COMMON STRUCTURES OF SUKUK

BY: MUGHEES SHAUKAT

1.1. INTRODUCTION:

Recent innovations in Islamic finance have changed the dynamics of the Islamic finance industry. Specially in the area of bonds and securities the use of Sukuk or Islamic securities have become increasingly popular in the last few years, both as a means of raising government finance through sovereign issues, and as a way of companies obtaining funding through the offer of corporate sukuk. Sukuk has developed as one of the most significant mechanisms for raising finance in the international capital markets through Islamically acceptable structures[1]. Multinational corporations, sovereign bodies, state corporations and financial institutions use international sukuk issuance as an alternative to syndicated financing.

The essence of Sukuk is to provide Shariah compliant instruments for investment which do not involve interest and excessive uncertainty (Gharar). The Sukuk market has been a primary area of growth, providing an avenue for the short and medium-term placement of funds by investors. This development has been fuelled not only by the desire of institutions to raise funds in a Shariah compliant manner but also by investor demand for such products. Sukuk are entitlement to rights in certain assets inclusive of some degree of asset ownership. These Sukuk are more commonly based on Ijarah, Salam, Mudaraba, Musharaka, and Murabaha, Istisna mode of finance and on the basis of pooled portfolios. Sukuk promises the global financial arena many opportunities for managing the capital needs of the emerging economies of the Islamic world in a manner consistent with Islamic values[2].

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which issues standards on accounting, auditing, governance, ethical, and Shariah standards has laid down 14 different types of Sukuk. (This particular write-up sets out 7 types of most commonly

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[1]Blair, William (2005), *"Legal Issues in the Islamic Financial Services Industry"* paper presented in a Seminar on Legal Issues in the Islamic Financial Services Industry, Kuwait City.

[2]Billah, Mohd. Ma'sum. (2006). *Shar'iah Standard of Business Contract*. Kuala Lumpur, Malaysia: A.S. Noordeen.

practiced sukuk structures which are favored in the market and explains each structure and set up in great detail). Hence the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) released an exposure draft of its Shariah standards concerning Sukuk in November 2002. According to the exposure draft: “Investment Sukuk are certificates of equal value representing, after closing subscription, receipt of the value of the certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs, and services, or equity of a given project or equity of a special investment activity”. Exposure Draft of AAOIFI Shariah Standard No. 18, p.4.

The salient features of the different types of investment Sukuk identified in the exposure draft are summarized in the tables below. Firstly, there are certificates of ownership in leased assets.

1.2. Expanded List of Sukuk

The salient features of the different types of investment Sukuk identified in the exposure draft are summarized in the tables below.

Firstly, there are certificates of ownership in leased assets.

Types of Investment Sukuk	**Description of Investment Sukuk**	**Shariah rulings & requirements**
1. **Certificates of ownership in leased assets**	These are certificates that carry equal value and are issued either by the owner of a leased asset or an asset to be leased by promise, or by his financial agent, the aim of which is to sell the asset and recover its value from subscription, in which case the holders of the certificates become owners of the assets.	**Issuer:** sells a leased asset or an asset to be leased on promise. **Subscribers are:** The subscribers are buyers of the asset. **Mobilized Funds:** are the purchase price of the asset **Certificate Holders:** become the owners of the assets jointly with its benefits and risks.

Also, the draft discusses the viability of certificates of ownership in usufructs.

2. **Certificates of ownership of usufructs**	These certificates have various types, including the following:	
2.A. **Certificates of ownership of usufructs of existing assets.**	These are documents of equal value that are issued either by the owner of usufruct of an existing asset or a financial intermediary acting on the owner's behalf, with the aim of leasing or subleasing this asset or receive rental from the revenue of subscription. In this case, the holders of the certificates become owners of the usufruct of the asset.	**Issuer:** sells usufruct of an existing asset. **Subscribers are:** buyers of the usufructs **Mobilized Funds:** are the purchase price of the usufructs **Certificate Holders**: become the owners of the usufructs jointly with its benefits and risks.
2.B. **Certificates of ownership of usufructs to be made available in the future as per description.**	These are documents of equal value issued for the sake of leasing assets that the lessor is liable to provide in the future whereby the rental is recovered from the subscription income, in which case the holders of the certificates become owners of the usufruct of these future assets.	**Issuer:** sells usufruct of an asset to be made available in the future as per specification **Subscribers are:** buyers of the usufructs. **Mobilized Funds:** from subscription are the purchase prices of the usufructs. **Certificate Holders:** become the owners of the usufructs jointly with its benefits and risks

Following that is an outline of the applicability of certificates of ownership of services of a specified supplier or of services to be made available in the future.

3. **Certificates of ownership of services of a specified supplier.**	These are documents of equal value issued for the sake of providing or selling services through a specified supplier (such as educational programmes in a nominated university) and obtaining the value in the form of subscription income, in which	**Issuer:** sells services. **Subscribers are:** buyers of the services. **Mobilized Funds:** are the purchase price of the

	case the holders of the certificates become owners of the services.	Services. **Certificate Holders:** are entitled to sell all types of usufructs in addition to the funds of reselling such usufructs.
4. **Certificates of ownership of services to be made available in the future as per description.**	These are documents of equal value issued for the sake of providing or selling services through non-existing supplier with the description of the subject matter (such as educational programs of a specific quality, schedule, duration, etc. without mentioning the educational institution) and obtaining the value in the form of subscription income, in which case the holders of the certificates become owners of the services.	

Furthermore, the draft continues to outline the specifics pertaining to certificates on Salam, Istisna and Murabaha contracts before discussing the applicability of certificates of participation contracts.

5. Salam certificates.	These are documents of equal value issued for the sake of mobilizing Salam capital and the items to be delivered on Salam basis are owned by the certificate holders.	**Issuer:** sells Salam commodity **Subscribers are:** buyers of that Commodity. **Mobilized Funds:** are the Purchase price of the commodity, which the Salam capital. **Certificate Holders:** are entitled to the Salam commodity, the

		selling price or the price of selling the on parallel Salam basis, if any.
6. Istisna certificates.	These are documents that carry equal value and are issued with the aim of mobilizing the funds required for producing a certain item and the items to be produced on Istisna basis are owned by the certificate holders.	**Issuer:** is the manufacturer (supplier). **Subscribers are:** the buyers of the item to be produced **Mobilized Funds:** are the cost of the item **Certificate Holders:** are entitled to the item or the selling price of the manufactured item.
7. Murabahah certificates.	These are documents of equal value issued for the purpose of financing the Murabahah commodity and the certificate holders become the owners of the Murabahah commodity.	**Issuer sells:** Murabahah commodity **Subscribers are:** the buyers of that commodity **Mobilized Funds:** are the purchasing cost of the commodity **Certificate Holders:** owns the Murabahah commodity or the price of selling it.
8. Participation certificates.	These are documents of equal value issued with the aim of using the mobilized funds for establishing a new project or developing an existing one or financing a business activity on the basis of one of partnership contracts. The certificate holders become the owners of the project or the assets of the activity as per their respective shares. The participation certificates may be managed on the basis of Musharakah or Mudarabah or	

	through an investment agent.	

8.A. Participation certificates managed on the basis of Musharakah contract.	These are documents representing projects or activities that are managed on the basis of Musharakah by appointing either one of the parties or any other party to manage the operation.	**Issuer:** is the inviter to a partnership in a specific project or activity **Subscribers are:** the partners in the Musharakah contract **Mobilized Funds:** are the share contribution of the subscribers in the Musharakah capital **Certificate Holders:** own the assets of partnership and are entitled to profit, if any.
8.B. Participation certificates managed on the basis of Mudarabah contract.	These are documents that represent projects or activities that are managed on the basis of Mudarabah by appointing mudarib for management.	**Issuer:** is the Mudarib. **Subscribers are:** the capital owners. **Mobilized Funds:** are the Mudarabah capitals. **Certificate Holders:** own the assets of Mudarabah operation and profit share as per agreement. The certificate holders, being the capital providers, bear the loss, if any.
8.C. Participation certificates managed on the basis of investment agency.	These are documents that represent projects or activities that are managed on the basis of investment agency by appointing an agent to manage the operation on behalf of the certificate holders.	**Issuer:** is an investment agent. **Subscribers are:** the principals. **Mobilized Funds:** are the subject matter of investment. **Certificate Holders:** own the assets represented by the certificates with its risks.

Finally, the exposure draft outlines the features of the different agricultural oriented certificates as well as concession certificates.

9. Muzara'a (sharecropping) certificates.	These are documents of equal value issued for the sake of using the mobilized funds in financing a Muzara'a contract. The certificate holders become entitled to a share in the crop as per agreement.	**Issuer:** is the landlord. **Subscribers are:** farmers who invest on the basis of Muzara'a contract. **Mobilized Funds:** are the cultivation costs. **Certificate Holders:** are entitled to a share of the produce of the land as per agreement.

10. Musaqa (irrigation) certificates.	These are documents of equal value issued on the basis of a Musaqa contract for the sake of using the mobilized funds for irrigating trees that produce fruits and meeting other expenses relating to maintenance of the trees. The certificate holders become entitled to a share in the crop as per agreement.	**Issuer:** is the owner of the land that consist of trees **Subscribers are:** those who assume the irrigation process on the basis of Musaqa contract. **Mobilized Funds:** stand as the maintaining cost of the trees. **Certificate Holders:** are entitled to a share in the produce of the trees as per agreement.
11. Mugarasa (agricultural) certificates.	These are documents of equal value issued on the basis of a Mugarasa contract for the sake of using the mobilized funds for planting trees and meeting expenses of the work. The certificate holders become entitled to a share in the land and the plantation.	**Issuer:** is the owner of land that is suitable for planting trees. **Subscribers are:** those who assume the agricultural or horticultural process on the Basis of Mugarasa contract. **Mobilized Funds:** stand as cost of maintaining the plantation. **Certificate Holders:** are entitled

		to a share in both the land and trees as per agreement.
12. Concession certificates.	These are documents of equal value that are issued for the sake of using the mobilized funds to finance execution of a concession offer in which case the certificate holders become entitled to rights associated with the concession.	

1.3. Uses of Sukuk Funds

The most common uses of sukuk can be named as project specific, asset-specific, and balance sheet specific.

a. Project-specific Sukuk

Under this category money is raised through sukuk for specific project. For example, Qatar Global sukuk issued by the Government of Qatar in 2003 to mobilize resources for the construction of Hamad Medical City (HMC) in Doha. In this case a joint venture special purpose vehicle (SPV), the Qatar Global sukuk QSC, was incorporated in Qatar with limited liability. This SPV acquired the ownership of land parcel that was registered in the name of HMC. The land parcel was placed in trust and Ijarah-based Trust Certificates (TCs) were issued worth US$700 million due by October 2010. The annual floating rate of return was agreed at LIBOR plus 0.45 per cent.

b. Assets-specific Sukuk

Under this arrangement, the resources are mobilize by selling the beneficiary right of the assets to the investors. For example, the Government of Malaysia raised US$ 600 million through Ijara sukuk Trust Certificates (TCs) in 2002. Under this arrangement, the beneficiary right of the land parcels has been sold by the government of Malaysia to an SPV, which was then re-sold to investors for five years. The SPV kept the beneficiary rights of the properties in trust and issued floating rate sukuk to investors.

Another example of Asset-specific sukuk is US$250 million five-year Ijarah sukuk issued to fund the extension of the airport in Bahrain. In this case the underlying asset was the airport land sold to an SPV.

c. Balance Sheet-specific Sukuk

An example of the balance sheet specific use of sukuk funds is the Islamic Development Bank (IDB) sukuk issued in August 2003. The IDB mobilized these funds to finance various projects of the member countries. The IDB made its debut resource mobilization from the international capital market by issuing US$ 400 million five-year sukuk due for maturity in 2008.

1.4. Structures and Explanation of The most Practiced Sukuk:

Sukuk can be of many types depending upon the type of Islamic modes of financing and trades used in its structuring. However, the most important and common among those are Ijarah, Mudarabah, Musharakah, Murabaha, BBA, Salam, Istisna and even the Hybrid versions. We will now examine one by one the dynamics of each of the most commonly practiced sukuk and try and look into each structure as to how they work.

1.1.1. Ijarah Sukuk.

These are sukuk that represent ownership of equal shares in a rented real estate or the usufruct of the real estate. These sukuk give their owners the right to own the real estate, receive the rent and dispose of their sukuk in a manner that does not affect the right of the lessee, i.e. they are tradable. The holders of such sukuk bear all cost of maintenance of and damage to the real estate. (AAOIFI)

Ijarah sukuk are the securities representing ownership of well defined existing and known assets tied up to a lease contract, rental of which is the return payable to sukuk holders. Payment of ijarah rentals can be unrelated to the period of taking usufruct by the lessee. It can be made before beginning of the lease period, during the period or after the period as the parties may mutually decide. This flexibility can be used to evolve different forms of contract and sukuk that may serve different purposes of issuers and the holders.

Features of Ijarah sukuk

1. It is necessary for an ijarah contract that the assets being leased and the amount of rent both are clearly known to the parties at the time of the contract and if both of these are known, ijarah can be contracted on an asset or a building that is yet to be constructed, as long as it is fully described in the contract provided that the lessor should normally be able to acquire, construct or buy the asset being leased by the time set for its delivery to the lessee (AAOIFI, 2003: 140-157). The lessor can sell the leased asset provided it does not hinder the lessee to take benefit from the asset. The new owner would be entitled to receive the rentals.

2. Rental in ijarah must be stipulated in clear terms for the firs term of lease, and for future renewable terms, it could be constant, increasing or decreasing by benchmarking or relating it to any well-known variable.

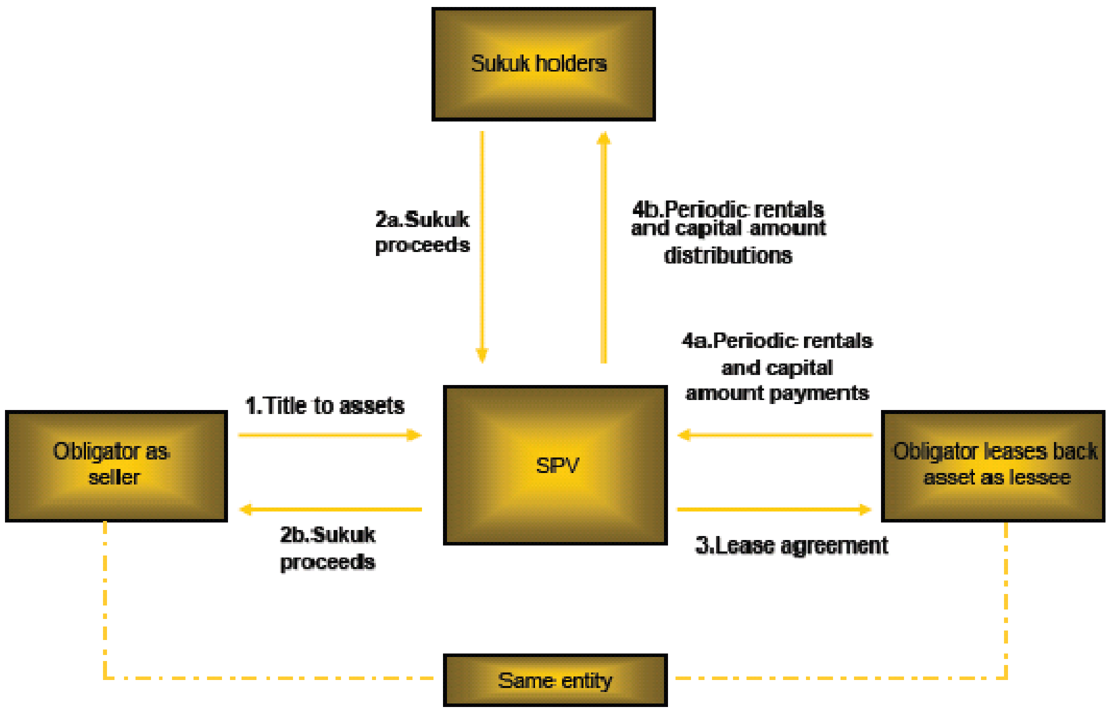
3. As per shariah rules, expenses related to the corpus or basic characteristics of the assets are the responsibility of the owner, while maintenance expenses related to its operation are to be borne by the lessee.

4. As regards procedure for issuance of ijarah sukuk, an SPV is created to purchase the asset(s) that issues sukuk to the investor, enabling it to make payment for purchasing the asset. The asset is then leased to third party for its use. The lessee makes periodic rental payments t the SPV that in turn distributes the same to the sukuk holders.

5. Ijarah sukuk are completely negotiable and can be traded in the secondary markets.

6. Ijarah sukuk offer a high degree of flexibility from the point of view of their issuance management and marketability. The central government, municipalities, awqaf or any other asset users, private or public can issue these Sukuk. Additionally, they can be issued by financial intermediaries or directly by users of the leased assets.

Sukuk al-Ijara transaction structure



Steps involved in the structure.

1. The obligator sells certain assets to the SPV at an agreed pre-determined purchase price.

2a. The SPV raises financing by issuing Sukuk certificates in an amount equal to the purchase price.

2b. this is passed on to the obligator (as seller).

3. A lease agreement is signed between SPV and the obligator fora fixed period of time, where the obligator leases back the assets as lessee.

4.a. SPV receives periodic rentals from the obligator;

4.b. These are distributed among the investors i.e. the Sukuk holders.

5. At maturity, or on a dissolution event, the SPV sells the assets back to the seller at a predetermined value. That value should be equal to any amounts still owed under the terms of the Ijarah Sukuk.

Ijarah Sukuk in Practice.

- US$150 million Serial Islamic Lease Sukuk by First Global Sukuk Inc.

  The US$150 million Islamic Lease Sukuk is part of a US$395 million Serial Islamic Sukuk issuance that Bank Islam (Labuan) Limited has been mandated to arrange by Kumpulan Guthrie Berhad (Guthrie). In December 2000, Kumpulan Guthrie Berhad (Guthrie) was granted a RM1.5 billion (US$400 million) Al-Ijarah Al-Muntahiyah Bit-Tamik by a consortium of banks. The original facility was raised to re-finance Guthrie's acquisition of a palm oil plantation in the Republic of Indonesia. The consortium was then invited to participate as the underwriter/primary subscriber of the Sukuk Transaction.

- US$250 million Sukuk Trust Certificate by BMA International Sukuk Company.

  The Kingdom of Bahrain, acting through the Ministry of Finance and National Economy (in such capacity, the Head Lessor), will lease by way of head lease for a term of 100 years a certain land parcel to the Issuer pursuant to the Al-Ijarah Head Lease Agreement. The Kingdom of Bahrain, acting through the Ministry of Finance and National Economy, (in such capacity, the Sub-Lessee), will lease by way of sub-lease from the Issuer the Land Parcel on the terms set out in the Al-Ijarah sub-Lease Agreement for a period of 5 years commencing on the Closing Date and terminating on the Periodic Distribution Date falling in June 2009. The sub-lease is subject to earlier termination if the trust is dissolved early.

- Sarawak Economic Development Corporation (SEDC) rose financing amounting to US$350 million by way of issuance of series of trust certificates issued on the principle of Sukuk al-Ijarah. For purposes of the proposed Sukuk, SCSI was incorporated on 23 November 2004 as a special purpose company, under the Offshore Companies Act (OCA), 1990 in Labuan. The certificates were issued with a maturity of 5 years and under the proposed structure, the proceeds will be used by the issuer to purchase certain assets from 1st Silicon (Malaysia) Sdn Bhd. Thereafter, the issuer will lease assets procured from 1st Silicon to SEDC for an agreed rental price for an agreed lease period of 5 years. The rental payable by SEDC will be supported by the State Government of Sarawak via a letter of support.

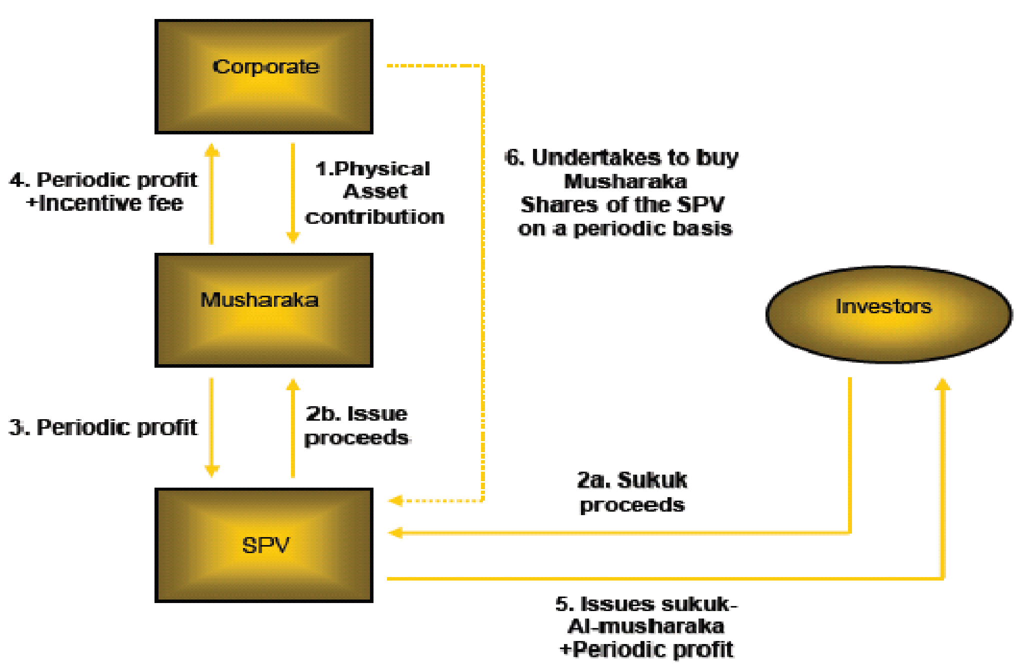
1.4.2. Musharaka Sukuk

These are investment sukuk that represent ownership of Musharaka equity. It does not differ from the Mudaraba sukuk except in the organization of the relationship between the party issuing such sukuk and holders of these sukuk, whereby the party issuing sukuk forms a committee from the holders of the sukuk who can be referred to in investment decisions (AAOIFI).

Musharaka Sukuk are used for mobilizing the funds for establishing a new project or developing an existing one or financing a business activity on the basis of partnership contracts. The certificate holders become the owners of the project or the assets of the activity as per their respective shares. These Musharaka certificates can be treated as negotiable instruments and can be bought and sold in the secondary market.

"These are certificates of equal value issued with the aim of using the mobilized funds for establishing a new project, developing an existing project or financing a business activity on the basis of any partnership contracts so that the certificate holders become the owners of the project or assets of the activity as per their respective shares, with the Musharaka certificates being managed on the basis of participation or Mudaraba or an investment agency." (AAOIFI Standard 17, 3/6).

Sukuk al-Musharaka transaction structure



Steps involved in the structure:

Corporate and the Special Purpose Vehicle (SPV) enter into a Musharaka Arrangement for a fixed period and an agreed profit-sharing ratio. Also the corporate undertakes to buy Musharaka shares of the SPV on a periodic basis.

1 Corporate (as Musharik) contributes land or other physical assets to the Musharaka.
2 a & b. SPV (as Musharik) contributes cash i.e. the issue Proceeds received from the investors to the Musharaka.
3 The Musharaka appoints the Corporate as an agent to develop the land (or other physical assets) with the cash injected into the Musharaka and sell/lease the developed assets on behalf of the Musharaka.
4 In return, the agent (i.e. the Corporate) will get a fixed agency fee plus a variable incentive fee payable.
5 The profits are distributed to the Sukuk holders.
6 The Corporate irrevocably undertakes to buy at a pre-agreed price the Musharaka shares of the SPV on say semi-annual basis and at the end of the fixed period the SPV would no longer have any shares in the Musharaka.

Musharaka Sukuk in Practice

- US$550 million sukuk transaction for Emirates, Dubai's national airline, the seven year deal was a structured on a Musharaka contract. The Musharaka or joint venture was set up to develop a new engineering centre and a new headquarters building on land situated near Dubai's airport which will ultimately be leased to Emirates. Profit, in the form of lease returns, generated from the Musharaka or joint venture will be used to pay the periodic distribution on the trust certificates.

- Sitara Chemical Industries Ltd, a public limited company, made a public issue of profit-and-loss sharing based term finance certificates (TFC's) worth Rs 360 million which were subscribed on 19 and 20 June 2002. The TFC's had a fixed life tenor of five years and profit and loss sharing was linked to the operating profit or loss of the Chemical Division of the company. The Musharaka contract stipulated semi-annual profit distribution on account payment (provisional) on the basis of projections irrespective of profit and loss and the final profit payment was to be determined on the basis of annual audited accounts of the company and adjustments made accordingly.

- Kuwait Finance House (KFH), Liquidity Management Center B.S.C. (LMC) and Al Muthanna Investment Company (MIC), the mandated lead arrangers, have launched the $125 million Lagoon City Musharaka Sukuk in support of the Lagoon City residential and commercial real estate development as part of Kheiran Pearl City project. The 2-year Musharaka Sukuk which is structured as a reducing Musharaka will offer a return of 200 basis points over 6 months US$ LIBOR payable semi-annually and has an average maturity of 1.25 years.

1.4.3. Mudaraba Sukuk:

Mudaraba means an agreement between two parties according to which one of the two parties provides the capital (capital provider) for the other (Mudarib) to work with on the condition that the profit is to be shared between them according to a pre-agreed ratio. Mudaraba certificates: The issuer of these certificates is the Mudarib, the subscribers are the capital providers, and the realized funds are the Mudaraba capital. The certificate holders own the assets of Mudaraba and the agreed upon share of the profits; losses, if any, are borne by capital providers only. Mudaraba Sukuk gives its owner the right to receive his capital at the time the Sukuk are surrendered, and an annual proportion of the realized profits as agreed. They play a vital role in the process of development financing, because it is related to the profitability of the projects.

Mudaraba Sukuk neither yield interest nor entitle owners to make claims for any definite annual interest. This shows that Mudaraba Sukuk are like shares with regard to varying returns, which are accrued according to the profits made by the project. Mudaraba Sukuk must represent a common ownership and entitle their holder to shares in a specific project for which the Sukuk have been issued to fund. A Sukuk holder is entitled to all rights, which have been determined by Shariah upon his ownership of the Mudaraba bond in matters of sale, gift, mortgage, succession and the like. On the expiry of the specified time period of the subscription, the Sukuk holders are given the right to transfer the ownership by sale or trade in the securities market at his discretion. Mudaraba sukuk are used for enhancing public participation in big investment projects.

Salient Features:

Following are the salient features of mudaraba sukuk:

I. Mudaraba sukuk (MS) represent common ownership and entitle their holders share in the specific projects against which the MS has been issued.

II. The MS contract is based on the official notice of the issue of the prospectus which must provide all information required by shariah for the Qirad contract such as the nature of capital, the ratio for profit distribution and other conditions related to the issue, which must be compatible with shariah.

III. The MS holder is given the right to transfer the ownership by selling the deeds in the securities market at his discretion. The sale of MS must follow the rules listed below:

   a. If the mudaraba capital, before the operations of the project, is still in the form of money, the trading of MS would be like exchange of money for money. In that case the rules of bay al-sarf would be applied.
   b. If mudaraba capital is in the form of debt then it must satisfy the principles of debt trading in Islam.
   c. If capital is in the form of combination of cash, receivables, goods, real assets and benefits, trade must be based on market price evolved by mutual consent.

IV. The Manager/SPV who receives the fund collected from the subscribers to MS can also invest his own fund. He will get profit for his capital contribution in addition to his share in the profit as mudarib.

V. Neither prospectus nor MS should contain a guarantee, from the issuer or the manager for the fund, for the capital or a fixed profit, or a profit based on any percentage of the capital. Accordingly;

a) The prospectus or the MS issued pursuant to it, may not stipulate payment of a specific amount to the MS holder,

b) The profit is to be divided, as determined by applying rules of shariah; that is, an amount access of the capital, and not the revenue or the yield; and

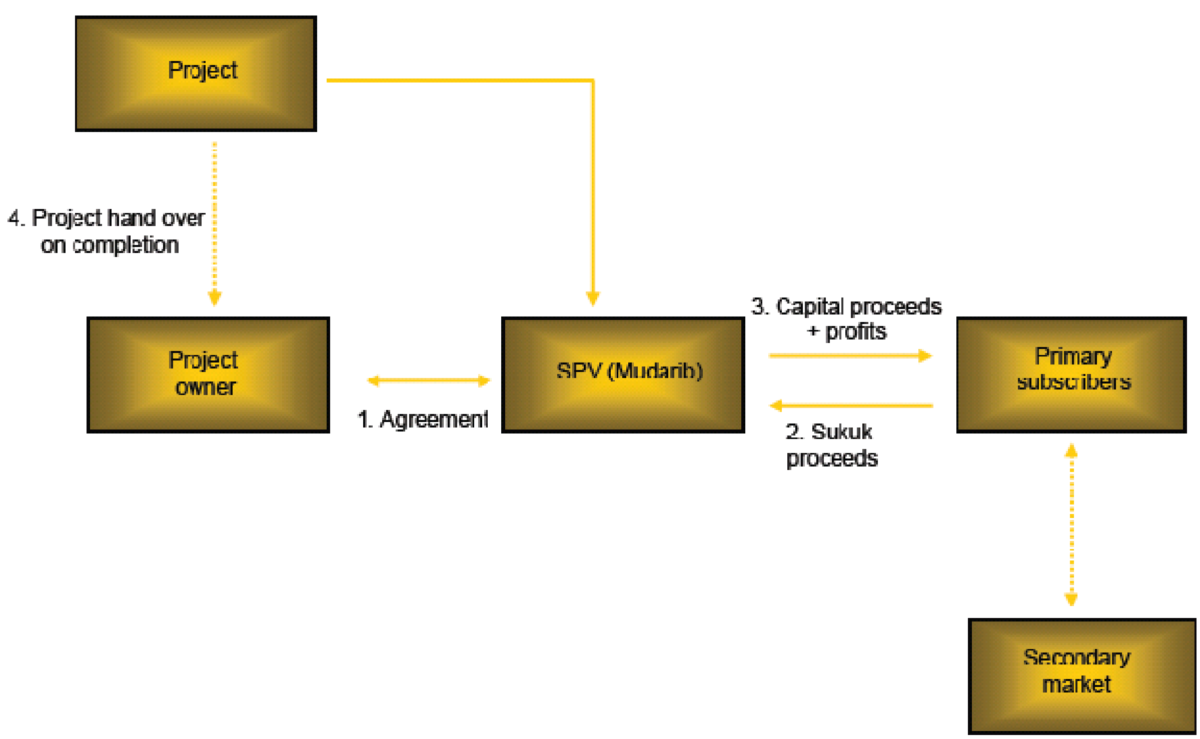
c) Profit and Loss account of the project must be published and disseminated to MS holders.

VI. It is permissible to create reserves for contingencies, such as loss of capital, by deducting from the profit.

VII. The prospectus can also contain a promise made by a third party, totally un-related to the parties to the contract, in terms of legal entity or financial status, to donate a specific sum, without any counter benefit, to meet losses in the give project, provided such commitment is independent of the mudaraba contract.

On the expiry of the specified time period of the subscription, the Sukuk holders are given the right to transfer the ownership by sale or trade in the securities market at his discretion.

Sukuk al-Mudaraba structure



Steps involved in the structure:

1. Mudarib enters into an agreement with project owner for construction/commissioning of project.
2. SPV issues sukuk to raise funds.
3. Mudarib collects regular profit payments and final capital proceeds from project activity for onward distribution to investors.
4. Upon completion, Mudarib hands over the finished project to the owner.

Mudaraba Sukuk in practice.

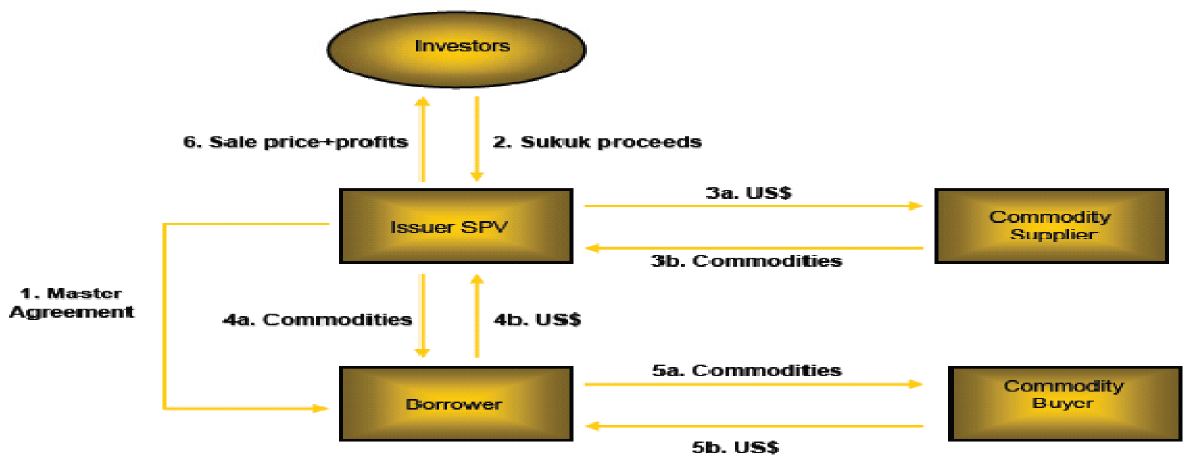
- Shamil Bank of Bahrain raised 360 million Saudi Riyal investment capital through the Al Ehsa Special Realty Mudaraba, representing an investment participation in a land development transaction with a real estate development company in the Kingdom of Saudi Arabia. The investment objective of the Mudaraba is to provide investors with annual returns arising from participation in the funding of a land financing transaction Profits due to investors will be accrued on the basis of returns attained from investing the subscriptions.

1.4.4. Murabaha Sukuk:

Murabaha is basically the sale of goods at a price comprising the purchase price plus a margin of profit agreed upon by both parties concerned. Sukuk al-murabaha are certificates of equal value issued for the purpose of financing the purchase of goods through murabaha so that the certificate holders become owners of the murabaha commodity. The issuer of the certificate is the seller of the murabaha commodity, the subscribers are the buyers of that commodity, and the realized funds are the purchasing cost of the commodity.

The possibility of having legally acceptable Murabaha-based sukuk is only feasible in the primary market. The negotiability of these Sukuk or their trading at the secondary market is not permitted by shariah, as the certificates represent a debt owing from the subsequent buyer of the Commodity to the certificate-holders and such trading amounts to trading in debt on a deferred basis, which will result in riba. Despite being debt instruments, the Murabaha Sukuk could be negotiable if they are the smaller part of a package or a portfolio, the larger part of which is constituted of negotiable instruments such as Mudaraba, Musharaka, or Ijarah Sukuk. Murabaha sukuk are popular in Malaysian market due to a more liberal interpretation of fiqh by Malaysian jurists permitting sale of debt (bai-al-dayn) at a negotiated price.

Sukuk al-Murabaha transaction structure



Steps involved in the structure.

1. A master agreement is signed between the SPV and the borrower.
2. a & b. SPV issues Sukuk to the investors and receive Sukuk proceeds.
3. a & b. SPV buys commodity on spot basis from the commodity supplier.
4. a & b. SPV sells the commodity to the borrower at the spot price plus a profit margin, payable on installments over an agreed period of time.
5. a & b. The borrower sells the commodity to the Commodity buyer on spot basis
6. The investors receive the final sale price and profits.

Murabaha Sukuk in Practice.

- Arcapita Bank, a Bahrain-based investment firm has mandated Bayerische Hypo-und Vereinsbank AG ("HVB"), Standard Bank Plc ("SB") and WestLB AG, London Branch ("WestLB") (together the "Mandated Lead Arrangers"), to arrange a Five Year Multicurrency (US$, € and £) Murabaha-backed Sukuk. Sukuk will have a five-year maturity and proposed pricing three month LIBOR.

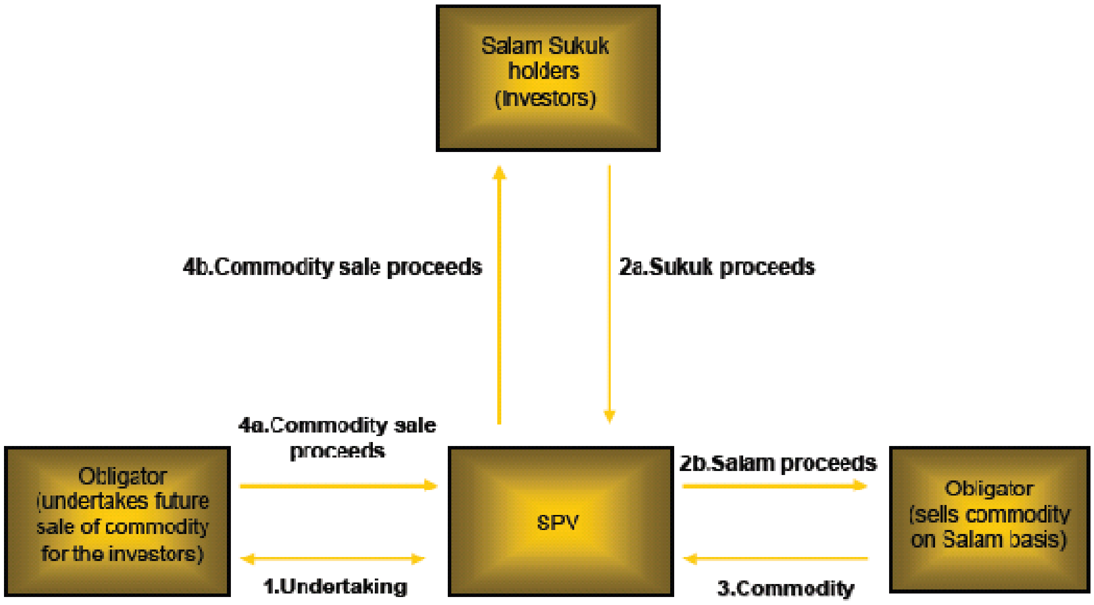
1.4.5. Salam Sukuk.

Salamis the sale of a specific commodity, well defined in its quality and quantity which will be delivered to the purchaser on a fixed date in the future against an advanced full payment of price at spot. Salam sukuk are certificates of equal value issued for the purpose of mobilizing Salam capital so that the goods to be delivered on the basis of Salam come to the ownership of the certificate holders. The issuer of the certificates is a seller of the goods of Salam; the subscribers are the buyers of the goods, while the funds realized from subscription are the purchase price (Salam capital) of the goods. The holders of Salam certificates are the owners of the Salam goods and are entitled to the sale price of the certificates or the sale price of the Salam goods sold through a parallel Salam, if any.

Salam-based securities may be created and sold by an SPV under which the funds mobilized from investors are paid as an advance to the company SPV in return for a promise to deliver a commodity at a future date. SPV can also appoint an agent to market the promised quantity at the time of delivery perhaps at a higher price. The difference between the purchase price and the sale price is the profit to the SPV and hence to the holders of the Sukuk. All standard shariah requirements that apply to Salam also apply to Salam sukuk, such as, full payment by the buyer at the time of affecting the sale, standardized nature of underlying asset, clear enumeration of quantity, quality, date and place of delivery of the asset and the like.

One of the Shariah conditions relating to Salam, as well as for creation of Salam sukuk, is the requirement that the purchased goods are not re-sold before actual possession at maturity. Such transactions amount to selling of debt. This constraint renders the Salam instrument illiquid and hence somewhat less attractive to investors. Thus, an investor will buy a Salam certificate if he expects prices of the underlying commodity to be higher on the maturity date.

Sukuk al-Salam transaction structure



Steps involved in the transaction.

1. SPV signs an undertaking with an obligator to source both commodities and buyers. The obligator contracts to buy, on behalf of the end-Sukuk holders, the commodity and then to sell it for the profit of the Sukuk holders.

2.a. Salam certificates are issued to investors and SPV receives Sukuk proceeds.

b The Salam proceeds are passed onto the obligator who sells commodity on forward basis.

3. SPV receives the commodities from the obligator.

4. a. Obligator, on behalf of Sukuk holders, sells the commodities for a profit.

b. Sukuk holders receive the commodity sale proceeds.

Salam Sukuk in Practice.

Aluminum has been designated as the underlying asset of the Bahrain Government al Salam contract, whereby it promises to sell aluminum to the buyer at a specified future date in return of a full price payment in advance. The Bahrain Islamic Bank (BIB) has been nominated to represent the other banks wishing to participate in the Al Salam contract. BIB has been delegated to sign the contracts and all other necessary documents on behalf of the other banks in the syndicate. At the same time, the buyer appoints the Government of Bahrain as an agent to market the appropriate quantity at the time of delivery through its channels of distribution. The Government of Bahrain provides an additional undertaking to the representative (BIB) to market the aluminum at a price, which will provide a return to al Salam security holder's equivalent to those available through other conventional short-term money market instruments.

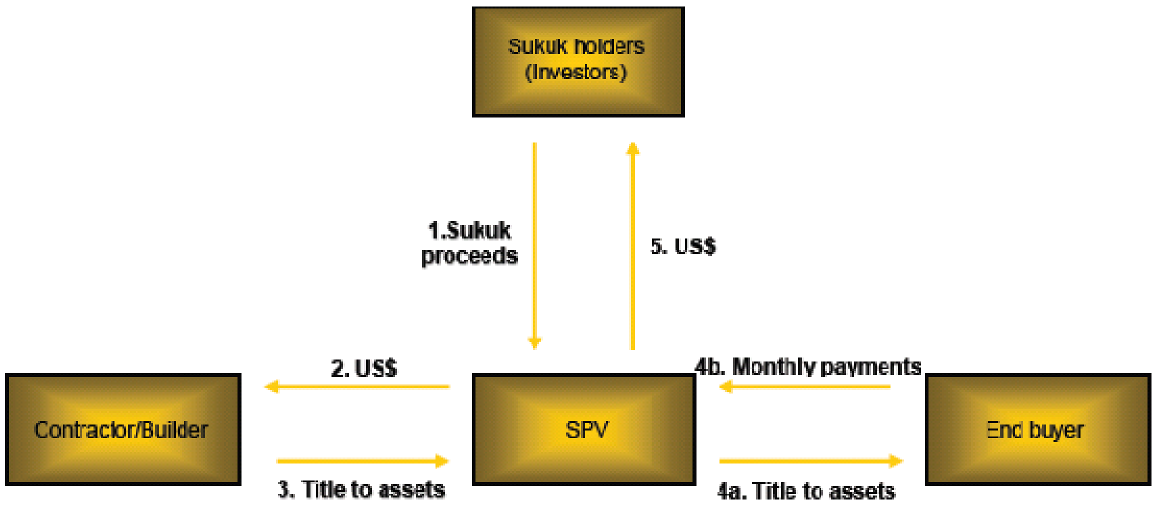
1.4.6. Sukuk al-Istisna:

Istisna is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder agrees to produce or build a well described good or building at a given price on a given date in the future. Price can be paid in installments, step by step as agreed between the parties. Istisna can be used for providing the facility of financing the manufacture or construction of houses, plants, projects, and building of bridges, roads and highways. Istisna sukuk are certificates that carry equal value and are issued with the aim of mobilizing the funds required for producing products that are owned by the certificate holders.

The issuer of these certificates is the manufacturer (supplier/seller), the subscribers are the buyers of the intended product, while the funds realized from subscription are the cost of the product. The certificate holders own the product and are entitled to the sale price of the certificates or the sale price of the product sold on the basis of a parallel Istisna, if any. Istisna Sukuk are quite useful for financing large infrastructure projects. The suitability of Istisna for financial intermediation is based on the permissibility for the contractor in Istisna to enter into a parallel Istisna contract with a subcontractor. Thus, a financial institution may undertake the construction of a facility for a deferred price, and sub contract the actual construction to a specialized firm.

Shariah prohibits the sale of these debt certificates to a third party at any price other than their face value. Clearly such certificates cannot be traded in the secondary market.

Sukuk al-Istisna transaction structure



Steps involved in the structure.

1. SPV issues Sukuk certificates to raise funds for the project.
2. Sukuk issue proceeds are used to pay the contractor/builder to build and deliver the future project.
3. Title to assets is transferred to the SPV.
4. a & b. Property/project is leased or sold to the end buyer. The end buyer pays monthly installments to the SPV.
5. The returns are distributed among the Sukuk holders.

Istisna Sukuk in Practice.

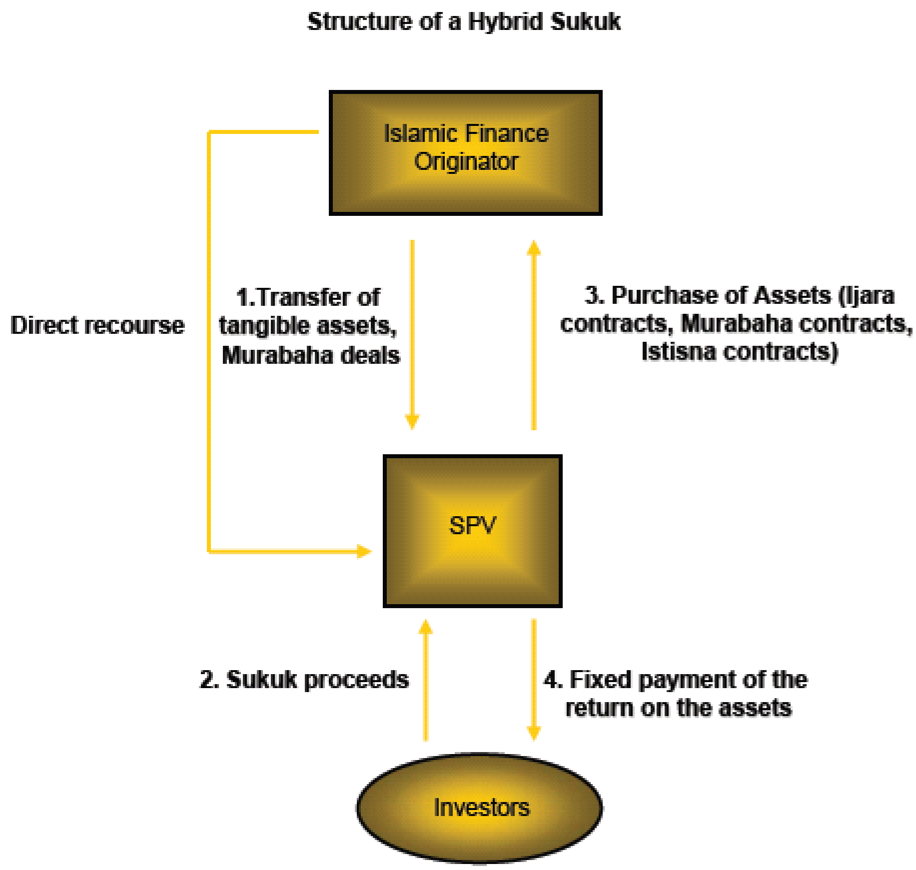
- Tabreed's five-year global corporate Sukuk (on behalf of the National Central Cooling Company, UAE) provided a fixed coupon of 5.50%. It is a combination of Ijara Istisna and Ijarah Mawsufah fi al dhimmah (or forward leasing contracts). The issue was launched to raise funds to retire some existing debt, which totals around US$136 million, as well as to finance expansion.
- The Durrat Sukuk will finance the reclamation and infrastructure for the initial stage of a broader US$ 1 billion world class residential and leisure destination known as 'Durrat Al-Bahrain', currently the Kingdom of Bahrain's largest residential development project. The return on the Sukuk is 125 basis points over 3 months LIBOR payable quarterly, with the

Sukuk having an overall tenor of 5 years and an option for early redemption. The proceeds of the issue (cash) will be used by the Issuer to finance the reclamation of the land and the development of Base Infrastructure through multiple project finance (Istisna) agreements. As the works carried out under each Istisna are completed by the Contractor and delivered to the Issuer, the Issuer will give notice to the Project Company under the Master Ijarah Agreement and will lease such Base Infrastructure on the basis of a lease to own transaction.

1.4.7. Hybrid Sukuk:

Considering the fact that Sukuk issuance and trading are important means of investment and taking into account the various demands of investors, a more diversified Sukuk - hybrid or mixed asset Sukuk - emerged in the market. In a hybrid Sukuk, the underlying pool of assets can comprise of Istisna, Murabaha receivables as well as Ijarah. Having a portfolio of assets comprising of different classes allows for a greater mobilization of funds. However, as Murabaha and Istisna contracts cannot be traded on secondary markets as securitized instruments at least 51 percent of the pool in a hybrid Sukuk must comprise of Sukuk tradable in the market such as an Ijarah Sukuk. Due to the fact the Murabaha and Istisna receivables are part of the pool, the return on these certificates can only be a pre-determined fixed rate of return.

The hybrid Sukuk have yet to make headways in the market, the structure nevertheless represents the potential of new structures and benefits to the investors.



Steps involved in the structure.

1. Islamic finance originator transfers tangible assets as well as Murabaha deals to the SPV.
2. SPV issues certificates of participation to the Sukuk holders and receive funds. The funds are used by the Islamic finance originator.
3. Islamic finance originator purchases these assets from the SPV over an agreed period of time.
4. Investors receive fixed payment of return on the assets.

Hybrid Sukuk in practice.

Islamic Development Bank issued the first hybrid Sukuk of assets comprising 65.8% Sukuk al-Ijarah, 30.73% of Murabaha receivables and 3.4% Sukuk al-Istisna. This issuance required the IDB's guarantee in order to secure a rating and international marketability. The $ 400 million Islamic Sukuk was issued by Solidarity Trust Services Limited (STSL), a special purpose company incorporated in Jersey Channel Islands. The Islamic Corporation for the Development of Private Sector (ICD) played an intermediary role by purchasing the asset from IDB and selling it to The Solidarity Trust Services Limited (STSL) at the consolidated net asset value.

1.5. Other Forms of Sukuk:

1.5.1. Zero-coupon non-tradable Sukuk.

Another possible classification of Sukuk structures can be created where the assets to be mobilized do not exist yet. Consequently, the objective of the fund mobilization would be to create more assets on the balance sheet of company through Istisna'. However, certificates of this nature would not readily be tradable because of Shariah restrictions. The primary asset pools to be generated would be of the nature warranted by Istisna and installment purchase/sale contracts that would create debt obligations. The certificate on these debt arrangements can be termed as fixed rate zero coupon Sukuk.

1.4.2.Embedded Sukuk.

These could be Sukuk whether zero-coupon, pure-Ijarah or hybrid, with the embedded option to convert into other asset forms depending on specified conditions.

1.5.3. Convertible or Exchangeable Sukuk.

Convertible or exchangeable Sukuk certificates are convertible into the issuer's shares or exchangeable into a third party's shares at an exchange ratio which is determinable at the time of exercise with respect to the going market price and a pre-specified formula. The convertible or exchangeable feature can be exercised anytime before maturity and works in the same way as for any conventional convertible or exchangeable issue. It is permissible under Shariah as long as the conversion price or the exchange price fluctuates with the market price of the shares. An issue would arise where such price is required to be a minimum amount equivalent to the face value of the Sukuk, however, that is unlikely as it defeats the very purpose of issuing a convertible security. Some Sukuk combine exchangeability with another Shariah compliant structure such as Mudarabah or Musharakah. For instance the Dana Gas Sukuk issued in October 2007 is an exchangeable Mudarabah. Khazanah national's three issues are only exchangeable issues, not mingling it with Mudarabah or any other form of Shariah based financing. The following are the Sukuk so far issued in the international market that offers an exchangeability or convertibility feature:

TABLE: 4.1 International Convertible or Exchangeable Sukuk

Date	Obligor	Domicile	Issue Type	Amount (US$mio)	Tenor (Years)
05 - Mar -08	Khazanah Nasional Bhd	Malaysia	Quasi sovereign	550	5
23 - Jan - 08	Tamweel PJSC	UAE	Corporate	300	5
15 – Jan - 08	The Nakheel Group	UAE	Quasi sovereign	750	4
07 – Oct - 07	Dana Gas	UAE	Corporate	1000	5
27 – Jun - 07	Khazanah Nasional Bhd	Malaysia	Quasi sovereign	850	5
11 – Feb - 07	Aldar Properties PJSC	UAE	Corporate	2530	5
29 – Sept -06	Khazanah Nasional Bhd	Malaysia	Quasi sovereign	750	5
2 – Jun - 06	Aabar Petroleum Investment Company PJSC	Cayman Islands	Corporate	460	4

Source: Author's own