Malaysia

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Sukuk issuer payment obligations

Sukuk is no longer a new concept in financial markets. Joining the sovereign and *quasi*-sovereign entities that have issued *sukuk* are European countries such as the UK and Luxembourg, as well as Asean countries such as Singapore, Malaysia, Indonesia and even further east to Hong Kong. Popularly referred to as Islamic bonds, a *sukuk* is anything but a bond. Bonds typically involve an element of lending and interest payment, and Islam prohibits the payment of interest. Bonds represent in effect a lending transaction with a payment obligation of more than the amount being borrowed. *Shariah*, which is an embodiment of Islamic laws, prohibits such lending transactions. It is a misconception that lending *per se* is prohibited under *Shariah*. Islam sees lending as a charitable act and in that perspective encourages it. In fact Islam goes further to enjoin to even grant indulgence of time and forgive debts where the debtor cannot afford to repay. What is prohibited is to impose an obligation to be repaid more than what is lent. Interest is thus prohibited.

So what then is a *sukuk*? The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) defines *sukuk* as certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activities. Based on this definition, *sukuk* can hardly be said to represent the typical principal and coupon of a bond. A *sukuk* can be structured to create a payment obligation nonetheless but on transactions not based on lending. Hence the use of the terminology of principal payment and profit (or expected profit) where *sukuk* are involved is in most cases one of convenience. Many *sukuk* in fact do not embody 'principal' payment as being outstanding on the date of issuance but are structured to be outstanding and due at the point of maturity. This is a major difference often missed. The 'profit' coupons in *sukuk* are structured as payment obligations that are due periodically, which makes structures using leases or rentals a good fit. Key to understanding *sukuk* structures is the way the payment obligation is created, as there is no one way of structuring *sukuk*. For example, Malaysia's sovereign *sukuk* and the Petronas *sukuk*, both issued this year, were not structured the same way as the issuers' previous *sukuk* issuances. Being a relatively new financial instrument, as yet there is no such thing as a standard *sukuk*.

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