



**Accounting and Auditing Organization for Islamic Financial Institutions  
(AAOIFI)**

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

*In the name of Allah, the Beneficent, the Merciful*

*Praise be to Allah, and peace and blessings on His Noble Prophet and  
on his family and Companions*

As to what follows:

The Shari'ah Board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), in view of the increased use of Sukuk worldwide, the public interest in them, and the observations and questions raised about them, studied the subject of the issuance of Sukuk in three sessions; first, in al-Madinah al-Munawwarah, on 12 Jumada al-Akhirah 1428 AH (27 June, 2007), second, in Makkah al-Mukarramah, on 26 Sh'aban 1428 AH (8 September, 2007), and third in the Kingdom of Bahrain on 7 and 8 Safar 1429AH (13 and 14 February, 2008).

Following the meeting of the working group, appointed by the Board, which met in Bahrain, on 6 Muharram 1429AH (15 January, 2007), which was also attended by a significant number of representatives from various Islamic banks and financial institutions, the working group presented its report to the Shari'ah Board.

After taking into consideration the deliberations in these meetings and reviewing the papers and studies presented therein, the Shari'ah Board - while re-affirming the rules provided in the AAOIFI Shari'ah Standards concerning Sukuk - advises Islamic financial institutions and Shari'ah Supervisory Boards to adhere to the following matters when issuing Sukuk:

**First:** Sukuk, to be tradable, must be owned by Sukuk holders, with all rights and obligations of ownership, in real assets, whether tangible, usufructs or services, capable of being owned and sold legally as well as in accordance with the rules of Shari'ah, in accordance with Articles (2)<sup>1</sup> and (5/1/2)<sup>2</sup> of the AAOIFI Shari'ah Standard (17) on Investment

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<sup>1</sup> 2. Definition of Sukuk: 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



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Sukuk. The Manager issuing Sukuk must certify the transfer of ownership of such assets in its (Sukuk) books, and must not keep them as his own assets.

**Second:** Sukuk, to be tradable, must not represent receivables or debts, except in the case of a trading or financial entity selling all its assets, or a portfolio with a standing financial obligation, in which some debts, incidental to physical assets or usufruct, were included unintentionally, in accordance with the guidelines mentioned in AAOIFI Shari'ah Standard (21) on Financial Papers.

**Third:** It is not permissible for the Manager of Sukuk, whether the manager acts as Mudarib (investment manager), or Sharik (partner), or Wakil (agent) for investment, to undertake to offer loans to Sukuk holders, when actual earnings fall short of expected earnings. It is permissible, however, to establish a reserve account for the purpose of covering such shortfalls to the extent possible, provided the same is mentioned in the prospectus. It is not objectionable to distribute expected earnings, on account, in accordance with Article (8/8)<sup>3</sup> of the AAOIFI Shari'ah Standard (13) on Mudaraba, or to obtaining project financing on account of the Sukuk holders.

**Fourth:** It is not permissible for the Mudarib (investment manager), sharik (partner), or wakil (agent) to undertake {now} to re-purchase the assets from Sukuk holders or from one who holds them, for its nominal

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or special investment activity, however, this is true after the receipt of the value of the Sukuk, the closing of the subscription and employment of funds received for the purpose for which the Sukuk were issued.

<sup>2</sup> 5/1/2 It is permissible to issue certificates for (to securitize) assets that are tangible assets, usufruct and services by dividing them into equal shares and issuing certificates for their value. As for debts owed as a liability, it is nor permissible to securitize them for the purpose of trading.

<sup>3</sup> 8/8 The Mudarib is entitled to a share of profit as soon as it is clear that the operations of the Mudaraba have led to the realization of a profit. However, this entitlement is not absolute, as it is subject to the retention of interim profits for the protection of the capital. It will be an absolute right only after distribution, i.e. when actual or constructive valuations take place. It is permissible to distribute the realized profit among the parties on account, in which case the distribution will be revised when actual or constructive valuation takes place. The final distribution of profit should be made based on the selling price of the Mudaraba assets, which is known as actual valuation. It is also permissible that the profit be distributed on the basis of constructive valuation, which is valuation of the assets on the basis of fair value. Receivables shall be measured at the cash equivalent, or net realizable, value, i.e. after the deduction of a provision for doubtful debts. In measuring receivables, neither time value (interest rate) nor discount on current value for extension of period of payment shall be taken into consideration.



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value, when the Sukuk are extinguished, at the end of its maturity. It is, however, permissible to undertake the purchase on the basis of the net value of assets, its market value, fair value or a price to be agreed, at the time of their actual purchase, in accordance with Article (3/1/6/2)<sup>4</sup> of AAOIFI Shari'ah Standard (12) on Sharikah (Musharaka) and Modern Corporations, and Articles (2/2/1)<sup>5</sup> and (2/2/2)<sup>6</sup> of the AAOIFI Shari'ah Standard (5) on Guarantees. It is known that a Sukuk manager is a guarantor of the capital, at its nominal value, in case of his negligent acts or omissions or his non-compliance with the investor's conditions, whether the manager is a Mudarib (investment manager), Sharik (partner) or Wakil (agent) for investments.

In case the assets of Sukuk of al-Musharaka, Mudarabah, or Wakalah for investment are of lesser value than the leased assets of "Lease to Own" contracts (Ijarah Muntahia Bittamleek), then it is permissible for the Sukuk manager to undertake to purchase those assets - at the time the Sukuk are extinguished - for the remaining rental value of the remaining assets; since it actually represents its net value.

**Fifth:** It is permissible for a lessee in a Sukuk al-Ijarah to undertake to

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<sup>4</sup> 3/1/6/2 It is permissible for a partner to issue a binding promise to buy, either within the period of operation or at the time of liquidation, all the assets of the Sharika as per their market value or as per agreement at the date of buying. It is not permissible, however, to promise to buy the assets of the Sharika on the basis of face value.

<sup>5</sup> 2/2 Guarantees in trust (fiduciary) contracts

2/2/1 It is not permissible to stipulate in trust (fiduciary) contracts, e.g. agency contracts or contracts of deposits, that a personal guarantee or pledge of security be produced, because such a stipulation is against the nature of trust (fiduciary) contracts, unless such a stipulation is intended to cover cases of misconduct, negligence or breach of contract. The prohibition against seeking a guarantee in trust contracts is more stringent in Musharaka and Mudaraba contracts, since it is not permitted to require from a manager in the Mudaraba or the Musharaka contract or an investment agent or one of the partners in these contracts to guarantee the capital, or to promise a guaranteed profit. Moreover, it is not permissible for these contracts to be marketed or operated as a guaranteed investment.

<sup>6</sup> 2/2/2 It is not permissible to combine agency and personal guarantees in one contract at the same time (i.e. the same party acting in the capacity of an agent on one hand and acting as a guarantor on the other), because such a combination conflicts with the nature of these contracts. In addition, a guarantee given by a party acting as an agent in respect of an investment turns the transaction into an interest-based loan, since the capital of the investment is guaranteed in addition to the proceeds of the investment, (i.e. as though the investment agent had taken a loan and repaid it with an additional sum which is tantamount to riba). But if a guarantee is not stipulated in the agency contract and the agent voluntarily provides a guarantee to his clients independently of the agency contract, the agent becomes a guarantor in a different capacity from that of agent. In this case, such an agent will remain liable as guarantor even if he is discharged from acting as agent.



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purchase the leased assets when the Sukuk are extinguished for its nominal value, provided he {lessee} is not also a partner, Mudarib, or investment agent.

**Sixth:** Shari'ah Supervisory Boards should not limit their role to the issuance of fatwa on the permissibility of the structure of Sukuk. All relevant contracts and documents related to the actual transaction must be carefully reviewed {by them}, and then they should oversee the actual means of implementation, and then make sure that the operation complies, at every stage, with Shari'ah guidelines and requirements as specified in the Shari'ah Standards. The investment of Sukuk proceeds and the conversion of the proceeds into assets, using one of the Shari'ah compliant methods of investments, must conform to Article (5/1/8/5)<sup>7</sup> of the AAOIFI Shari'ah Standard (17).

Furthermore, the Shari'ah Board advises Islamic Financial Institutions to decrease their involvements in debt-related operations and to increase true partnerships based on profit and loss sharing in order to achieve the objectives of the Shari'ah.

In the end, all praise is due to Allah, Lord of all the Worlds!

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<sup>7</sup> 5/1/8/5 The prospectus must state that the investment of the realized funds and the assets into which the funds are converted will be undertaken through Shari'ah-compliant modes of investment.