable goods.

4. The Reflection of Sharī'ah Requirements in Sukūk Standards, Fiqhi Bodies Resolutions, Laws and Acts, and Prospectus

Hence *Şukūk* are Islamic financing tool and instrument, so its commitment to the Sharī'ah requirements, rule and principals is a must for the sake of the sound and successful application and public trust and confident. Through the next samples, I will present how *Şukūk* professional standards by AAOIFI, IFSB, and Dubai Financial and Market Laws present and detail the related Sharī'ah requirement. I will also include the resolutions by Islamic Fiqh Academy (IFA) and Islamic Fiqh Council (IFC-MWL) which subjected *Şukūk*. After, IPOs and prospectus will be examined to present the Sharī'ah requirements related point and articles. I will finish by suggesting a sample model for a Sharī'ah Rating index to measure the issuance process fulfilment of Sharī'ah requirements, rules and principles in the *Şukūk*.

4.1. The proposed Sukūk Sharī'ah Rating Sample index Model:

This research ends with giving a proposed sample to rate the şukūk Sharī'ah compliance. This proposal focuses and rating just the Sharī'ah aspects. The rating is applied on every phase of şukūk from issuance until the maturity and redemption. It will cover the aspects of risk, compliance, accounting, legal, documental, trading, distribution, business, activities, assets, management, and so on from Sharī'ah angle.

Conclusion:

In this research, the first chapter presents, the definition of şukūk from different perspectives. I have examined the economists, experts of capital market, and scholar's perspectives as well. There was a try to mix all these definitions in order to harmonize and standardize a definition that all perspectives can agree upon in attempting to make it inclusive and showing all şukūk features.

In the second chapter, this research states the historical development of *şukūk*, from pre-1978 and until the present day. Then it moved to state classifications of *şukūk*, which is classified under two main categories: asset-based and asset backed.

This thesis which is the base of this paper concluded to introduce a sample of an index that focus on rating the sharia compliance through all phases of issuance. This proposed index aims to cover different aspects from sharia perspective. It rates *şukūk* from 5 different rating criteria.

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