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## **Working Paper in Islamic Economics and Finance No. 1015**

### **Sukuk Structure: An International Comparison**

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### **Abstract**

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. Beginning modestly in 2000 with total three sukuk worth \$336 millions the total number sukuk by the end of 2006 has reached to 77 with over US\$ 27 billion funds under management. As a percentage of GDP, the Malaysian bond market is now the largest in the ASEAN region and, excluding Japan, is the second largest in Asia after South Korea. Efforts to position Malaysia as an international Islamic financial hub has also yielded positive results. In 2007, the issuances of sukuk (Islamic securities) rose by 161% to account for 63% of total private debt securities issued. Malaysia accounts for 69% of the total global sukuk issuances. This trend has gained further momentum in early 2008 despite the uncertainties in the global financial markets. Sukuk has developed as one of the most significant mechanisms for raising finance in the international capital markets through Islamically acceptable structures. Multinational corporations, sovereign bodies, state corporations and financial institutions use international sukuk issuance as an alternative to syndicated financing. What are sukuk and how are they structured will be discuss in this paper in some detail.

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## 1. Introduction

Islamic finance has, for some time, missed investment opportunities that offer predictable returns with low risk. The majority of investment opportunities are based either on stock market with high volatility or on real estate transactions. The investment galaxy for the Islamic investor is lacking the variety of instruments to create an efficient portfolio in line with portfolio theory and financial planning. Already a number of world-class borrowers have used the new Islamic Sukuk market: Germany; the IMF Group; and Sovereign states like Qatar, Malaysia and Pakistan.

Basically, sukuk grant investors a share of the asset along with the cash flow and risks that commensurate from such ownership. Leveraging on various shari'ah principles, sukuk can be structured in a number of ways to offer the issuing entity greater financial flexibility and options to meet its funding requirements. Sukuk can be structured based on the principles of: (i) Contract of exchange such as murabahah, istisna' and ijarah; or (ii) Contract of participation such as musyarakah and mudharabah.

Sukuk are securitised assets and therefore belong to the category of Asset Backed Securities (ABS). Unlike conventional ABS structures, Sukuk need to have an underlying tangible asset transaction either in ownership or in usufruct. The securitisation of pure cash flow streams from credit portfolios as undertaken in the mortgage market, for instance, cannot be structured in the same way. A properly made Sukuk limits the debt to the value of the underlying assets. A solid investment policy of the borrower results and the vicious circle of raising debts and running after them in hard times is handled in an ethical and socially more convenient way. This allows the borrowers time sort the situation out. This is important for modern states as many of them borrow money to be repaid by future generations without regard whether any assets cover the debt or not.

The Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) issued standards for 14 different Sukuk types. The most common in 2004 were Sukuk Al Ijarah based on a leasing transaction. In Malaysia the Sukuk Bithaman Al Ajil (Murabaha based) is very popular but not so for Middle Eastern investors. Furthermore Sukuk Al Istisna' had been used to raise financing facilities for real estate development. The reasoning of the federal state of Saxony-Anhalt in issuing an Islamic certificate was to broaden the investor basis to gain access to different sources of funding with a long-term view. Furthermore the state is also looking for investors and entrepreneurs interested in going into Germany and choose Saxony-Anhalt as their new location. The German Sukuk demonstrates their open-mindedness and interest in Muslim investors worldwide. A message which was widely heard.

The Malaysian Sukuk Bithaman Al Ajil structure is controversial in the Islamic finance industry. It results in a debt and could not therefore be traded other than at face value as debt and money cannot change value with passage of time. The majority of Middle Eastern Islamic scholars declare such an action as belonging to the definition of the forbidden Riba. Consequently the IFC did not list their Sukuk on any stock exchange in the world and there is no intended secondary market. It is likely that future issues in Malaysia will consider applying the tradable Ijarah type of Sukuk to enable secondary market trading worldwide and foster the acceptance in the Middle East markets for Malaysian Sukuk. Otherwise the Malaysian issuers will face higher pricing expectations as non-tradable Sukuk will carry an increasing premium.

The Sukuk was listed on the Bahrain Stock Exchange to enable trade and secondary market for its investors. Since a Sukuk Istisna' is not a tradable security by Shari'ah as the underlying asset does not yet exists, the goal to be tradable set by the issuer needs to be met in a pool securitisation. Contemporary Islamic scholars accept a security as tradable as long as the underlying tangible assets are of 51 per cent

of market value. The proceeds of the issue 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. If the Sukuk is listed during the Istisna' period, the Istisna' receivable (amounts held as cash) shall be traded only at par value. Any appreciation or depreciation in the value of the Sukuk will represent a relative change in the value of the Base Infrastructure.

The remaining discussion of this paper will be divided into seven sections. In section 2 gives comparison about sukuk vs securitization; section 3 presents the classical structure; section 4 explain the shariah requirements for sukuk; section 5 will explain the examples of the activity which is implement this product; section 6 describes the example of case studies of Sukuk musyarakah Binariang GSM Sdn Bhd & Pasir Gudang Municipal Assets Berhad, and in the last section will provide the conclusion of this paper.

## 2. What is Sukuk?

Sukuk is an Islamic financial certificate, similar to a bond in Western finance, that complies with Shariah, Islamic religious law. It represents ownership of an asset or its usufruct. The claim embodied in sukuk is not simply a claim to cash flow but an ownership claim in a pool of assets. Whereas, in conventional bonds, bondholders are entitled to claim over interest bearing securities

Originally, in classical period, sukuk, was cognate with the European root 'cheque', meant any document representing a contract or conveyance of rights, obligations or monies done in conformity with the shari'ah. Empirical evidence shows that sukuk were a product extensively used during medieval Islam for the transferring of financial obligations originating from trade and other commercial activities.

In modern perspective, the essence of sukuk lies in the concept of asset monetisation, the so called securitization, that is achieved through the process of issuance of sukuk. Its great potential is in transforming an asset's future cash flow into present cash flow. Sukuk may be issued on existing as well as specific assets that may become available at a future date.

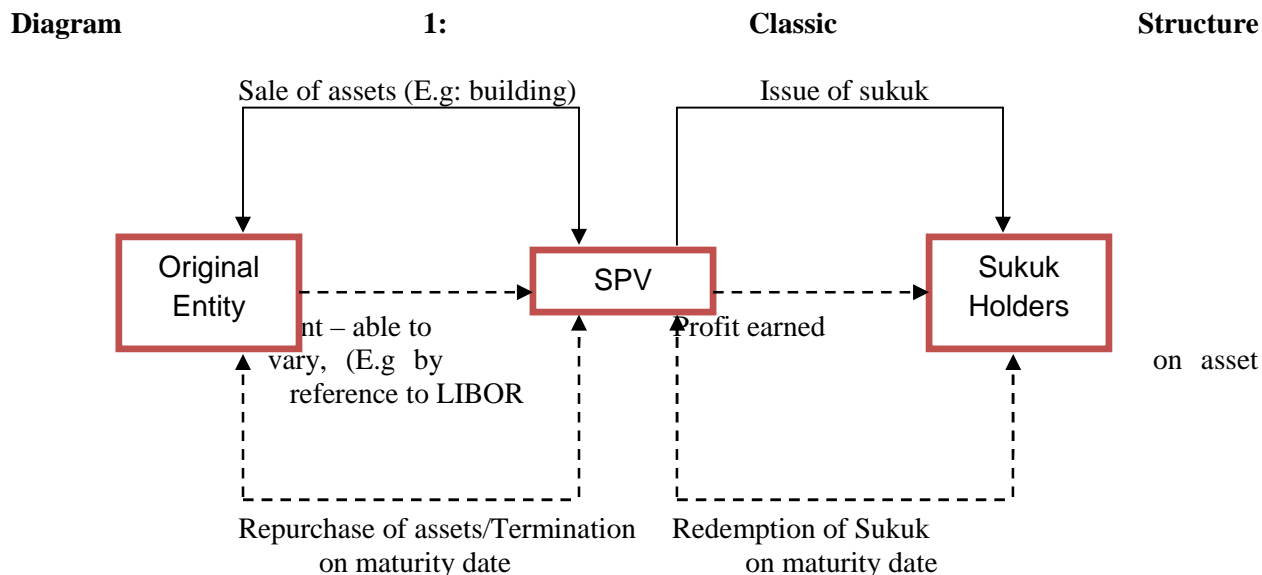
Therefore, sukuk is in many aspects similar to securitization, one common characteristic being that the payouts are based on the performance of the underlying assets. However, some practitioners think sukuk are 'asset-based' rather than 'assetbacked'. In their view, there are two key differences between sukuk structures and securitization. First, for Sukuk there is no de-linkage of the assets from the originator (in other words, there is no 'true sale' of the assets by the originator to the Special Purpose Vehicle). Second, investors in Sukuk are exposed to issuer's risk rather than the assets' risk. The implication for the issuer is that cash flow segregation is only a book entry.

## 3. The Classical Structure

The classic sukuk structure involves an acquisition of a property asset by a special purpose Vehicle (SPV) established in a tax neutral jurisdiction. The SPV funds itself by the issue of sukuk, declaring a trust in favour of the sukuk holders. The sukuk holders receive a return based on the rental income of the asset, taking the credit risk of the underlying lessee. The main challenge for the sukuk market is the availability of underlying assets that generate a shariah compliant income as interest derived income is not allowed under Shariah principles.

As shown in Diagram 1, initially, a special purpose vehicle company (SPV) was set up as a subsidiary of the originator. This practice has fallen away as there are potential conflicts of interest and occasional bankruptcy issues. Instead, the SPV follows the classic market practice of being a new company, owned by a 'widows and orphans' charity (one that is acceptable under the shari'ah), whose sole purpose is to

participate in that specific sukuk transaction. To negate any potential conflict of interest when the SPV was a subsidiary of the originator, some sukuk that adopted this structure also employed a transaction administrator whose function was essentially to direct the issuer to do or not to do certain things.



#### 4. The Shari'ah Requirements for Sukuk

Based on the classical structure, there are several shari'ah requirements that need to be fulfilled. We will discuss each of them below.

##### a. Form of Shirkah

The Sukuk structures rely on the creation of a Special Purpose Vehicle (SPV). SPV would issue Sukuk certificates which represent for example the ownership of an asset, entitlement to a debt or to rental incomes or even accumulation of returns from various Sukuk (a hybrid Sukuk). The return provided to Sukuk holders therefore come in the form of profit from a sale, rental or a combination of both. Sukuk could be based on Mudaraba, Musharaka, Murabaha, Salam, Istisna, Ijara or hybrid of these. We will discuss further in section 5 about example types of sukuk.

Therefore, capital contribution and utilization of capital depend on the contracts. The most common uses of sukuk can be named as project specific, asset-specific, and balance sheet specific. Under project-specific Sukuk 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 Ijara-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.

Under Assets-specific Sukuk arrangement, the resources are mobilised by selling the beneficiary right of the assets to the investors. For example of Asset-specific sukuk is US\$250 million five-year Ijara 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. An example of the balance sheet specific use of sukuk funds is the Islamic Development Bank (IDB) sukuk issued in August 2003. The IDB mobilised 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.

b. Eligibility of Assets

The main stumbling block for accessing the Sukuk market is the availability of underlying assets that generate a Shariah compliant income stream. An interest-derived income stream will not be eligible for inclusion in a Sukuk, but a rental-based income stream (whether from real estate or movable property) is ideal. The most popular asset class to date is real estate where rental income can be generated to provide cash flow returns to holders and repurchase obligations can be entered into to ensure principal repayments on the scheduled maturity dates. Other eligible assets have included aircraft, car fleets, pipelines and large air conditioning units.

c. Role of Shari'ah Advisors

Sharia advisor (Sharia scholars or Sharia advisory firms with recourse to Sharia scholars) have a significant role to play. Amongst others, following may be listed as examples: (i) Advising on proposed Sukuk structure and suggest a Sharia structure which otherwise fulfils the set economic aims; (ii) Working closely with legal counsel of the issuer to ensure that the legal documents are in line with Sharia requirements; (iii) Working closely with legal counsel of the arranger to ensure that the legal documents are in line with Sharia requirements; and (iv) Issuing Fatwa on the whole Sukuk deal before the same can be put into circulation.

d. The Contracting Parties

Although the essential condition of a valid contract is that it must be concluded by a qualified and competent person. This qualification is known as legal capacity (*ahliyyah*) which means "the competency of a individual to accept or to perform the responsibilities or rights imposed on him or against him".<sup>2</sup> For a person to be qualified to conclude a contract, he must possess complete legal capacity to execute or discharge his rights and duties emanating from the contract that he has entered, in a manner recognized by the law and Shariah. The most important element of competency are puberty and prudence as revealed in the Quran 5:4 that "prove orphans till they reach the marriageable age; then if you find them of sound judgement, deliver over unto them their property".

The justifications behind these requirements are that the parties to the contract must possess intellectual standard and the ability to distinguish between the useful and harmful, profitable or unprofitable. A person who has reach the age of puberty is presumed to have possess the standard qualification of prudence and is able to know the legal consequences of any contract that he has entered into.

e. Selling Price

The Sukuk shall be sold by auction to the primary dealers and Islamic Banks as determined by the Central Bank for the purpose of Sukuk.

f. Rental Payment

To issue a Sukuk, a financial institution or other entity (such as a sovereign) will typically incorporate a special purpose company (SPV). The SPV issues Sukuk certificates to investors and uses the proceeds raised to purchase a rental generating real property or other cash generating asset from the financial institution or other entity. The SPV in turn leases the property or asset back to the financial institution or other entity for a period corresponding to the duration of the tenure of the Sukuk certificates with the property or the asset being held on trust for the Sukuk holders.

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<sup>2</sup> Zaydan (1985), *al-Wajiz fi Usul al-Fiqh*, Beirut: Muassasah al-Risalah, p. 95.

The rental payments due from the financial institution or other entity to the SPV will exactly match the periodic payments under the Sukuk holders. These rental payments may be fixed, or under more recent jurisprudence, calculated with reference to the inter bank offered rate plus a margin which represents the market rate for rental payments. In structuring such transactions it is important to note that all amounts due to the SPV, including the rent that will fund the periodic payments under the Sukuk certificates are direct, unconditional and irrevocable obligations of the financial institution or other entity. The financial institution or other entity is obliged to purchase from the SPV the asset or property upon the maturity of the lease at an agreed price which will be used for the repayment of the principal to the Sukuk holders.

#### g. Repurchase of Assets

Most commonly Sukuk structures replicate the cash flows of conventional bonds, and are listed on exchanges and made tradable through conventional organizations. A key technique to achieve capital protection without amounting to a loan is a binding promise to repurchase certain assets, e.g. in the case of Sukuk Al Ijara, by the issuer. In the meantime a rent is being paid, which is often benchmarked to an interest rate like LIBOR (which is disliked by Shariah Scholars).

#### Redemption of Sukuk

The originator has to buy back the underlying assets from the certificate holder. The principal amount paid may not be equal to the Sukuk issue amount and, as a result, there is the risk that the assets may not be fully redeemed.

#### Tax/Zakat Treatment

The general description about zakat or tax considerations relating to the Sukuk should be addresses. It does not purport to be a complete analysis of all zakat or tax considerations relating to the Sukuk nor does it address the considerations that are depend on individual circumstances. Prospective purchasers of Sukuk should consult their own tax advisers to determine the zakat or tax consequences for them of acquiring, holding and disposing of any Sukuk and receiving distributions, payments of principal, profit and/or other amounts under the Sukuk and the consequences of such actions under the zakat or tax regulations. This is based upon the regulations in effect at the date of this offering circular and is subject to any change in such regulations that may take effect after such date.

### 5. Other Sukuk Structures

#### 5.1 Mudharabah

These are investment sukuk that represent ownership of units of equal value in the mudharabah equity and are registered in the names of holders on the basis of undivided ownership of shares in the mudharabah equity and its returns according to the percentage of ownership of share. The owners of such sukuk are the rabbul-mal. Mudharabah sukuk are used for enhancing public participation in big investment projects. There are certain ingredients which are peculiar to the introduction of sukuk mudharabah. They are contracting parties, offer and acceptance, contract, capital, entrepreneurship and profit distribution.

##### a) Contracting parties

There are two contracting parties in mudharabah which is (i) The provider of the capital, example Rab al Maal. In mudharabah business, Rab al Maal provides the capital and mudarib undertake the management. Therefore, the Rab al Maal should hand over the agreed capital to mudarib and leaves everything to mudarib with no interference from his side but he has authority to oversee the mudarib's activities and work with mudarib if the mudarib consents; (ii) The mudarib. The mudarib should utilize his best efforts to achieve the objectives of the mudharabah business example to get profit. He should assure the Rab al Maal that his capital is in good hands that will act to find the best ways of interesting it in a permissible manner. Both Rab al Maal and mudarib must be eligible to act as principal and agent

#### b) Offer and acceptance

Through offer and acceptance both the parties express their willingness to conclude a contract which must conform to the followings: (i) the wording offer and acceptance should be clearly or completely indicate the purpose of the contract; (ii) acceptance of the offer is contingent on its taking place during the time which both the parties are negotiating agreement to the contract. However, acceptance is not valid if one party refuses the terms of the offer or leaves the place where the negotiation of the contract is being made before the deal is concluded. Contracting is permissible by verbal utterance or in writing and signing it. It is also permissible through correspondence or by the use of modern communication means.

#### c) Contract

A mudharabah sukuk is a trust based contracts. Therefore, the mudarib invests mudharabah capital on trust basis in which case the mudarib is not liable for losses except in case of breach of trust, such as misconduct, negligence and breach of the terms of mudharabah contract. In committing any of the above, mudarib becomes liable for the mudharabah capital.

#### d) Capital

Capital is the amount of money given by the provider of funds, example Rab al Maal to the mudarib with the purpose of investing it in the mudharabah business. Capital of muharabah sukuk must fulfill the following conditions: (i) Generally capital of mudharabah should be provided in cash. However, it may be in business assets like inventory, machinery etc. At the time of contracting, the valuation of such assets is to be conducted by experts or as agreed upon by the contracting parties; (ii) Capital of mudharabah should clearly be known to the contracting parties and defined in terms of quality and quantity in a manner that eliminates any possibility or ambiguity; (iii) Capital cannot be in the form of debt due from a third party or the mudarib. It must be readily available for use in cash or in kind; (iv) Capital should be paid to the mudarib or it may be put at the disposal of the mudarib or the mudarib must have free access to and control over the capital. The payment may be made in several instalments.

#### e) Entrepreneurship

Entrepreneurship is the contribution provided by the mudarib against the capital provided by Rab al Maal. Entrepreneurship relates to the management of the mudharabah. The shariah conditions of entrepreneurship are as under: (i) Entrepreneurship is the exclusive right of the mudarib without intervention from the part of the provider of funds; (ii) The provider of funds should not restrict the mudarib's action in such a way as to prevent him from achieving the objective of mudharabah example profit; (iii) The mudarib should not violate shariah rules in his actions related to the mudharabah and should abide by the applicable current practice of the activity; (iv) The mudarib should abide by the

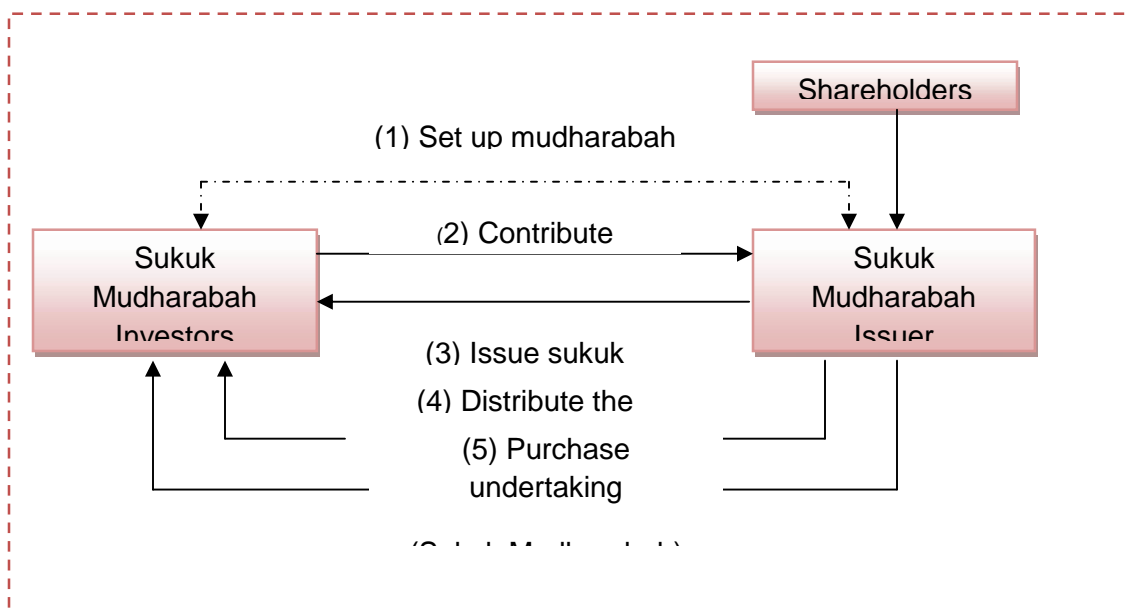
conditions set by the provider of funds subject to such conditions do not contradict those of the mudharabah sukuk.

#### f) Profit distribution

Profit is the amount earned in excess of capital. Profit is the end objective of mudharabah sukuk. The shariah conditions of profit are as under: (i) Profit should be for both Rab al Maal and mudarib, and no one should have possession thereof without the other; (ii) The mechanism for distribution of profit must clearly be expressed to eliminate uncertainty and any possibility of dispute. The distribution of profit must be on the basis of an pre agreed ratio of the profit and not on the basis of a lump sum or a percentage of the capital; (iii) The parties should agree on the ratio of profit distribution when the contract is concluded. However, it is permissible to change the ratio of distribution of profit at any subsequent time; (iv) The mudarib is entitled to a share of profit as soon as it is clear that the operations of the mudharabah 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; (v) The Rab al Maal bears all losses incurred from the mudharabah, and the mudarib shall not bear any portion thereof unless it arises from his breach of trust, example misconduct or negligence or violations of conditions agreed upon.

The typical structure of mudharabah sukuk is shown in Diagram 2.

Diagram 2: Structure of Sukuk Mudharabah



It involves the following steps:

#### (1) Setting up a mudharabah venture

Pursuant to the concession agreement, the issuer is set up to undertake the assigned business



For the purpose of undertaking the assigned business, the issuer shall invite the investors to participate in the mudharabah venture. Under this venture, the issuer shall be the entrepreneur (Mudharib) whereas the investors shall be the capital providers (Rabbul Maal).

#### (2) Contribution of mudharabah capital

The Rabbul Maal shall contribute financing capital (Mudharabah capital) to fund the Mudharabah venture. In order to carry out the assigned business, the issuer, in the capacity of Mudharib, shall also invite other investors to part finance the project.

#### (3) Issuance of sukuk mudharabah

The Mudharib shall issue the Sukuk Mudharabah to the Rabbul Maal or investors (also referred to as the Sukuk Mudharabah holders), evidencing the Rabbul Maal's participation in Mudharabah venture.

The Sukuk Mudharabah shall be presented by Global Sukuk Mudharabah Certificates evidencing the Sukuk Mudharabah holders' participation and beneficial interest in the Mudharabah venture, hence entitling the Sukuk Mudharabah holders to receive the distributable profit.

The obligations of the holders shall be limited up to the amount invested in the Mudharabah venture.

The assigned business under the Mudharabah venture shall be, at all time, developed, operated, managed and represent by the issuer (as Mudharib).

#### (4) Distribute the distributable profit

Under the Mudharabah venture, the Mudharib shall distribute the distributable profit to the Sukuk Mudharabah holders based on agreed profit sharing ratio.

The distributable profit is the budgeted profit for the collection period based on the formula of profit equals budgeted revenue minus budgeted expenditure, subject to availability of the same.

#### (5) Purchase undertaking (Sukuk Mudharabah) or dissolution of the Mudharabah venture

Either upon each maturity of the serial sukuk Mudharabah or upon declaration of any event of default, the issuer shall acquire the interest in the Mudharabah venture.

Upon completion of the purchase, the Mudharabah venture shall then be dissolved.

### 5.2 Musharakah

These are investment sukuk that represent ownership of Musharakah equity. It does not differ from the Mudharabah 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).

Musharakah 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 Musharakah 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 Musharakah certificates being managed on the basis of participation or Mudharabah or an investment agency.

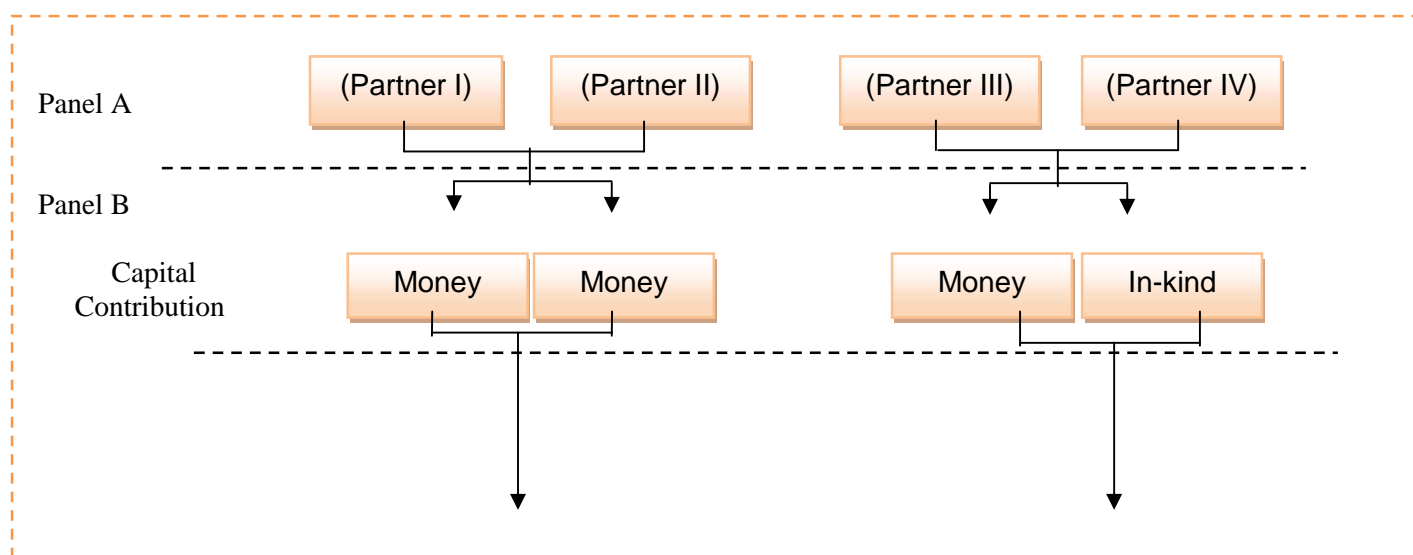
There are certain ingredients which are peculiar to the introduction of sukuk musharakah. They are partners, capital contribution, special purpose vehicle (SPV), utilization of capital, tenure, and profit distribution.

### Partners

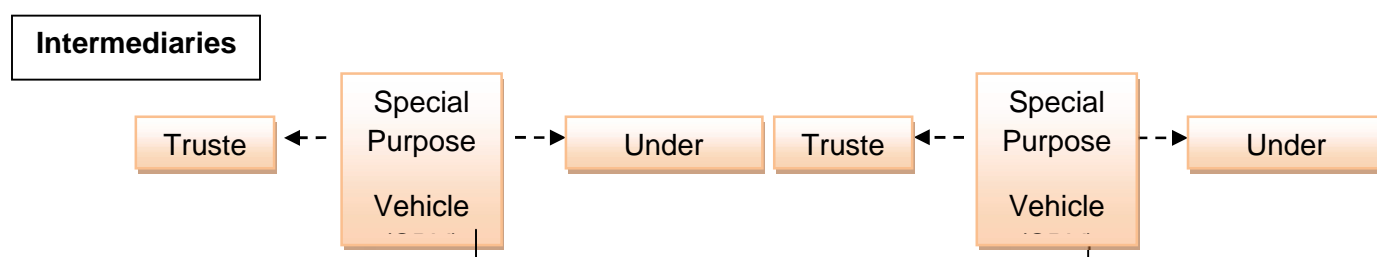
Musharakah is a relationship established by the parties (called partners), as shown in Panel A Diagram 4, through a mutual contract. Therefore, it goes without saying that all the necessary ingredients of a valid contract must also be present. For example, the partners should be capable of entering into a contract; the contract must take place with free consent of the partners without any duress, fraud or misrepresentation. A partnership could be an individual and companies in which partners (owners) share with each other the profits or losses of the business undertaking in which all have invested. In sukuk musharakah transactions involve partnership arrangements entered into by musharakah partners comprising sukukholders. The issuer of sukuk musharakah typically acts as the wakeel for the sukukholders, or acts as one of the musharakah partners.

In addition, the partnership has a specific conditions for unlimited partnerships: (i) the sukukholders must be eligible to delegate legal authority, serve as a guarantor, as well as serve as legal agents of one another. Thus, they must be sane and of legal age. This follows from the joint responsibility for the actions of any of them, which requires considering each a legal agent of the other, as well as a guarantor of the other; (ii) sukukholders' shares in the capital must be equal from beginning to end. Thus, the majority agreed that inequality in wealth between the sukukholders means that it is not an unlimited partnership; (iii) each sukukholder must include all of his wealth of the genus used as capital in the partnership. Law does not require that the capital conditions be of the same genus, thus one may contribute silver and other may contribute gold, as long as the contributions are of equal value. Also, some view did not require physical mixture of the capital, as we have seen; (iv) profit shares must be equal, since contributions to the capital are equal; (v) All permissible trading must be part of the partnership business, thus neither sukukholders is allowed to trade on his own, since that would negate the mutual legal delegation and representation. This explains the condition stipulated by Abu Hanifa and Muhammad that all partners must be Muslim, otherwise one would be able to conclude a trade that is not permitted for the other. However, as we have seen, permitted unlimited partnership between a muslim and non-muslim if they are eligible for agency and guaranty. Further discussion on items (ii), (iii), (iv) and (v) will be discussed further in (b), (e), (g) and (h), respectively.

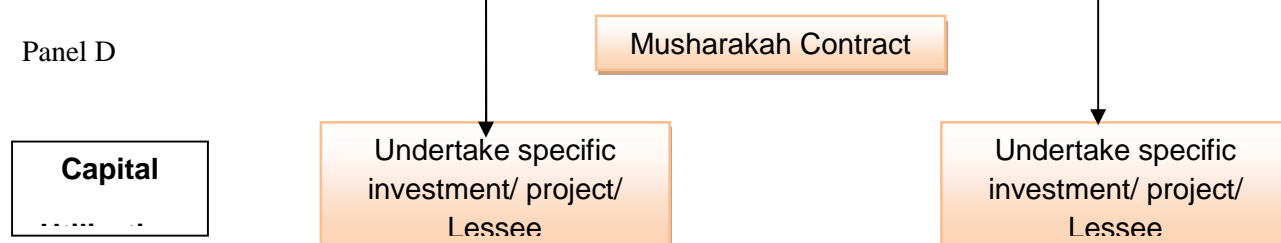
Diagram 4: Structure of Sukuk Musharakah



Panel C



Panel D



### Capital Contribution

As shown in Panel B, Diagram 4, capital in sukuk musharakah can be pooled in two different forms: partners contribute money capital; and other partners contribute in-kind capital. Under the sukuk musharakah, the sukukholders' contribute capital amount to the issuer. The issuer then enters into a joint venture with the party seeking finance (the originator) where the issuer provides the capital received from the sukukholders, and the originator supplies the assets and or their own capital required for the business to function. Every partners produce the same denomination of capital (e.g. money) or the issuer has already fixed assets (then turn into capital) and other partners produce money (as capital). Similar to the limited investment partnership (inan)<sup>3</sup> or mufawada.<sup>4</sup>

Most of the Muslim jurists are of the opinion that the capital invested by each partner must be in liquid form. It means that the contract of musharakah can be based only on money, and not on commodities. In other words, the share capital of a joint venture must be in monetary form. No part of it can be contributed in kind. However, there are different views in this respect.

However, Imam Malik argued that the liquidity of capital is not a condition for the validity of musharakah, therefore, it is permissible that a partner contributes to the musharakah in kind, but his share shall be determined on the basis of evaluation according to the market price prevalent at the date of the contract. This view is also adopted by some Hanbali jurists.

While, Imam Abu Hanifah and Imam Ahmad said that no contribution in kind is acceptable in a musharakah. Their standpoint is based on two reasons: Firstly, they say that the commodities of each partner are always distinguishable from the commodities of the other. For example, if A has contributed

<sup>3</sup> Partnership of partial investment involving only mutual agency and not mutual suretyship. An obligation can be also jointly undertaken by inan partners.

<sup>4</sup> Partnership of equal partners embracing all the resources of the parties to the contract. The mufawada partnership has three essential features: the complete equality of the partners in every respect, the inclusion of all trade activities within its scope, and the mutual agency and surety of the partners. Accordingly, each partner empowers his colleague to act freely with the entire partnership capital. The equality of the partners mentioned above applies not only to the amount of each one's investment and to the division of profits and losses between them, but also to the personal status of the partners.

one motor car to the business, and B has come with another motor car, each one of the two cars is the exclusive property of its original owner. Now, if the car of A is sold, its sale-proceeds should go to A. B has no right to claim a share in its price. Therefore, so far as the property of each partner is distinguished from the property of the other, no partnership can take place. On the contrary, if the capital invested by every partner is in the form of money, the share capital of each partner cannot be distinguished from that of the other, because the units of money are not distinguishable, therefore, they will be deemed to form a common pool, and thus the partnership comes into existence.

Secondly, they say, there are a number of situations in a contract of musharakah where the partners have to resort to redistribution of the share-capital to each partner. If the share-capital was in the form of commodities, such redistribution cannot take place, because the commodities may have been sold at that time. If the capital is repaid on the basis of its value, the value may have increased, and there is a possibility that a partner gets all the profit of the business, because of the appreciation in the value of the commodities he has invested, leaving nothing for the other partner. Conversely, if the value of those commodities decreases, there is a possibility that one partner secures some part of the original price of the commodity of the other partner in addition to his own investment.

### Special Purpose Vehicle (SPV)

A special purpose vehicle or simply (SPV) is a corporate body and act as intermediaries (see Panel C, Diagram 2). SPV is usually a [limited company](#) of some type or, sometimes, a [limited partnership](#), created to fulfill narrow, specific or temporary objectives, primarily to isolate financial risk, usually [bankruptcy](#) but sometimes a specific [taxation](#) or [regulatory](#) risk. A SPV may be owned by one or more other entities and certain jurisdictions may require ownership by certain parties in specific percentages. Often it is important that the SPV not be owned by the entity on whose behalf the SPV is being set up (the sponsor). For example, in the context of a financing securitization if the securitized assets were owned or controlled by the Islamic bank whose financings were to be secured, the SPV would be consolidated with the rest of the Islamic bank's group for regulatory, accounting, and bankruptcy purposes, which would defeat the point of the securitization. Therefore many SPVs are set up as [orphan companies](#) with their shares settled on [charitable trust](#) and with professional [directors](#) provided by an administration company to ensure there is no connection with the sponsor.

Some of the reasons for creating special purpose entities are: (i) Securitization: SPVs are commonly used to [securitize](#) loans (or other receivables). For example, a bank may wish to issue a [mortgage-backed security](#) whose payments come from a pool of loans. However, these loans need to be legally separated from the other obligations of the bank. This is done by creating an SPE, and then transferring the loans from the bank to the SPV. (ii) Risk sharing: Corporates may use SPVs to legally isolate a high risk project or asset from the parent company and to allow other investors to take a share of the risk. (iii) For competitive reasons: For example, when [company](#) A and company B started developing project, they created a SPV which owned the licensing deals behind the project. (iv) Regulatory reasons: A SPV can sometimes be set up within an orphan structure to circumvent regulatory restrictions, such as regulations relating to nationality of ownership of specific assets. (v) Property investing: Some countries have different tax rates for capital gains and gains from property sales. For tax reasons, letting each property be owned by a separate company can be a good thing. These companies can then be sold and bought instead of the actual properties, effectively converting property sale gains into capital gains for tax purposes.

### Other Parties Involved

Other parties could be involved in sukuk musharakah likes a trustee and underwriter. The former is considered as a person to whom asset is legally committed in trust, to be applied either for the benefit of specified individuals, or for public uses; one who is entrusted with asset for the benefit of another; also, a person in whose hands the effects of another are attached in a trustee process. Hence, trustee is a [legal](#)

[term](#) that refers to a holder of asset on behalf of a [beneficiary](#). A [trust](#) can be set up either to benefit particular persons, or for any [charitable purposes](#).

Trustees have certain duties (some of which are [fiduciary](#)). These include the duty to carry out the express terms of the trust instrument, the duty to defend the trust, the duty to prudently invest trust assets, the duty of impartiality among the beneficiaries, the duty to account for their actions and to keep the beneficiaries informed about the trust, the duty of loyalty, the duty not to delegate, the duty not to profit, the duty not to be in a conflict of interest position and the duty to administer the trust in the best interest of the beneficiaries. These duties may be expanded or narrowed by the terms of the instrument creating the trust, but in most instances cannot be eliminated completely.

A trustee carries the fiduciary responsibility and liability to use the trust assets according to the provisions of the trust instrument (and often regardless of their own or the beneficiaries' wishes). The trustee may find himself liable to claimants, prospective beneficiaries, or third parties. In the event that a trustee incurs a liability (for example, in litigation, or for taxes, or under the terms of a lease) in excess of the trust property they hold, they may find themselves personally liable for the excess.

Trustees are generally held to a "prudent person" standard in regard to meeting their fiduciary responsibilities, though investment, legal, and other professionals can be held to a higher standard commensurate with their higher expertise. Trustees can be paid for their time and trouble in performing their duties only if the trust specifically provides for payment. It is common for lawyer's to draft will trusts so as to permit such payment, and to take office accordingly: this may be an unnecessary expense for small estates.

While, Islamic financial institution (including Shariah boards) become underwriter for musharakah sukuk. The Shariah boards may have different interpretations and advise differently because, in Islam, there is no generally accepted codification of the jurisprudence. In a conventional sense, that can lead to uncertainty and confusion. In this part, in this sense, the necessity for a unified Shariah board at a national and international level, and mention the recommendations regarding the role of the Shariah board in the harmonization and configuration of various Shariah board rulings across the globe to develop sukuk musharakah related instrument.

### Utilization of Capital

Utilization could be used undertake: specific investment and project, and leasing activities. For examples where finances are required for the working capital of a business, the instrument of musharakah may be used in the following manner. The capital of the business may be evaluated with mutual consent. It is already mentioned while discussing the traditional concept of musharakah that it is not necessary, according to Imam Malik, that the capital of musharakah is contributed in cash form. Non-liquid assets can also form part of the capital on the basis of evaluation. This view can be adopted here.

In this way, the value of the business can be treated as the investment of the person who seeks finance, while the amount given by the financier can be treated as his share of investment. The musharakah may be effected for a particular period, like one year or six months or less. Both the parties agree on a certain percentage of the profit to be given to the financier, which should not exceed the percentage of his investment, because he shall not work for the business. On the expiry of the term, all liquid and non-liquid assets of the business are again evaluated, and the profit may be distributed on the basis of this evaluation.

### Tenure

Sukuk is issued for a fixed time period rather than in perpetuity as in the case of equity. The time period can vary from three months in the case of sukuk that are similar to treasury bills, to five or even ten years for those that resemble conventional notes. What makes a sukuk acceptable under shariah law is that it must be backed by a real asset such as a piece of land, a building or an item of equipment, and therefore

when sukuk are bought and sold the purchaser and seller are dealing indirectly in a real asset, and not simply trading paper. Revision to terms in sukuk documents involving maturity date and profit rate. During the tenure of a sukuk, revision to the terms in the sukuk document, such as an extension of the maturity date and the revision of the profit rate, would adversely affect the original contract (ʿaqd) of the sukuk. Therefore, revisions can only be implemented by first cancelling the initial contract and replacing it with a new contract stating the new maturity date and profit rate.

### Profit Distribution

Profit is shared among the partners according to the capital provider and the entrepreneur according to a pre-determined profit sharing ratio. The profit sharing ratio has to be mutually consented upon and explicitly stated at the time of contracting (ʿaqad) and has to be a proportion or percentage of the profits. To mitigate various risks embedded in musharakah contracts, the underwriter must ensure that their valuation methodologies on profit calculation and allocation are appropriate, consistent and mutually agreed upon by both contracting parties at the inception of the contract. The potential impact of their valuation methods on profit calculations and allocations must be properly assessed, particularly with regard to the risk of potential manipulation on the reported earning results leading to overstatements or understatements of musharakah earnings.

Although, according to the traditional concept, the profit cannot be determined unless all the assets of the business are liquidated, yet the valuation of the assets can be treated as constructive liquidation with mutual consent of the parties, because there is no specific prohibition in Shari'ah against it. It can also mean that the working partner has purchased the share of the financier in the assets of the business, and the price of his share has been determined on the basis of valuation, keeping in view the ratio of profit allocated for him according to the terms of musharakah.

The profits from the musharakah business are distributed between the SPV and the entrepreneur to the agreed ratio between the partners at a predetermined basis. However as a shareholding partner, the share of profit of the entrepreneur cannot be less than the ratio of his investment since he is the sole provider of labor. The same rule applies on the operation of Islamic Banks on the basis of Musharakah. The actual shareholders apart from being the manager are also shareholding partners; their ratio of profit cannot be less than their ratio of investment. However their ratio of profit as Mudarib can be determined at whatever rate they agreed.

Any losses are shared in proportion to the capital contribution, and the issuer pays a periodic distribution amount to the sukuk holders from the musharakah profit distribution. These the distribution must be agreed upon at the time of effecting the contract. If no such proportion has been determined, the contract is not valid in Shari'ah. The ratio of profit for each partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital invested by him. It is not allowed to fix a lump sum amount for any one of the partners, or any rate of profit tied up with his investment. Therefore, if A and B enter into a partnership and it is agreed between them that A shall be given RM10,000 per month as his share in the profit, and the rest will go to B, the partnership is invalid. Similarly, if it is agreed between them that A will get 15% of his investment, the contract is not valid. The correct basis for distribution would be an agreed percentage of the actual profit accrued to the business.

In the case of loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of his investment. Therefore, if a partner has invested 40% of the capital, he must suffer 40% of the loss, not more, not less, and any condition to the contrary shall render the contract invalid. There is a complete consensus of jurists on this principle. Therefore, according to Imam Shafi'i, the ratio of the share of a partner in profit and loss both must conform to the ratio of his investment. But according to Imam Abu Hanifah and Imam Ahmad, the ratio of the profit may differ from the ratio of

investment according to the agreement of the partners, but the loss must be divided between them exactly in accordance with the ratio of capital invested by each one of them.<sup>5</sup>

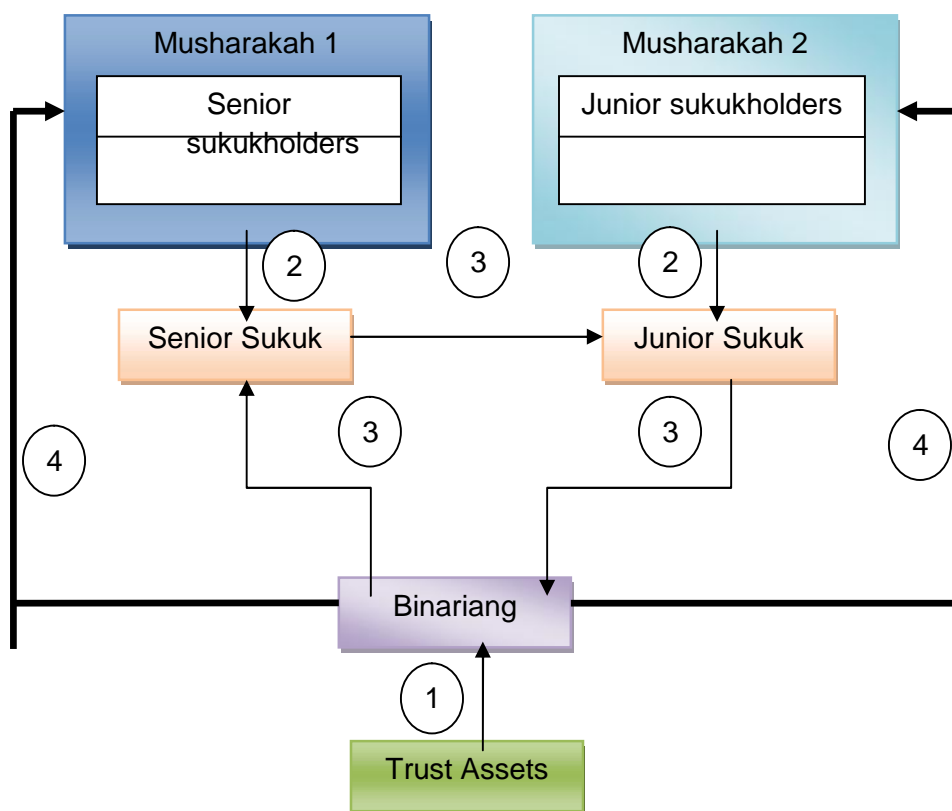
Other sukuk structure can be seen in Appendix A.

## 5. Examples

### A) Sukuk musyarakah Binariang GSM Sdn Bhd

Maxis Communications Bhd (Maxis), the provider of mobile telecommunication services in Malaysia, had through its special purpose company, Binariang GSM Sdn Bhd (Binariang), originated the largest-ever sukuk issue in the world on 28 December 2007, with a total of RM15.35 billion (US\$4.71 billion) of sukuk musharakah. The sukuk structure was designed as in Diagram 5.

Diagram 5: Sukuk Musharakah Structure of Binariang GSM Sdn. Bhd



<sup>5</sup> It is this principle that has been mentioned in the famous maxim:

الربح على ما اصطاحا عليه والوضيعة على قدر المال

**Profit is based on the agreement of the parties, but loss is always subject to the ratio of investment.**

The structure could be explained as follows:

The holders of the sukuk (Sukukholders) shall from time to time form a Musyarakah and shall enter into a venture (Venture) together with the Issuer as part of the financing arrangement. Binariang (i.e. the Issuer) shall make a declaration that it holds in trust the Assets for the benefit of the Venture partners, namely the Sukukholders and itself.

The Sukuk shall represent the Sukukholders undivided share of beneficial interest in the Trust Assets (the quantum of which is evidenced by the Sukuk held by them) and thereby any distribution made. The holders of the Senior Sukuk (Senior Sukukholders) shall form a Musyarakah among themselves to invest in the Senior Sukuk. The holders of the Junior Sukuk (Junior Sukukholders) shall form a Musyarakah among themselves to invest in the Junior Sukuk. In terms of the entitlement to the Trust Assets, the Senior Sukuk and the Junior Sukuk will rank on an equal basis. The Sukukholders and the Issuer will be entitled to income generated from the Trust Assets and/or proceeds from the sale of the Trust Assets.

The distributable income generated from the Trust Assets after deducting the necessary expenses such as operating expenses and taxation shall be shared and distributed to the Venture partners, namely the Senior Sukukholders, Junior Sukukholders and the Issuer, based on the respective proportionate interests in the Trust Assets. The Issuer's proportionate interest in the Trust Assets will be calculated based on the excess of the value of the Trust Assets over the amount of the outstanding Sukuk at such time. The amounts to be distributed to the Senior and the Junior Sukukholders will be made (after netting off the Issuer's entitlement as mentioned above) based on the agreed ratio of (85:15) respectively. The Senior Sukukholders and the Junior Sukukholders will receive the distribution up to an amount to be calculated based on the expected return of the respective Sukuk, subject to the terms of a management agreement and in accordance with the priority of cashflow applicable.

Binariang intends to acquire Junior Sukukholders' interest in the Trust Asset in proportion to the capital contribution (Relevant Portion) on the date falling 50 years from the date of issuance of the Junior Sukuk, or upon occurrence of a Winding-up Event or may acquire the Trust Assets from the Junior Sukukholders on any such date upon the occurrence of certain events. The Junior Sukukholders shall grant an option to Binariang to acquire the Junior Sukukholders' interest in the Musyarakah Venture at the Redemption Amount to be calculated based on certain formula upon certain events as described under Sale Undertaking.

These sukuk issues marked the largest corporate bond issue exercise and one of Asia's largest corporate bond issues ex-Japan. They were the largest hybrid instrument issued by a Malaysian corporation and were subscribed by Saudi Telecom Company and Shield Estate NV.

The Binariang GSM Sdn Bhd has successfully refinanced the RM20billion bridge loan it took to fund the buyout of Malaysia's largest mobile operator, Maxis Communications Bhd, in June 2007. The bridge loan was refinanced by the largest local currency corporate bond deal in emerging Asia, comprising RM12.05billion nominal value of medium-term notes, RM300million nominal value of commercial papers (collectively the senior sukuk) and RM3.02bil nominal value of junior debt (junior sukuk) as well as a US\$1.2billion syndicated term loan facility. Both the senior and junior sukuk were issued under the syariah principle of Musyarakah with the senior sukuk being issued pursuant to a RM2billion Islamic commercial paper programme and a RM19billion Islamic medium-term notes programme put in place by Binariang.

The senior sukuk was Malaysia's largest corporate bond issue and one of the largest Asian corporate bond issues ex-Japan. The US\$1.2bil loan facility is also one of the largest ever US dollar-denominated loan syndicated in Malaysia. In addition, the Junior Sukuk, which was subscribed by Saudi Telecom Co and Shield Estate N.V., is the largest hybrid instrument issued by a Malaysian corporate.

Objective



The significant objective of the issuance of these sukuk structured under the widely-accepted Shariah principle of musharakah is to use of such an innovative instrument, which was granted full equity credit by various Shariah principles have been used in developing the Islamic capital market (ICM) in Malaysia. This has contributed to the growth of Malaysian ICM and brought it up to par with the conventional capital market.

#### SPV

The Binariang GSM Sdn Bhd through an independent special purpose partnership, whose shares the Junior Sukuk, together with the senior sukuk issued by the Issuer under an Islamic commercial papers programme of up to RM2 billion and an Islamic medium term notes programme of up to RM19 billion (“Senior Sukuk”) are collectively referred to as “Sukuk” and the holders of the Sukuk are collectively referred to as the Sukukholders. The Senior Sukuk has a combined limit of RM19 billion. The Junior Sukuk shall be issued under the Islamic principle of Musyarakah.

An Islamic commercial papers programme with an aggregate nominal value of up to RM2.0 billion (“CP Programme”) and an Islamic medium term notes programme with an aggregate nominal value of up to RM19.0 billion (“MTN Programme”) (together, “Senior Sukuk Issuance Programmes”). The Senior Sukuk Issuance Programmes has a combined limit of RM19 billion. The commercial papers (“CPs”) issued under the CP Programme and the medium term notes (“MTNs”) issued under the MTN Programme are collectively referred to as “Senior Sukuk”. The Senior Sukuk together with the RM equivalent of USD900 million nominal value Junior Sukuk are collectively referred to as “Sukuk” and the holders of the Sukuk are collectively referred to as “Sukukholders”.

#### Tenure

Tenor of the facility or issue : The Junior Sukuk will mature fifty (50) years from the date of issuance (“Maturity”) and shall be redeemed via proceeds from Replacement Capital.

Tenure of the Facility: CP Programme - Seven (7) years from the date of the first issue under the CP Programme. While MTN Programme – Twenty (20) years from the date of the first issue under the MTN Programme. Tenure of the Issue: CPs: 1, 2, 3, 6, 9 or 12 months as the Issuer may select provided that the CPs mature prior to the expiry of the CP Programme and for MTNs: More than 1 year and up to 20 years as the Issuer may select, provided that the MTNs mature prior to the expiry of the MTN Programme. The yield to maturity (the “Expected Return”) will be determined prior to issuance.

#### Utilization of Capital

The Sukukholders shall contribute capital which will be utilised by the Issuer as the asset trustee to acquire a certain percentage of interest of the Venture from the Issuer. The Musharakah Capital will essentially be equal to the issue proceeds of the Junior Sukuk, which entitles the Junior Sukukholders to profits from the Venture.

The Sukukholders shall from time to time form a Musharakah and shall enter into a venture together with the Issuer as part of the financing arrangement. The venture refers to the investment in Trust Assets (“Venture”). The Issuer will also function as the capital trustee where it holds the Trust Assets for the benefit of the Venture partners comprising the Sukukholders and itself. Each Sukuk shall represent the Sukukholders’ undivided share of beneficial interest in the Trust Assets and thereby any distribution made.

#### Profit and loss distribution

Any profit derived from the venture will be distributed based on a pre-agreed profit sharing ratio, but a loss will be shared on the basis of capital contribution. The distributable profit generated from the Trust

Assets after deducting the necessary expenses, such as operating expenses and taxation, shall be shared and distributed to the respective Venture partners namely, the Senior Sukukholders, Junior Sukukholders and the Issuer, based on their respective proportionate interests in the Trust Assets. The Issuer's proportionate interest in the Trust Assets will be calculated based on the excess of the value of the Trust Assets over the amount of the outstanding Sukuk at such time. The amounts to be distributed to the Senior and Junior Sukukholders will be made based on the agreed ratio of 85:15 respectively.

The Senior Sukukholders and Junior Sukukholders will receive the distribution of profits up to an amount to be calculated based on the expected return of the respective Sukuk, subject to the terms of a management agreement and in accordance with the priority of cashflow applicable. The Sukukholders together with the Issuer will be entitled to profit generated from the Trust Assets and/or proceeds from the sale of the Trust Assets. The holders of the Senior Sukuk (Senior Sukukholders) shall form a Musharakah among themselves to invest in the Senior Sukuk. The holders of the Junior Sukuk (Junior Sukukholders) shall form a Musharakah among themselves to invest in the Junior Sukuk. In terms of the entitlement to the Trust Assets, the Senior Sukuk and the Junior Sukuk will rank on an equal basis.

Under the management agreement, the Sukukholders will agree for the Issuer to manage the Trust Assets on behalf of the Venture and on the manner of the distribution of income from the Trust Assets and that the Issuer will continue to manage the Trust Assets. The Senior Sukukholders and the Junior Sukukholders shall agree that any amount above their respective expected return under the relevant Sukuk will be retained by the Issuer as consideration for managing the Trust Assets. The Issuer has no obligation to guarantee, pay or make any Distribution from the Trust Assets should there be no income generated from the Trust Assets.

The expected return will be the return expected by the Junior Sukukholders from the Musharakah Venture which shall be the yield for the Junior Sukuk. The Senior Sukukholders, the Junior Sukukholders and the Issuer shall share income to be distributed based on a priority of cashflow application. The Manager at its sole discretion, can opt to distribute returns to the Junior Sukukholders up to the Expected Periodic Distribution, subject to certain restrictions described in Periodic Distribution Restriction below, or reinvest the monies into the business. Should the Manager opt not to make any distribution or distribute less than the Expected Periodic Distribution to the Junior Sukukholders, there shall be no distribution to the Issuer as the monies would be reinvested in the business and redistributed based on the priority of cashflow application.

## B) Pasir Gudang Municipal Assets Berhad

### Principal Activities

The Issuer has the sole and specific purpose of undertaking the Mudharabah Arrangements and in that regard, has the following objects to be undertaken solely in connection with or incidental to the said Mudharabah Arrangements: a) Granting a Mudharabah facility to or entering into a Mudharabah arrangement with the Administrators (and taking such security in respect of the same as may be necessary or desirable); b) Obtaining a Mudharabah Bonds facility or entering into any other financing arrangements in order to enable it to grant the facility or enter into a Mudharabah Arrangement

ii) Issue size: (RM) RM80.0 Million.

iii) Facility description

The Mudharabah Bonds are Islamic securities which apply the underlying Syariah principle of Mudharabah, a form of financing via profit-sharing arrangement. To facilitate the financing under the principle of Mudharabah, the Issuer and the Investors shall together enter into the First Mudharabah

Arrangement, which involves the issuance of the Mudharabah Bonds by the Issuer. The Investors herein provide the capital via their subscription of the Mudharabah Bonds.

The Mudharabah Bonds, structured on a diminishing basis, shall be evidenced by negotiable and noninterest bearing promissory notes. By the relevant payment date as per the agreed diminishing participation schedule of the Mudharabah Bonds, the Issuer would have refunded the respective funds provided at the outset of the venture in full to the Investors. Parallel to the First Mudharabah Arrangement mentioned above, the Issuer shall utilise the proceeds from the Mudharabah Bonds to provide capital into the venture with the Administrators under the Second Mudharabah Arrangement.

iv) Profit-Sharing Ratio and Entitlement

Profits from the First and Second Mudharabah Arrangements shall be shared according to a fixed pre-agreed Profit-Sharing Ratio of 1:99 (Mudarib:Rabbulmal). The Mudharabah Bonds redemption amounts are as per tabulated below:

Tranche	Maturity	Redemption Amount
	1	1 year RM 15.0 million
	2	2 years RM 15.0 million
	3	3 years RM 15.0 million
	4	4 years RM 15.0 million
	5	5 years RM 10.0 million
	6	6 years RM 10.0 million
	Total	RM 80.0 million

The Investors shall agree upfront that their entitlement (i.e. refund of capital and expected profit sharing amounts) is limited to the Mudharabah Bonds redemption amounts as listed above.

First Mudharabah Arrangement: Rabbulmal (Investors) under the First Mudharabah Arrangement shall forego any amount in excess of the agreed Mudharabah Bonds redemption amounts.

Second Mudharabah Arrangement: Rabbulmal (Issuer) under the Second Mudharabah Arrangement shall forego any amount in excess of the agreed sum which is to be flowed from Collection Account 2 to SPV Collection Account. The Issuer shall agree that their entitlement shall not exceed the aggregate amounts.

v) Redemption: The Mudharabah Bonds will be redeemed at par on the respective maturity dates.

vi) Maturity Date and Refund Obligation

The agreed diminishing participation schedule shall be as follows: (in RM'million):

Tranche 1: 14.375 1 year

Tranche 2: 13.589 2 years

Tranche 3: 12.747 3 years

Tranche 4: 11.841 4 years

Tranche 5: 7.333 5 years

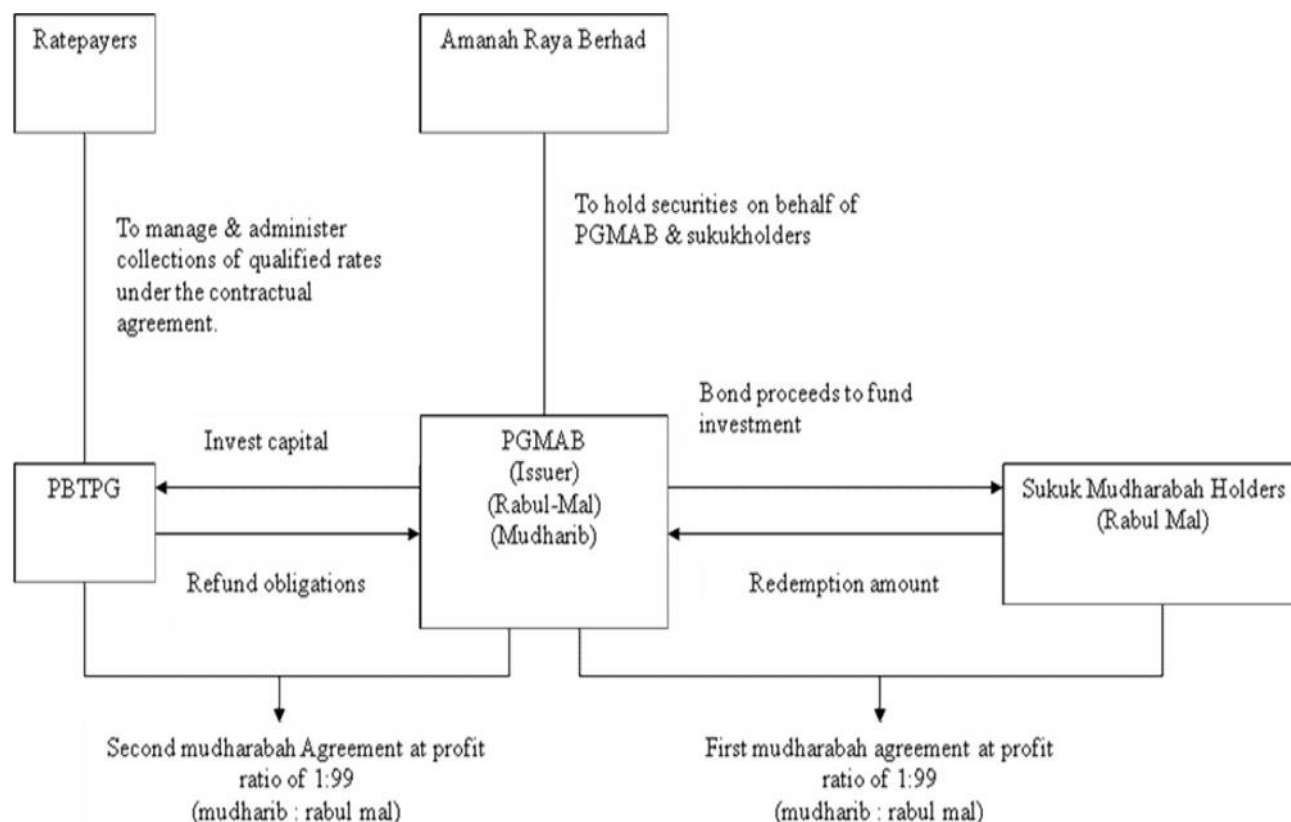
Tranche 6: 6.773 6 years

The Issuer may at any time prior to the Maturity Date, purchase the Mudharabah Bonds in the open market or private treaty for cancellation. All Mudharabah Bonds purchased shall be cancelled and shall not thereafter be available to the Issuer for re-issue.

## vii) Taxation

All payments by the Issuer shall be made without withholding or deductions for or on account of any present or future tax, duty or charge of whatsoever nature imposed or levied by or on behalf of Malaysia or Malaysian law unless such withholding or deduction is required by law, in which event, the Issuer shall gross up for any such withholding or deduction.

Diagram 6: Pasir Gudang Municipal Sukuk



## 7. Conclusion

There are a very limited numbers of Sukuk structures available, due to the issues still being addressed of non-Shariah compliance and the factor of Riba. Shariah scholars have commented against some of the Sukuk structures, even after their issuance in the capital markets. These comments came on the post issuance review of the Sukuk. These reviews helped Islamic financial institutions to correct the structures for the future issue of the Sukuk, as well as, the standardization of the Sukuk market. Using the basic structures, different types of innovated Sukuk have been floated in the market. The view behind such innovative Sukuk was to accommodate the risks of financial markets. The innovated structures have facilitated investors in evaluating the Sukuk for the portions of the fixed rental (Ijarah) income and also for the profit and loss (Musharakah/Mudharabah) shared portions within one Sukuk