

***Bai' al-Mu'ajjal of GoP Ijārah Şukūk***

**Liquidity Management Product of the State Bank of Pakistan  
Introduced vide SBP, DMMD Circular No. 17 Oct. 15, 2014**

*Keeping in view the significance of the Product under discussion for huge investments by the Islamic Banking Institutions (IBIs) in Pakistan and its implications on future of Islamic finance, the JIBM management decided to launch an academic debate in JIBM Discussion Forum. To introduce the product to the readers / experts, the Editor prepared a Note for discussion and sent to a large number of experts including Sharī'ah scholars, practitioners and the researchers with request that they may take any position or give any argument while discussing the product or may like to suggest any option or measure. The 'Note' and the views received by the end of December, 2015 are given hereunder for benefit of the readers. Scholars / practitioners who may like to take part in the discussion or give any comments on views and arguments offered as below, or give any suggestions for benefit of Islamic finance discipline, are invited to send their views, which could be published finally in the next Issue of the JIBM.*

**Note:** The views are personal of the contributors and not of the institutions to which they belong.

**KAUJIE Classification:** K0, L32, L4, Q21

**JEL Classification:** E5, H63

**A. Editor's Note for discussion**

First, we briefly discuss what led to this unique product in Pakistan and what its process is:

The Government of Pakistan - GoP *şukūk* with the underlying contract of *ijārah* were issued during last some years and the Islamic Banking Institutions (IBIs) as *şukūk* holders were getting rental. Although *ijārah şukūk* can be traded in the secondary market at the market price, but IBIs have been generally holding them till maturity and practically there had been a little trading, that too to meet serious liquidity shortages only. As new *şukūk* could not be issued, nor the existing *şukūk* renewed, due to any

reason, whatsoever, the practitioners / treasury personnel needed some way that banks' liquidity remains invested.

A way out was suggested to the Sharī'ah Board of the SBP according to which *ṣukūk* would be sold some time before maturity to the SBP for the period of one year on credit basis (*bai' al-mu'ajjal*) in such a way that the seller bank would add one year's T-Bills related rate to the face value and the rental receivable by that time. [The *fatwá* pertained to this step only.] [One year's time for this credit sale was suggested probably to avoid rate of return risk on account of which *murābahah* / *musāwamah* are normally used in Pakistan maximum for one year. Otherwise, as per the logic, if *ṣukūk* can be sold on credit for one year, the same could be for any period, may be 5, or even 10 years.]

The SBP as manager of the public debt did further work to evolve a procedure through which the money moped up by it from the IBIs could be adjusted in the public debt system. According to the procedure, the above step of purchasing *ṣukūk* from the IBIs is the first leg of the *ṣukūk* based OMO by which liquidity that was to be received by the IBIs upon maturity of *ṣukūk*, is moped up by the SBP a few days earlier than the maturity on one year's mark-up basis.

The money being fungible, in the second leg of almost simultaneous OMO operations, SBP as manager of the public debt (of GoP), injects the liquidity in the market by selling the T-Bills in the market that are purchased by the interest based banks. It is pertinent to observe that as the *ṣukūk* cease to exist upon termination of lease, the underlying cause to get return is no more there; hence the same cannot be sold after maturity to the Islamic banks. [However, if the maturity of lease and hence that of *ṣukūk* is extended any time up to the time of execution of the *mu'ajjal* sale, then the same could be sold up to the period of extension, and the rental added to their price.]

## 2. Possible Sharī'ah bases for *Bai' al-mu'ajjal* of *Ṣukūk*

The SBP in its above referred Circular has not given any Sharī'ah basis and has suggested only the procedure of bidding, and pricing for that purpose. It has been verbally explained that it is simple credit sale of *ijārah ṣukūk* that represent the real underlying assets and hence the sale could be at any price agreed between the IBI and the SBP. As regards the impact of the second leg of the OMO, it may or may not be financial *tawarruq* (broadly, getting or investing liquidity by way of trading). Even if someone may consider it *tawarruq*, it is claimed that *tawarruq* has been allowed by IBD Circular No, 2 of 2008. No Sharī'ah basis or clarification

has been given with regard to the certainty of the subject matter of sale, pricing of *ṣukūk* by adding one year's return, maturity of *ṣukūk* and culmination of lease and the impact of both legs of OMO with regard to indirect supply of billions of Rupees by the IBIs to the conventional banks.

### 3. Sharī'ah based appraisal of the Product

**3.1** In our view, the product is Sharī'ah compliant neither in letter nor in spirit. The reasons why the product is not Sharī'ah compliant even in letter are as below:

- a) Sale or exchange of *a'yān* (corporeal goods or the commodities of material value in themselves) or the instruments representing them (like shares that are perpetual in nature; or *ijārah ṣukūk* that are time bound in nature) is subject to rules different from sale /exchange of *athmān* that are used primarily as a medium of exchange, receivables, or the instruments of debt;
- b) The subject matter of any sale contract should be precisely determined with full disclosure. In the present case, the impression that the sale of the subject matter (*ṣukūk*) is for the credit period of one year is problematic as *ṣukūk* as evidence of *ijārah* practically cease to exist on the maturity date—may be one or two days after the deal;
- c) The subject matter or *ijārah ṣukūk* represents any assets purchased from the GoP (through SPV), then taken on lease from the GoP up to December 31 2015, for example; on the maturity date: i) the subject matter will transform into a receivable, and ii) the corporeal asset will be sold back to the GoP as per undertaking;
- d) *Ijārah ṣukūk* that mature at an agreed date and hence are to be redeemed cannot be sold for any period after maturity because then they represent receivable and the holders have to get cash.
- e) As receivables /debt instruments are not tradable *per se*, the *ṣukūk* after maturity are not tradable and in case an Islamic bank knows that after a few days, the lease, the *ṣukūk* and hence the right to rental will cease to exist, it does not have any right to add rent for the period afterwards;
- f) Sale of a receivable or debt is allowed if it is subject to the condition of *ḥawālah*, i.e. at face value with recourse. But here, rent is being charged expressly (in the name of price) for the period after the lease termination and without ownership of the underlying asset.
- g) As this takes a form of a formal process on the basis of which Islamic banks continue to earn return even after maturity of *ṣukūk*, termination of lease and resale of the asset to the GoP, the sale before maturity cannot be

considered as a genuine / valid sale if the rent for the credit period is added to the credit price.

### 3.2 The reason why the product is not Sharī'ah compliant in spirit

- a) Actions are judged as per the intentions (ḥadīth):- The purpose of any contract and its underlying cause should not be contrary to the fundamental principles of Islamic law of contracts and hence the objectives of the Sharī'ah. Here the objective is to continue earning on liquidity after termination of *ijārah* and maturity of *ṣukūk*; as practically the receivable is sold to get return, it is nothing but *ribā*.
- b) It is like roll-over *murābaḥah* which is not allowed as per SBP instructions: The objective here is to circumvent the prohibition of *ribā* by a *ḥilah fi al-dayn* to circumvent the prohibition of interest; If I know that the *ijārah* would terminate on December 31, 2015 for example, and I will no more be getting return on my money / cash that I would get on maturity; I resort to a trick (as in case of roll-over *murābaḥah*) that I should sell it on credit any time before maturity, for any period after the maturity and add the amount of rent to be accrued during the credit period, so that my cash remains invested for that period. The intention clearly is continue getting return on money (without any real economic activity), which renders the return *ḥarām*.
- c) While sometimes, it is claimed that *tawarruq* is allowed vide IBD Circular No. 2 of 2008 (which is not a factual position; banks were rather advised to get approval for each such specific transaction; further SBP's Sharī'ah Board has not expressly allowed the financial *tawarruq*); it is argued by some that it is not *tawarruq*. It may or may not be *tawarruq* in specific sense, but it is necessarily a trick for investing cash by way of invalid trading and ultimately a means to provide the funds mobilized for the purpose of Islamic business / banking to the interest based system. It may also be kept in view that the Makkah and the Jeddah based Fiqh Councils prohibited the organized or financial *tawarruq* in 2009.

## 4. Use of the Product by the IBIs in Pakistan

As circulated by the SBP, the product has been used by almost all Islamic banks in Pakistan for the GoP *ijārah ṣukūk* maturing during last one year. As required by the Sharī'ah Governance Framework, all IBIs got permission from their respective Sharī'ah boards on the ground that SBP's Sharī'ah board has already allowed the product. If any of the Sharī'ah board members expressed difference of opinion, it was explained that as almost all other IBIs have allowed the transaction, it has become a *mujtahid feh* matter. Practically, however, it reflects a 'contagion effect' or path dependency pattern – the case is presented to the Sharī'ah Board of any IBI with the plea that as the SBP's

Sharī'ah Board has approved, it may be approved, or may be considered as approved by all. Hardly anyone from the members of the Sharī'ah boards would have discussed the nature of subject matter being traded, impact in case of maturity, return for the period after maturity, OMOs to mop-up and inject liquidity from the IBIs and the conventional banks respectively.

## 5. Implications of the product on Islamic Banking Finance:

- a) Earlier, the *ṣukūk* were criticized **due to the clauses of obligor's undertaking and guarantee of the principal and the return one way or the other** and, hence, the Sharī'ah scholars, and the most prominently, Hazrat Maulan Mufti Muhammad Taqi Usmani sahib declared that 85 % of *ṣukūk* were non-Sharī'ah compliant. The product under review is an extreme case of earning money on money, even without any underlying *ijārah*, the case that practically implies sale of an instrument of debt. It is practically trading in money and financial papers that has been prohibited by Hazrat Maulan Mufti Muhammad Taqi Usmani sahib himself <sup>1</sup>.
- b) Now, when Islamic banking has crossed the milestone of 40 years of its existence, such *ḥilah* cannot be allowed even in case of apparent necessity (to keep the cash assets earning). Sharī'ah compliance is the core requirement and the profit taking is subservient to it. The Product could be highly harmful for integrity of Islamic banking in Pakistan and abroad.
- c) The product provides relief in terms of liquidity placement for about one year only, while the permanent solution is in changing approach and mind-set to do real sector business and facilitate the micro, SMEs, agriculture and other sectors of the economy.

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<sup>1</sup> While emphasizing the permissibility of the trade and lease based modes, Shaikh Taqi Usmani says, "In fact, if implemented with all their necessary conditions that have always been stressed upon by the Sharī'ah scholars, they are substantially different from an interest based financing. **At the first place**, all these instruments are based on real assets, and do not amount to trading in money and financial papers, which is the case in an interest based financing. **Secondly**, unlike an interest-based transaction, the financier, in each one of these instruments, assumes the risk of real commodities, properties or equipment without which the transactions cannot be valid in Sharī'ah. **Thirdly**, these modes can be used only to finance a commercial activity that is permissible according to Islamic rules and principles. These basic distinguishing features are enough to draw a line of difference between the two techniques of financing. Therefore, the notion that they are another form of interest is not correct. .... Since they are modified versions of certain forms of trade, they are subject to strict conditions and cannot be used as alternatives for interest-based transactions in all respects. ----- This situation needs serious consideration of the players in the field and of the Sharī'ah scholars who oversee the new products for Islamic financial Institution". [Looking for New Steps in Islamic Finance]

<http://www.sunniforum.com/forum/showthread.php?87356-All-articles-by-MUFTI-MUHAMMAD-TAQI-USMANI-SAHAB!>

d) Last, but not the least, this product exists nowhere in the world except in Pakistan. If it is used for longer periods of times in countries where the latent inflation rate is nominal, it would become the major product for earning money on money by Islamic banks thus providing irreparable loss to the integrity of Islamic banking. All members of the Sharī'ah boards are accountable to the depositors as also to the Allah Almighty. All their decisions and moves have to be for the real benefit for the Islamic finance movement.

## 6. Recommendation:

- a) Efforts should have been made to renew the *ijārah* terms leading to extending the life of *ṣukūk*.
- b) The product may, *prima facie*, benefit the IBIs for taking relatively low return only for about a year; ultimately they need to invest the funds in real sector business – SMEs, Micro businesses, energy sector, industry, agriculture, etc that may give higher return for the bank and the depositors and would lead to stable and sustainable growth of Islamic banking in the country. New *ṣukūk* could also be issued.
- c) *Salam* can be used for forward purchases of wheat or other products of the corporate sector. Short term *salam ṣukūk* could be issued and used by the IBIs for the purpose of SLR as in the case of Bahrain.
- d) All IBIs may constitute a joint Mutual Fund, Stock Market Fund and / or Venture Capital Fund to mutually invest the liquidity by way of *mudārabah* in Sharī'ah compliant stocks and for the newly established projects in the country that is the dire need of the time to create employment opportunities and alleviate poverty.

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## B. Comments by Dr. Salman Syed Ali, Senior Research Economist; IRTI, IDB, Jeddah

You may have seen illusive pictures that appear two different things to two different viewers. A famous one (origin unknown) is such that from one angle it appears to be a sketch of an old woman. Flip the picture upside down and it appears to be a portrait of a young woman. Hence, two contradictory perceptions! Another famous case is a black and white illustration of a symmetric drinking cup. The same picture viewed with a different perspective, appears to be the side views of two human faces one at left the other at right. The case of the “*bai' al-mu'ajjal* of GoP *ijārah ṣukūk*” is somewhat analogous. It appears perfectly Sharī'ah compliant to some, yet from another perspective it appears Sharī'ah non-compliant. This note discusses this product and shows how it is, and it is not Sharī'ah complaint. Further it proposes a resolution method for the paradox.

This note is organized as follows: In Section A, we discuss a general principle why *bai' al-mu'ajjal* (deferred payment sale) of *ijārah sukūk* (as well as some other kinds of *sukūk*) is permissible. In Section B, we discuss the other perspective, why *bai' al-mu'ajjal* of *ijārah sukūk* is not Sharī'ah compliant. Here a different argument, than those provided by the Editor, is forwarded as primary possible cause of prohibition. In Section C, we endorse part of the conclusion by the Editor. In Section D, we discuss a methodology of addressing matters lying in the gray areas. While it is better to refrain from using a product that lies in the gray area between the boundaries of *ḥalāl* and *ḥarām*, a judgment on use or refrainment can be made based on the likely macro impact of the product. The broader challenges of liquidity management in Islamic banking system and the issues of monetary policy instrument along with possible new methods are left for another future note.

### Section A:

Assume that the *ijārah sukūk* 'structure' under discussion is Sharī'ah compliant in the sense that it satisfies all the conditions of *ijārah sukūk* stipulated by the OIC Fiqh Academy and complies with the AAOIFI's Sharī'ah standards for *ijārah sukūk*; such that the *sukūk* have not been issued on some further lenient terms than the above. Thus, the *sukūk* represent ownership of the *sukūk* holders in the underlying tangible asset held in trust by the SPV on behalf of the *sukūk* holders.

Then as a general rule, because the *sukūk* grant temporary (time bound) ownership of the underlying asset, the *sukūk* -holder can perform sale, purchase, gift or other exchange transactions with *sukūk* within that pre-maturity time period. This is what continuously happens in the secondary market for *sukūk*. Such secondary sale can take place at freely negotiable prices as long as the underlying asset has not been destroyed/finished its useful life/exited the claim of the *sukūk* holder or its trustee at the time of sale. The payment of the price can however be on spot as well as deferred (if no violation of *ahkām* of sarf i.e. rules of *ribā al-faḍl* takes place).

When a *sukūk* holder sells the *sukūk* to a third party, it has to be with transparency and full information. Including, the clear understanding of the secondary buyer that the *sukūk* are going to retire at certain time and the underlying asset is either going to revert to the originator (as in *ijārah sukūk*) or to someone else (as in *sukūk* based on *ijārah muntahiyah bi al-tamlīk*). If still the secondary buyer is willing to buy it at a premium (or at a discount), it is up to the consideration of the buyer and the seller. This

sale and purchase is not *ribā* as *ṣukūk* represent ownership of the underlying tangible asset albeit held through the trusteeship of an SPV at the time of transaction. By this interpretation, under legalistic thinking, *ṣukūk* can be sold until and up-to the end of maturity date for any mutually agreed price. This price can be paid on spot or the payment can be deferred to some later date, even to a date falling after the maturity date of the *ṣukūk*.

### **Section B:**

Think of a scenario that we are at a point in time very close to the maturity date of *ijārah ṣukūk*. The underlying asset is automatically going to become liquid (cash) in few days, it is ‘near money’ now. So, the *ṣukūk* now are representing ‘near money’. At his point, if this *ṣukūk* is bought (or sold) at deferred payment basis, then this is violation of *aḥkām al-ṣarf* (rules of *ribā al-faḍl*).

Any party that is buying the *ṣukūk* just before its maturity date (i.e. the date of its automatic transformation into cash) and it is willing to pay a higher amount (than the cash receivable from retirement of *ṣukūk*) if allowed to make the payment on a deferred time. It is violating *aḥkām al-ṣarf* (rules of *ribā al-faḍl*). Hence, sale of *ṣukūk* just before maturity on a price contractually deferred beyond the maturity date of the *ṣukūk* is prohibited.<sup>2</sup>

### **Section C:**

Now we have two opposing judgments based on our perspective of the nature of the underlying asset. So, what do we conclude? In such cases, rule based reasoning has to be combined with dominant motive based reasoning.

As the *ṣukūk* are traded in the secondary market there is the possibility that some settlements of a sale made during the pre-maturity period take place much after the maturity. It would be permissible because over the dominant time that the *ṣukūk* was held, it was tied with its underlying asset. Deferment of settlement on a later date is not substantial in time and may not be intentional.

However, a planned buy very near to the maturity date such that the *ṣukūk* are held only for a short time with intact tangible underlying asset

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<sup>2</sup> Note that this argument does not require knowing the procedure of earnings calculation. It is immaterial whether the increase is calculated as rent for the period in which the tangible asset did not remain with the SPV or it is calculated as mark-up built into the price of the underlying asset or in the price of the *ṣukūk*. The transaction now must be done as a spot transaction.

and for a longer planned time without a tangible underlying asset while earning a return falls under prohibition zone.

The Editor's note has described the liquidity management product and its operational procedure. From it this is clear that the open market operation (OMO) arrangement has been made to keep the money invested to earn a return beyond the maturity date, into a period when the *ṣukūk* have transformed from representing a real asset to pure cash (or cash receivable or liquid) asset. This intension is not simply hidden, but made explicit in the policy evidenced by the arrangement to do it regularly and on a large scale. Thus, the arrangement is not Sharī'ah compliant. The Editor in his note is correct when he states:

*“Actions are judged as per the intentions (ḥadīth):-* The purpose of any contract and its underlying cause should not be contrary to the fundamental principles of Islamic law of contracts and hence the objectives of the Sharī'ah. Here the objective is to continue earning on liquidity after termination of *ijārah* and maturity of *ṣukūk*; as practically the receivable is sold to get return, it is nothing but *ribā*.”

#### **Section D:**

At this point, we would like to highlight some further problems with allowing deferment of sale price beyond maturity date of *ṣukūk*. In the *ṣukūk* market there is a realization that tying the *ṣukūk* issuance with some real underlying asset is limiting the scale and scope of issuance. The *ṣukūk* structures that targeted global acceptance in all markets started in 2002 as *ijārah ṣukūk* with real assets backing the *ijārah* transaction. Later, dilution in the requirement for the real asset was made by accepting the mixed asset (30 percent receivables and 70 percent tangible assets). It was further diluted to the 49:51 percent rule. Then a move towards so-called *mushārahah ṣukūk* (with all features of a guaranteed capital and fixed returns but labeled as *mushārahah*) was an attempt to remove the requirement of a tangible asset underlying the sukuk contract. When this move failed due to pronouncement against this practice and revision of the sukuk standard by AAOIFI, the sukuk structures moved to wakala-based *ṣukūk* – again an asset-lite structure. Now, allowing the sale of *ijārah ṣukūk* on deferred payment with price payable much after the maturity date would open the gate for another kind of asset-lite structure; whereby, a company would issue *ijārah ṣukūk*, with all Sharī'ah compliant asset and *ijārah* contract, but maturing in short duration (say six months). Just before the maturity date the obligor company buys back the *ṣukūk* on a deferred price payable after two years with mark-up added reflecting the accrued interest over the next (two) years. This will allow the issuer to

commit the underlying tangible asset just for six months while getting finance for two years and six months. These *ṣukūk* will be essentially non-collateralized bonds during the latter two-year period. It is bond not *ṣukūk* because the extension of debt with a return is not tied to any real economic activity. It is non-collateralized because no asset remains held by SPV on behalf of the *ṣukūk* holders.

A seemingly small move by the SBP to accommodate an incidental need of return-generating short-term liquid asset for Islamic banks is going to create a hole that will open the floodgates of wrong practices and undermine some core values of Islamic finance.

As this practice of buying the *ṣukūk* at deferred price just before the maturity takes hold, the traders will make the anticipation of this move, and hence it will be built into the initial price at the time of offering of the *ṣukūk*. The offering price will go up, any chance of rate of return to be related with the underlying asset will be further eliminated, the rate of return will become more tied to the rate of interest, and the credit rating of the obligor (or the guarantor) will become the ultimate factor in financing.

We are already experiencing the above stated problems due to other leniencies and exceptions tolerated in the structuring of *ṣukūk*.<sup>3</sup> Adding dubious ‘practices in trading’ of *ṣukūk* will further accentuate the problems, making it difficult for the society to experience the benefits of the Islamic finance.

However, the liquidity management is also a need at present<sup>4</sup>, and if the intension is the dividing factor in the grey area that falls near the boundaries of *ḥalāl* and *ḥarām* then a regulator cannot always judge intensions. So what is the expression of intension and what is the demarcation timeline before maturity that we can say that the *ṣukūk* become near money? What if, the trader buys the *ṣukūk* much before that cutoff time but for deferred payment much beyond the maturity date?

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<sup>3</sup> Binding promise to buy-back the underlying asset at pre-stated price, no recourse of *ṣukūk* holders to the underlying assets even in case of default, guarantees on rent and the principal, deliberate ambiguities in the specification or identification of the underlying asset. These and other such tricks in the structuring of *ṣukūk* have already undermined the Islamic nature of the *ṣukūk*. They have created a delink between the economic activity and the *ṣukūk* price.

<sup>4</sup> A discussion about the nature of liquidity management is needed in Islamic banking compared to the conventional banking; review of the liquidity management practices of Islamic banking industry in various countries as well as some new recommendations can also be made here. However, this discussion is left for future note.

The answer to this lies in the earlier statement that intentions of the trader would be important. However, to make a regulatory rule the principle can be adopted that for anyone who sells *ijārah šukūk* with a price deferred beyond the maturity date, the number of days beyond maturity cannot exceed the number of days he has held the *šukūk* immediately before this transaction.

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### **C. Comments by Prof. Dr. Sayyid Tahir; Professor of Economics at International Islamic University Malaysia**

JIBM has taken a commendable timely initiative to launch academic debate on emerging issues in Islamic finance. The absence of a solid theory of Islamic finance as well as the shortage of time at the decision-makers' end are complicating the matters. With the passage of time every new development in Islamic finance is narrowing the divide between it and conventional finance.

Roots of the issue at hand are deep. Historically, Islamic jurists never allowed arranging finance by selling one's property for cash and at the same time repurchasing it at a higher price payable in the future. Thus, a person owning a property and seeking cash could meet his target by either selling it outright or leasing it for advance rental. In the latter instance, rental rate and period of lease have to be such as to enable the respective person meet his need for cash. As against these clear-cut options, a party's creation of a special purpose vehicle (SPV), selling an asset to it (with an undertaking for re-purchasing the asset at the same price at a future date) and leasing it back, in order to provide legal basis for securitization and sale of *ijārah šukūk*, raises suspicion. The apparent difference in this equation is the replacement of marked-up repurchase price in the simple sale-and-repurchase arrangement by the initial sale price *plus* "rental" payable to the bearers of *šukūk* during the tenor of the *šukūk*. This is reminiscent of the ingenious tricks as mentioned in the Holy Qur'ān (*al-A'raf* 162-166). The matter of *ijārah šukūk* is disturbing because from the Sharī'ah point of view, the SPV and its creator are practically not two independent persons, a pre-requisite for a valid sale. The initial sale to the SPV is, therefore, void *ab initio*, and does not provide any basis for further steps in the creation of *ijārah šukūk* as generally in vogue. Then the undertaking by the obligor to repurchase the asset at its sale price irrespective of its market price refers to another structural drawback. If these reasons were not enough for reviewing reliance on *ijārah šukūk* for resource mobilization, issuance of new Circular by the SBP has further complicated the matters.

The above circular authorizes the purchase of the existing *ijārah sukūk* by SBP, on behalf of the Government of Pakistan, from their bearers on a deferred payment basis. The bearers are usually financial institutions. The time of the purchase is fairly close to the maturity date. And, the deferred price represents both the value of the *sukūk* (on the maturity date) and the rental payable during the credit period. This is on the assumption that rental for the last period is paid on time to the existing *sukūk*-holders. If that is not the case, the deferred price will include that as well [the case of non-payment may not be in GoP (sovereign) *sukūk*, but could be in the corporate sector *sukūk*, if the Sharī'ah advisors of respective banks permit credit sale of corporate *sukūk* with possibility of default, or near to maturity sale, relying on the permission by the SBP Sharī'ah Board].

Four issues call for attention here: (1) the motivation behind the purchase of *ijārah sukūk* by the State Bank of Pakistan on deferred payment basis, (2) the Sharī'ah objections, if any, on the transaction, (3) measures for addressing the Sharī'ah objections, and (4) alternative arrangements for meeting the goals behind the purchase of *ijārah sukūk* on deferred payment basis. The following lines shed some light on these matters, though not in the said order.

The assessment may begin with the question: why does the need for the transaction under reference arise in the first place? One rational explanation might be that the issuer of the *sukūk* lacks funds to retire them on time. Of course, the *sukūk*-holders would need incentive for further delaying their encashment claims if they get some premium over and above on their claims at the existing maturity date. Mopping of excess liquidity from the system through the sale under reference cannot be a convincing reason, especially when the needful may be done in other ways, such as selling new *sukūk*.

Notwithstanding the above points, however, at the time of the purchase of the *sukūk* (by the SBP) on deferred payment basis, the status of redemption price of the *sukūk* plus the return payable for the last period is that of a debt outstanding against the issuer of the *sukūk*. And, once the transaction is done, the price payable by the State Bank, on behalf of the Government of Pakistan, too would be debt. Thus, the purchase of maturing *sukūk* on deferred payment basis is a modern-day manifestation of *trading of debt for debt*. The reading of trading of an asset-linked instrument for money is inconsequential here. The element of *ribā* is unavoidable, because the bearers of the *sukūk* will require some incentive for not liquidating their *sukūks*.

There are some other complications as well. Arrival of the (approaching) maturity date will mean ending of the lease period as well as the period of transfer of ownership to the *ṣukūk* buyer. In the absence of additional legal steps to reinstate or replicate the sale-lease back process for the extension period, payment of rental for the extension period will have no basis.

Both of the foregoing points reveal that the idea of sale of *ijārah ṣukūk* on deferred payment basis while maturity period is already approaching is ill-conceived. In passing, one may ask about selling of *ijārah ṣukūk* to other investors, not their issuer, on deferred payment basis during the tenor of the *ṣukūk*. That would be a premature question. First of all, the *ijārah ṣukūk* themselves have to be above reproach from the Sharī‘ah point of view. In the event a genuine financial instrument is developed, the transaction will be subjected to the edicts on *ribā* and *gharar*.

The use of *ijārah ṣukūk* for open market operations by the State Bank of Pakistan also requires a fresh look. If the SBP acts as operational arm of the Government of Pakistan for the issuance of *ijārah ṣukūk*, what would be the Sharī‘ah status of its buying and selling of the instrument issued against its principal? The Sharī‘ah scholars are yet to take a formal position on such matters.

Addition of new Sharī‘ah twists to the existing *ijārah ṣukūk* is unlikely to solve the problems. Research is needed on fiscal management in the light of the Islamic financial architecture and liquidity management in line with Islamic law of contracts. Islamic banking offers some lessons in this regard: things have to move from asset-backed to asset-based instruments.

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**D. Comments by Mr. Muhammad Zeeshan Farrukh(CPIF)  
Manager Product Development, Al Baraka Bank  
(Pakistan) Limited; Karachi, Pakistan**

I understand that the clarity of ownership and risk of the parties, involved in a certain transaction, must be considered as a base for Sharī‘ah compliance. If these aspects are not clear, the transaction must not be certified as Sharī‘ah-compliant. Considering on this basis, the product under discussion is an ambiguous product.

As far as these types of ambiguous and doubtful transactions are concerned, they must be avoided. It is disappointing to note that rather than going towards real solutions and research-oriented environment, we still resort to finding out solutions through easy ways to obtain results as conventional counterpart.

This approach and behavior of industry, those who suggest and approve such products and the regulators need to be changed to enable creating environment for constructive product development and research that could pave the way towards the implementation of Islamic economic system.

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Mufti Syed Mohammad Abubakr Siraj ud Din, Sharī‘ah Board Member at Silk Bank Limited, also gave his personal views on the product. But some parts of his note needed clarification for which we requested him. He was of the view that he needed some more time to study and analyse the product and its implications. We give below the gist of what he contended in his earlier note.

[IBIs operating in competitive environment with the conventional banks needed instruments / products to manage their liquidity as well as meeting the regulatory SLR. The product under discussion serves the purpose. “The *ṣukūk* holders are the owners of the assets till the maturity of *ijārah* and *asset will be sold back to GoP as per undertaking.*” The *ṣukūk* holder IBIs executed a Sale/Purchase contract with GoP before the maturity of the *ṣukūk*. GoP would be liable to pay the deferred sale price as per the agreed maturity. As per Sharī‘ah rulings, when one purchases an asset it can use it in any Sharī‘ah compliant way including selling the same in the market. Therefore, there seems to be no Sharī‘ah problem with this transaction. Further, as per Islamic law of sale, there is no issue with earning profit or adding the profit for credit period.

However, “the likes of this product should be discouraged and the size of such transactions should be capped at a certain percentage. The GoP should support and work on facilitating IBIs so that they can enter into SME and agriculture financing. The mind set of taking one asset as collateral and executing multiple transactions might create a bubble in the economy and risk the stability of Islamic finance”.]

In case he gives his views / observations in detail, we would publish the same in the next Issue of the JIBM.