Comment of

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on

Necessary Legal Reforms to Create Legal Basis for Effective Islamic Asset Securitization (*Ṣukūk*) in Indonesia.

by

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The issuance of the global *ṣukūks* by the Qatar, Bahrain and Malaysian governments has prompted similar *ṣukūk* issuance in Indonesia. In this respect, the author has made an honest attempt to explore the possibility of Islamic bond (*ṣukūk*) issuance via asset securitization in Indonesia by looking at its existing legal environment.

Before proceeding on my comments, it is important to note that the issuance of fixed income instruments such as bills, notes and bonds constitute the sale of debt securities by the issuing company or government (i.e. Debtor) to the investors (i.e. Creditor). In this regards, the bond sale does not implicate an asset securitization process but an issuance of a debt certificate or security backed by collaterals.

Asset securitization is the structured process whereby interest in loans and other receivables are packaged, underwritten and sold in the form of "asset-backed" securities (ABS). The receivables can include auto loans, real estate loans, student loans and credit card receivables.

Asset securitization enables the credit originators to transfer some of the risks of ownership to parties more willing to manage them. By doing so, it gives them broader funding sources at more favourable rates and also helped them overcome potential asset-liability mismatches.

Islamic asset securitization (IAS) however has been used to describe the Sharīʿah compliant structured process leading to the issuance of a Sharīʿah compliant security or *ṣukūk.*

In Malaysia for example, IAS can mean three structured processes, namely:

a. Issuance of Islamic private debt securities (IPDS) such as coupon (BAIDS) and zero coupon Islamic bonds (MuNif) using the contract of *bayʿ' al-ʿ'īnah* and *bayʿ al-dayn* at discount.

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b. Issuance of asset-backed securities (ABS) that also employ the contract of *bayʿ al-ʿīnah* and *bayʿ al-dayn* at discount.

c. Issuance of global *ṣukūks* with *ijārah* as the income generating vehicle.

In this paper, the author has specifically focus at Islamic ABS where the author has raised two important issues that warrants serious look by both market players and Islamic jurists, namely:

- The nature of the *ṣukūk* security – debt or equity
- The subject matter of securitization, namely the tangible asset or property.

Let's look at the issue one by one.

The Nature of *Ṣukūk* Security – Debt or Equity?

The Qur'ānic prohibition of interest as *ribā* (Al-Baqarah:275) has automatically prohibits the purchase of fixed-income instruments that both offers capital preservation and contracted-fixed interest income. In this way the *ṣukūk* is expected to avoid providing the same to investors.

The paper has mentioned that existing Indonesian legal environment (i.e. Draft law) has clearly stated that securitization can only implicate the issuance of a debt security. The same applies to Kontrak Investasi Kolektif or Collective Investment Contract (CIS) known also as Cagamas Bhd. In Malaysia that only caters for the issuance of debt security.

In Malaysia, existing guidelines on debt securities contained in the Securities Commission Act (SCA) 1993 have also defined Islamic bond as a debt security and debenture, hence providing investors capital protection and upfront fixed income (i.e. Indebtedness). Debenture is defined in Section 2 of the SCA in a manner that requires an element of indebtedness of a corporation. In this sense, the Private Debt Securties (PDS)

Guidelines issued by the SC in 2000 has constrained the issuance of Islamic bonds to debt securities alone contracted under the principle of *bayʿ al-ʿīnah* and *bayʿ al-dayn* with BBA and *murābaḥah* branding. The guideline could not be used for the issuance of Islamic bonds with equity features. In 2004, the Securities Commission has decoupled Islamic bonds from the definition of debentures and introduced a new term "Islamic Securities" in a new set of guidelines, namely the Islamic Securities Guidelines (ISG) 2004. Indonesia should be able to extract some points from the ISG to make way for the Islamic equity issues in CIS.

The Subject-Matter of Securitization – Tangible asset

The paper is also written to describe the process of asset securitization in Indonesia with specific reference to asset-backed securities (ABS). One pertinent issue raised is the ownership of securitized asset. Conventional ABS deals with the sale of receivables (i.e. Claims on future cash flows arising from debt obligation – securitized asset)) by the Originator to the SPV but Islamic asset securitization

usually entails the sale of tangible assets. I will use two examples of tangible assets in the case of *ṣukūk al-ijārah* issued by the government of Malaysia and Qatar:

Malaysian ṣukūk Assets – The Selayang Hospitals, The Tengku Ampuan Rahimah Hospitals, a Government-owned hospital, a parcel of land along Jalan Duta on which Government living quarters are being constructed.

Qatar ṣukūk Assets – Land Parcels belonging to the Qatar government

The SPV for CIC in Indonesia serves as a bankruptcy remote legal entity but only on claims to future cash flows (i.e securitized assets), namely the receivables. The *ṣukūk* model however uses a different mode of securitization, namely securitization of tangible assets and not the securitization of rental receivables arising from the (leasing) *ijārah* business.

Existing ABS in Indonesia deals with the securitization of receivables. In this sense, it does not have an inbuilt mechanism to cater for insolvency against a pool of tangible assets as evident in the *ṣukūk* model. In this regards, the author is correct to say that some reforms in the Indonesian law must be introduced to make the issuance of *ṣukūks* possible.

This issue of asset segmentation is therefore critical. The Sharīʿah legitimacy of *ṣukūk* trading (i.e. Buy and selling of *ṣukūks* in the secondary market at above or below face IPO value)

rests on the existing juristic opinion that the paper must be backed by tangible assets up to 51%. Any less than that (ie. 51%) will deemed the *ṣukūk* prohibitive for trading. Unless, investors hold the *ṣukūks* to maturity, trading is not an issue.

But liquidity is one critical requirement of an efficient financial system. Without liquidity, financial transactions ceased to move steadily to fulfil the demand and supply of capital.

Finally, the securitization of *ijārah* receivables (i.e. Rental) is not within the scope of the current global *ṣukūk ijārah*. This is true since the main emphasis of the global *ṣukūk* is the securitization of physical and tangible assets from which rentals can be earned. It is different from conventional asset-backed securities that focus on the securitization of future income flows, namely the rentals.

Likewise, it is premature to indulge into talks about securitization of *muḍārabah* profits (i.e. Future income flows arising from a *muḍārabah* project) as the latter is unknown by virtue of contractual agreement. Securitization of *ijārah* rentals and securitization of *ijārah* assets can mean two also different things. The former (i.e. as the author has clearly mentioned) has not yet received global Sharīʿah compliant status while the latter constitutes current global *ṣukūk ijārah* practises acceptable by all school of *fiqh.* It emphasizes on the income generating capacity of tangible asset via *ijārah* mechanism and certainly not the securitization of idle assets (i.e. property of value but unable to generate cash flows).

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