

## THE ISLAMIC BONDS MARKET: POSSIBILITIES AND CHALLENGES

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Bonds are long-term debt obligations that are secured by a specified asset or a promise to pay. In effect, a bond investor has lent money to the bond issuer. In return, the issuer of that bond promises to pay interest and to repay the principal on maturity<sup>1</sup>.

The certificate itself is evidence of a lender-creditor relationship. It is a “security” because unlike a car loan or home improvement loan, the debt can be bought and sold on the open market. In fact, a bond is a loan which is intended to be bought and sold.<sup>2</sup>

It is clear from this definition that in the conventional system of bond issuance and trading the issue of interest is at the centre of any transaction. In contrast, in the Islamic financial system usury and interest are the first elements to be avoided. However, this does not mean that the door of debt financing or, more generally, the possibility of bonds issuance and trading is closed to Islamic finance. However, it shall be noted that beside the rejection of the obvious system of interest in bond trading, the Islamic alternative must also avoid any transaction of debt and credit on future basis which may result in usury and interest.

Considering the fact that bond issuance and trading are important means of investment in the modern economic system, Muslim jurists and economists are striving to find the Islamic alternative. However, to meet the various demands of investors Islamic bonds and certificates should be diversified. We have so far the *mudarabah* or *muqaradah* bonds, the *musharakah* bonds, the *Ijarah* bonds, the *istisna'* bonds, the *salam* bonds and the *murabahah* bonds. However, it should be noted that although some of these instruments have been generally accepted as being in compliance with Islamic principles so that they can be traded in the secondary market, the negotiability of certain others is still a point of debate and controversy due to their legal acceptability or compliance with *shari'ah*. Therefore, some of these bonds can be traded in the secondary market while the trade of others is limited to the primary market because they can be exchanged only at face value.

In Malaysia for instance, almost all of the domestic Islamic debt papers issued so far have been based on the principles of *murabahah* and *bay' bi al-thaman al-ajil* despite the controversy surrounding the issuance of tradable bonds in the secondary market based on the above two contracts. At the same time, there is a perceptible increase in the willingness amongst Malaysian issuers of bonds to explore other Islamic principles of financing, namely the profit-oriented based *musharakah* as well as the asset-backed mode of *ijarah*. The progress of developing Islamic securities based on these financing codes, nonetheless, has been painfully slow and, to some extent, stalled by the 97 economic recession.<sup>3</sup> However, the economy is picking up again and it is hoped that the future issuance of Islamic bonds will focus on the widely accepted bonds such as *musharakah* bonds, *mudarabah* bonds and *ijarah* bonds.

In this paper we will try to investigate the possibilities and challenges of developing an Islamic bonds market free from usury and interest and capable of making use of the existing financial resources.

## Salam Bonds

*Salam* is the sale of a specific commodity, well defined in its quality and quantity which will be delivered to the purchaser on a fixed date in the future at the price paid at the spot as it is the condition according to the majority of Muslim jurists or three days according to the Maliki school. To illustrate the possibility of issuing a *salam* certificate let us consider the following assumption of a corporation which is in need of funds.

1. If a corporation requires for instance, 500 million ringgit, it can use *salam* certificates equalling that amount in small denominations, say 10,000 ringgit each.
2. Each certificate represents a *salam* contract. The seller is the corporation while the buyer is the holder of that certificate who paid its nominal value.
3. Each certificate promises that on maturity (one year for example) the corporation will deliver to the holder a specified quantity of the underlying commodity, which is described fully on the back of the certificate or in the prospectus.
4. Once the corporation receives the cash, it can use it for any purpose.
5. On maturity the seller will be delivering the sold goods in kind. For this purpose the corporation will certainly buy on the open market and deliver to the certificate holder. However, it should be noted that *salam* is possible only for fungible goods or *mithli*. These are standardised into identical units. For instance, wheat, rice, barley and other grains are of this type. Oil, iron and copper are also *mithli*. Similarly, electricity measured in kilowatt could be considered a *mithli*. Seats on a aeroplane flight can also be *mithli*<sup>4</sup>.

Later, the corporation floats these *salam* certificates and it will receive immediately the face value of each certificate in cash according to the majority of Muslim jurists or three or more days later according to the Maliki and certain contemporary Muslim jurists<sup>5</sup>. The parties can use this flexibility of paying immediately or some time later. However, a viable *salam*-based bonds market will not be possible if the issued bonds cannot be liquidated easily.

Liquidity is one of the most important aspects of short-term investment, second only to profitability. A money market instrument that is not negotiable will not be very useful. Thus, an investor will buy a *salam* certificate if he expects prices of the underlying commodity to be higher on the maturity date. But if his expectations change before that date, he can offload his investment and dispose of his certificate. Furthermore, when an investor knows that it is possible to resell the *salam* certificate before maturity in an organised market, more and more people will invest in this instrument and subscribe to this venture.

However, there is a difference of opinion among Muslim jurists regarding the legality of selling the purchased goods in a *salam* contract prior to taking delivery. Thus, the majority<sup>6</sup> maintains that it is illegal to resell the subject matter in *salam* before taking possession, relying on the *hadith* of the Prophet (PBUH) "whoever makes *salam* shall not exchange it before taking possession".<sup>7</sup> They argue that in this *hadith* it is clear that the buyer should not exchange the subject matter of *salam* with the seller or with another person. However, this is a weak *hadith* as pointed out by Ibn Hajar.<sup>8</sup> Therefore, it could be not the basis for any ruling.

Ibn Taymiyyah and his disciple Ibn al-Qayyim maintained that there is no legal problem in exchanging the subject matter of *salam* before taking possession. However, if it is sold to the seller himself it should be at the same price or a lower price but not a higher price as the case may be. However, if it is sold to a third party it could be at the same price, a higher price or a lower price. Moreover, Ibn Abbas and Imam Ahmad in one of his opinions have the same opinion on the issue. This is also the Maliki stand. However, they maintained that it is illegal to resell *salam* before taking possession, if it is foodstuff.<sup>9</sup>

The contemporary position of Muslim scholars is also divergent. Thus, Nazih Hammad for instance, maintains that it is legal to resell *salam* before taking possession as it is maintained by Ibn Taymiyyah and Ibn al-Qayyim because there is no text from the Qur'an or sunnah, *ijma'* or *qiyas* to prohibit this. On the contrary the texts as well as the *qiyas* convey its legality.<sup>10</sup> This stand has also been backed by other scholars such al-Qaradaghi,<sup>11</sup> al-Zuhaili<sup>12</sup>, Jasim Ali Salim,<sup>13</sup> Hashim Kamali<sup>14</sup>, Sami Hammod<sup>15</sup> and Majd al-Din Azzam.<sup>16</sup> On the other hand, Siddiq al-Darir, Ajil Jasim al-Nashmi<sup>17</sup> and others have maintained that it is illegal to resell anything before taking possession of it.

However, it seems that it is logical to take into consideration the opinion of those who uphold the legality of reselling *salam* before taking possession since there is no genuine text to prohibit that and as a result the idea of *salam*-based bonds will materialize.

*Murabahah* is basically the sale of goods at a price covering the purchase price plus a margin of profit agreed upon by both parties concerned<sup>18</sup>.

The possibility of having legally acceptable *murabahah*-based bonds is only possible in the primary market. However, the negotiability of these bonds or their trading at the secondary market would be illegal due to the fact that they constitute debt and it is illegal in *shari'ah* to trade debt for debt on a deferred basis if it will result in *riba*. However, their use in the primary market alone has its own benefits.

Suppose the required commodity in *murabahah* is too expensive for an individual or a banking institution to buy alone e.g. 50 million dollars for an oil refinery. This requires the participation of many financiers. The financing of the project could be mobilized on an understanding with the would-be ultimate owner that the final price of the refinery would be 70 million dollars to be repaid by installments over five years. The various financiers may share the 20 million dollars *murabahah* profit in proportion to their financial contribution to the operation.<sup>19</sup>

Despite the fact that the *murabahah* instruments are debt instruments, and given the fact that debt cannot be sold to another debt, it is permissible to sell these instruments if mixed with other assets such as commodities, services and cash provided that real assets and services overwhelm debt and cash. In other words, the *murabahah* bonds could be negotiable if they are the smaller part of a package or a portfolio, the larger part of which is constituted of negotiable instruments such as *mudarabah* bonds, *musharakah* bonds or *Ijarah* bonds.<sup>20</sup>

It is perhaps on such a basis that it has been proposed by Sami Hamoud for instance, at the Second al-Barakah forum, that a company specializing in *murabahah* investment should be set up as a part of al-Barakah Islamic Bank in Bahrain and its instruments would be tradable on the grounds that although these instruments are debt-based they are just a small part of the total assets of the company. In fact, the idea has been developed and the company has been set up after a ministerial decree, to specialize in such trading.<sup>21</sup>

In Malaysia, the Islamic benchmark bonds were issued in 1990 and it is believed to be based on the *murabahah* concept. They are one of the most popular forms of Islamic financing methods used in Malaysia today and they are used as a substitute for the zero-coupon bond.<sup>22</sup> Therefore, it is necessary to look at these bonds in order to examine their conformity to *shari'ah* principles.

The benchmark bond is a non-coupon-paying bond issued on a zero coupon basis to eliminate the coupon effect on yield. Zero coupon bonds are bonds sold at discount.

The Islamic benchmark bonds are issued on the assets backed by the *murabahah* concept. This concept requires Khazanah to buy a pool of assets and investments at the behest of Private Debt Securities (PDS) investors for an agreed up-front lump sum cash payment comprising a cost and profit element. Then Khazanah agrees with the Private Debt Securities investors to purchase this pool of assets and investment from the investors at an agreed purchase price at the end of the agreed duration e.g. three years. Pending the resale of the pool of assets and

investments to Khazanah, PDS investors appoint Khazanah as trustee and manager of the pool of assets and investments. Until the resale of the pool of assets and investments any income arising from this pool is accrued to Khazanah as trustee and management fees. As documentary evidence of the arrangement entered into between Khazanah and PDS investors, Khazanah will issue to PDS investors the Islamic benchmark bonds. PDS investors may hold the benchmark bonds to maturity or sell them at the secondary market. In order to avoid reinvestment risk from the perspective of PDS investors, and interference with the benchmark yield curve, Khazanah is not given the right to early redemption of the benchmark bonds. In this respect, should PDS investors want early exit from the benchmark bonds, they can do so by disposing of these bonds in the open market<sup>23</sup>.

However, some objections have been raised against the Islamic benchmark bonds based on *murabahah* because of the structure of *murabahah* itself and the possibility that such a transaction will result in *bay' al inah* and *bay' al-dayn bi al-dayn* traded at discount which are generally considered as prohibited transactions by Muslim jurists.

However, Abdul Rashid Hussein for instance, while defending the viability of *murabahah* bonds says: "Questions have been voiced as to why *murabahah* has been chosen as the operative concept for the Islamic benchmark bonds issuance as compared to other Islamic operative concepts such as *Ijarah* (leasing) *mudarahah* (profit sharing) *musharakah* (joint venture) and *qard hassan* (benevolent loan)?<sup>24</sup> Abdul Rashid Hussein maintains that *murabahah* provides a sufficiently flexible structure to create, in essence, a choice of action owed by Khazanah to PDS investors without necessitating payment of coupon.

He further argues that if the financing is structured under the *Ijarah* concept as it is commonly understood, Khazanah being the lessee to the pool of assets and investments has to pay periodic lease rental which is not appropriate to the non-coupon structure. In the case of *mudarahah* concept, Khazanah and PDS investors are deemed to have entered into a venture to invest in assets and projects and as a result PDS investors have to bear any financial losses arising from such ventures. This is unacceptable to PDS investors from a risk return perspective.

Moreover, according to Abdul Rashid Hussein if the financing is structured under the *musharakah* concept, Khazanah is required to contribute part of the initial outlay to the joint venture with PDS investors to invest in the assets and projects that are inappropriate under the circumstances. Moreover, under *musharakah*, PDS investors, being co-partners to the joint venture, have the right to participate in the management of the assets and project which is inappropriate under the circumstances.

Finally, if the concept of *qard al- hasan* were to be used, Abdul Rashid Hussein argues Khazanah would be deemed to have received the bond subscription proceeds from PDS investors as a benevolent loan. Therefore, Khazanah being the borrower, is only obliged to return to PDS investors the entire principle amount of the benevolent loan borrowed and is not obliged to return a guaranteed return either as a gift (*hibah*) or as a kind of appreciation to the PDS investors<sup>25</sup>.

To illustrate the basic feature of the Khazanah Islamic bonds, suppose that through the bidding process, a RM1000 bond at par value is sold at RM 800 per unit. For one million unit issues, the market value of the securitized asset is therefore RM 800 million while the buy back price is 1 billion. The return to investors is 200 million.<sup>26</sup> Thus, given the above fact about the involvement on this transaction of *bay' al-inah*, Abdul Rashid Hussein's argument in favour of the above kind of bonds could not be justified from the *shari'ah* point of view.

## Ijarah Bonds

*Ijarah* is a contract according to which a party purchases and leases out equipment required by the client for a rental fee. The duration of the rental and the fee are agreed in advance and ownership of the asset remains with the lessor. Hence, the relationship between the parties differs from that of a debtor-creditor relationship since it is based on buyer-seller of an asset.

*Ijarah* bonds, on the other hand are securities of equal denomination of each issue, representing physical durable assets that are tied to an *ijarah* contract as defined by *shari'ah* <sup>27</sup>.

The basic feature of *Ijarah* bonds is that they represent leased assets, i.e. without relating the bonds holders to any common organisation, company or institution. For instance, an aircraft leased to an airline can be represented in bonds and owned by a thousand different bondholders, each of them, individually and independently, presenting his bond (s) to the airline company and collecting the periodic rent without having to have any relation with other bondholders. In other words, the *Ijarah* bondholders are not owners of a share in a company that owns the leased airline, but simply a sharing owner, who only owns one thousandth or more of the plane itself.

In a second example let us assume that a group of investors bought an office building and divided up the ownership rights into many certificates of equal face value. The group may rent out the whole building for the next ten years, then sell these certificates to the public. A buyer of a such certificate is acquiring a share in the ownership of the office building, and an equal share in the net income from it for the term of the lease. Such certificates could be easily traded in the market. Moreover, their generation of steady rental income renders them even less risky than common stocks. This is because in common stocks both annual net income and capital gains or losses are variable, whereas in rent sharing certificates part of the future income stream is the contractually fixed rental payments.<sup>28</sup>

There may be multiple forms of *Ijarah* bonds depending on the nature of the asset and the method and procedure of issuance of the bonds. Thus, besides the simple forms of *Ijarah* bonds mentioned above, more sophisticated forms of *Ijarah* bonds can be considered by including financial intermediaries. Let us suppose that the Ministry of Defence needs a training field to be used for one of its training programs. A suitable piece of land in a suitable location is needed. The Ministry of Defence resorts to an Islamic bank to prepare an issue of *Ijarah* bonds that allow the Ministry to acquire the needed plot. The Islamic bank buys the plot for 10 million dinars and rents it to the Ministry of Defence for 900,000 dinars a year. At the same time, the bank issues 1,000 *Ijarah* bonds, each bond representing 1000<sup>th</sup> of the plot and entitling its owner to 900 dinars per year as rent. The *Ijarah* contract has a period of ten years after which the contract will be renewed perpetually for term of ten years. The Islamic bank has an issuance commission of, say, 5% as premium above the purchase price of the land i.e., the bank sells the bonds at 10500 dinars each. In this form of *Ijarah* bonds, the bondholders own the land that is rented and they are entitled to the rent at the above-mentioned rate. The issuer of the bonds is the financial intermediary, not the division of Real Estate Recording, nor the beneficiary of the lease.

In a somewhat different example, let us suppose that in the above mentioned case, the Ministry decides to undertake the task of issuing the bonds on its own, without resorting to a financial intermediary, and it does not having the money to buy the land it transfers its ownership to the bondholders. The Ministry of Defence begins with issuing *Ijarah* bonds for the specific purpose of acquiring the land, whose purchase price is 10 million *dinars*. The bonds, now, contain a new clause permitting that the Ministry will collect the fund from the buyers of the bonds and will purchase the lot on their behalf, on *wakalah* basis. In this case, the issuer of the bonds becomes the beneficiary of the *Ijarah* contract, e.g. the user of the asset. Each bondholder has the same right to ownership and to a share of the total rent, which equals one thousandth each (assuming there are 1000 bonds). There will be no premium paid to a financial intermediary, although the Ministry of Defence may take some contractual compensation for its work on behalf of the savers/ purchasers of bonds.<sup>29</sup>

Thus, from the above it is clear that the contract of *Ijarah* seems to be the most flexible of all nominated contracts in Islamic law and many forms of *Ijarah* bonds, whether short term or long term, could be issued from it.<sup>30</sup>

### **Characteristics of *Ijarah* Bonds**

The characteristics of *Ijarah* bonds stem from its nature and from the contractual relationship defined in the *Ijarah* contract governing it. These can summarised as follows;

1. *Ijarah* bonds are securities representing the ownership of well defined existing and well known assets, that are tied up to a lease contract. This means that *Ijarah* bonds can be traded in the market at a price determined by market forces. This includes *inter alia*, the general market conditions in the economy and in the financial market, the opportunity cost (current and expected return on new financing), prices of real investment assets and economic trends in the specific market related to securities and *Ijarah* bonds, etc. The *Ijarah* bonds are also subject to risks related to the ability and desirability of the lessee to pay the rental instalments. Moreover, these are also subject to real market risks arising from potential changes in asset pricing and in maintenance and assurance costs.
2. Furthermore, the expected net return on some forms of *Ijarah* bonds may not be completely fixed and determined in advance, since there might be some maintenance and insurance expenses that are not perfectly determined in advance. Consequently, in such cases, the amount of rent given in the contractual relationship represented by the bond, represents a maximum return subject to deduction of this kind of maintenance and insurance expenditure.
3. *Ijarah* bonds are completely negotiable and can be traded in the secondary markets. Subject to market conditions, these bonds will offer a high degree of liquidity and therefore, have both the characteristics and necessary conditions for functioning as successful securities.
4. *Ijarah* bonds will offer a high degree of flexibility from the point of view of their issuance management and marketability. The central government, municipalities, *awqaf* or any other asset users, private or public can issue the bonds. Additionally, they can be issued by financial intermediaries or directly by users of the leased assets<sup>31</sup>. It should be noted that *Ijarah* bondholders as owners bear full responsibility for what happens to their property. They are also required to maintain it in such a manner that the lessee may derive as much usufruct from it as possible.<sup>32</sup>.

### **Istisna' Bonds**

*Istisna'* is a contract to sell a manufacturable thing with an undertaking by the seller to present it manufactured from his own material, according to specified description and at a determined price<sup>33</sup>.

The suitability of *istisna'* for financial intermediation is based on the permissibility for the contractor in *istisna'* to enter into a parallel *istisna'* contract with a subcontractor. Thus, a financial institution may undertake the construction of a facility for a deferred price, and sub contract the actual construction to a specialised firm.

Suppose, a public authority or a private company financing a project may first define the specifications of the investment project it wants to establish, and the number of years it requires to repay the price. Bids are invited on that basis from investors/ contractors who would undertake to construct the required facilities and sell them to the public authority or the private company for a price to be paid in instalments.

When the facilities are built and the *istisna'* contract is consummated, the full ownership of the facility is immediately transferred to the public authority or the private company against the deferred sale price that would normally cover not only the construction costs but also profits. These profits could legitimately include *inter alia*, the cost of tying funds for the duration of the repayment period.

The deferred price that the public authority or the private company will pay may be in the form interest-free DPCs (deferred price certificates of indebtedness) with the total face value exactly equal to the total deferred price. These certificates have different maturity dates to match the instalment plan that has been agreed upon between the two parties. DPCs represent a public authorities or a private company's debt. *Shari'ah* prohibition of *riba* (interest) precludes the sale of these debt certificates to a third party at any price other than their face value. Clearly such certificates which may be cashed only on maturity cannot have a secondary market. For the holders

of such certificates this non-liquidity is a disadvantage that would have been taken into account in the deferred sale price they agreed upon.

However, the illiquidity of these certificates may be an advantage whenever it is deemed desirable to reduce liquidity in the economy. Nonetheless, a limited possibility of liquidation is possible. Although a debt in *shari'ah* may not be exchanged at a price different from its face value, it may be transferred at face value to a third party. Suppose in our case that "B" is a holder of a DPC of 5000 *dirhams* due after a year. No one is likely to be interested in giving "B" 5000 *dirhams* in cash now for the certificate, e.g. no one is likely to extend an interest-free loan of 5000 *dirhams* to "B". But merchants may be willing to sell "B" 5000 *dirhams* worth of merchandise against this certificate. Thus, although "B" cannot sell the certificate for cash, he can legitimately buy against it goods or services, whose price is equal to the face value of the certificate.

Likewise, an Islamic bank holding such certificates may acquire against them property or merchandise for a deferred price. Once acquired, such property or merchandise may be disposed of in any manner.

Needless to say, the deferred price of goods acquired against such certificates would be higher than the spot price of the same goods. This price differential is clearly tolerated by *shari'ah* as a legitimate facet of trading activities. The certificate holder acquiring the goods now at higher than the spot price is in fact relinquishing to the seller of the goods some, (all, or even more) of the price differential which the certificate holder obtained from the public authority above the construction cost of the project he financed. This would mean that the market forces can play a role in encouraging or curtailing the exchange of these certificates for goods<sup>34</sup>.

The process of transferring the certificate from one holder to another is based on *hawala* contract in Islamic law, which generally requires the consent of the debtor who is in our case the public authority or the private company, which issued the certificates. The public authority may issue fully transferable certificates or, to go to the other extreme, and issue non-transferable certificates<sup>35</sup>.

### **Muqaradah or Mudarabah Bonds**

The term *muqaradah* has been taken from the term *qirad*, which is synonymous with *mudarabah*, which is commonly used by the Hanafi and Hanbali schools of Islamic law while the Malikis and Shafis use *qirad*.

*Mudarabah* or *muqaradah* means an agreement between two parties according to which one of the two parties provides the capital for the other to work with on the condition that the profit is to be shared between them according to an agreed ratio. In light of the above definition, *muqaradah* is regarded as an Islamic way of financing completely different from the *riba* mode of financing which is based on a predetermined rate of interest<sup>36</sup>. It is the norm in Islamic financial theory of contract that whatever is permissible for an individual contacting party is also for a group of people not necessarily identified by their number or specified by their personalities.<sup>37</sup>

*Muqaradah* bonds on the other hand are based on the conclusion of a lawful *mudarabah* contract with the capital provided by one party and labour by the other, while the shares of profit are determined beforehand by a definite proportion of the total<sup>38</sup>.

It should be noted that *mudarabah* bond bears close resemblance to revenue bond financing in the conventional system.<sup>39</sup> Revenue bonds are generally backed only by revenue generated by the project funded by the bond issue. For example a city wants to build a new airport, believing that the new facility will attract industry to the area. The local government issues revenue bonds to finance the construction of the airport. The money for the periodic dividend payment and eventual retirement of the bonds come from airplane landing fees, ticket counter and concession rental, hanger rentals airline fuel surtaxes, and other revenue associated with the facility.

In other words, only revenue generated by the airport can be used to service the airport revenue bonds. If the airport generates enough revenue to pay off the bonds, then bondholders receive their interest and principal in full and on time. However, if the airport does not generate enough revenue, bondholders either receive their interest and principal later or nothing at all. They have no recourse to the local government's general treasury fund. The bondholders are solely dependent on the revenue generated by the project being financed.<sup>40</sup>

Similarly, the *muqaradah* bonds give its owner the right to receive his capital at the time the bonds are surrendered, and an annual proportion of the realised profits as mentioned in the issuance publication. The *muqaradah* bonds can play a vital role in the process of development financing, because it is related to the profitability of the projects. Financing through *muqaradah* is more efficient in terms of the allocation of resources compared with financing based on the interest rate, which does not reflect the profitability of projects.

### Features of *Muqaradah* Bonds

1. *Muqaradah* bond is a tool for investment to raise funds, which is based on dividing *muqaradah* capital by issuing equal value units, which are registered under the bondholder's name (recorded bonds), which reflect the common asset in *muqaradah* capital<sup>41</sup>. In other words, *muqaradah* bonds mean the documents of definite value issued in the name of their owner against funds they pay to the owner of the project in question. Bonds owners acquire a definite proportion of the project profit, which is being set out in the bond issuance publication (the prospectus). *Muqaradah* bonds neither yield interest nor entitle owners to make claims for any definite annual interest<sup>42</sup>. This shows that *muqaradah* bonds are like shares with regard to varying returns, which are accrued according to the profits made by the project<sup>43</sup>.
2. *Muqaradah* bonds must represent a common ownership and entitle their holder to shares in a specific project for which the bonds have been issued to fund. A bondholder is entitled to all rights, which have been determined by *shari'ah* upon his ownership of the *muqaradah* bond in matters of sale, gift, mortgage, succession and the like. The contract in *muqaradah* bonds is based on the official notice of bonds sale. Subscription in these bonds is considered as an offer from the investors and approval of the issuer is then regarded as acceptance of the contract. Official notice of sale must contain all the conditions which are required by *shari'ah* in a *mudarabah* contract and the distribution of profit should also be in conformity with *shari'ah* rules.
3. On the expiry of the specified time period of the subscription, the bondholder is given the right to transfer the ownership by sale or trade in the securities market at his discretion.

### Sale and Disposal of *Muqaradah* Bonds

- When the subscription period in the *muqaradah* capital is over and the operation of the specific project is still in the form of cash, the trading of bonds should be based on the exchange of money for money and must satisfy the rules of *sarf* or currency exchange.
- If such capital is still in the form of debt, it must be based on the principle of Islamic debt trading or exchange of debt for debt.
- If such capital is in the form of cash, debt and asset, trade must be based on the market price evolved by mutual consent on the condition that the major part is composed of asset and usufruct. However, if the major part is debt or money then the rules of trading of debt and money must be observed.<sup>44</sup>

### Distribution of Profits

The distribution of profits must follow the rules stated below:

1. The *mudarib* or the person who has received the fund is charged with the duty of running the affairs of the specific project or business. Therefore, profit realised from investment in the *muqaradah* bonds will be distributed between the *mudarib* and the investors according to the agreement.
2. It is not permissible to guarantee him a fixed lump sum amount of profits. The issuer has the right to purchase bonds offered for sale by others according to the price declared by the issuer from time to time.
3. The *mudarib* is considered as the depository of the common fund and the project asset is entrusted to him. Therefore, he should not be held responsible unless due to a legal cause of liability such as being negligent or having committed dishonesty leading to losses.
4. The prospectus should not mention, whether explicitly or implicitly, that the *mudarib* should guarantee the capital or a fixed profit. If such a condition is included, it would be considered invalid and the *mudarib* would be given the wage of other *mudarib* comparable to him.<sup>45</sup>

### Guarantee of *Muqaradah* Bonds

It is permissible for a third party totally different in his person and financial liability, the government for instance, to promise to compensate for any losses sustained in a specific project. However, this guarantee should be concluded in a separate contract and not as a part of the main contract of *muqaradah* bonds between the issuer and the investors. Moreover, the validity and execution of the *muqaradah* bonds contract is not linked to this guarantee. However, it is not permissible for the issuer to guarantee the capital of the *mudarabah*

This is the stand endorsed by the Jordanian Ministry of Endowment, the first entity to issue *muqaradah* bonds. The Jordanian government guarantees the full settlement of the nominal value of the bonds on maturity. However, it should be noted that in the case of the Jordanian *muqaradah* bonds, the government considers the amount paid as a loan on the liability of the Awqaf Ministry that should be repaid as it is stated in the “*Muqaradah* Act” section 12. This section of the Act, among other issues, has been the point of criticism among the participants in the Islamic Fiqh Academy discussion on *muqaradah* and it has been agreed, as it is reflected in the resolution, that the guarantee should be in the form of *tabarru* or voluntary commitment and not as a loan. Otherwise, it will transform the whole issue into a loan with interest.<sup>46</sup>

On the other hand, it is permissible for the *mudarib* and the investors to agree to put aside a specific amount or certain profit as reserves to provide protection or to meet any losses arising during the implementation of the project.<sup>47</sup>

Moreover, the law under which the *muqaradah* bonds are issued by the Jordanian Ministry of Endowment has been criticized for the fact that it does not sanction any right to bond holders with regard to the project ownership. Rather it holds in trust the amount they have paid which will be returned to them at their value at the time of redemption. Furthermore, bond holders get their share of any realised profits. However, they are not bound as they should have been according to their status as fund providers in *muqaradah* contract, to any commitment in the absence of profits, which means that they do not incur losses. In other words, they are entitled to their principal (what they have paid) in full under all circumstances.

This undoubtedly is in conflict with the *mudarabah* contract which necessitates that the fund provider should share profits when realised and should bear losses when incurred whatever the amount is. The essence of the matter is that *mudarabah* contract does not permit the burdening of the *mudarib* with any responsibility to guarantee full repayment of the principal to fund provider whatever happens to the project.

In his comment to these criticisms, Abdul Rahman Yousri Ahmed argues that Islamic scholars consider guaranteeing repayment of the nominal value of bonds as a violation of *shari‘ah* rules for it involves a clear violation to

the *mudarabah* contract in which the principal cannot be guaranteed along with the right to share in the realised profits. Yet, Abdul Rahman Yousri argues that we cannot ignore the *fatwa* issued in Jordan allowing such a guarantee and that Islamic economists have to analyse the implication of these divergent views.

In addition, Yousri Ahmed argues that guaranteeing repayment of the principal value of the bond along with the payment of profits entails disregarding the principle of *al-kharaj bi al-daman* (no gain without risk bearing) but he said we should also take into consideration that the present-day Islamic societies lack Islamic economic products. They are dominated by the banks that openly deal in interest-based transactions and with stock markets that are replete with interest carrying bonds. In fact, any contemporary Islamic economic activity or any attempt to advocate such activity is strongly opposed from both inside and outside Islamic societies. Therefore, Yousri argues that when the government of an Islamic country under such circumstances offers guarantees to any Islamic security issued by one of its official bodies, this can only lead to greater acceptance of the “new instrument” by the masses. Let us therefore, Yousri Ahmed says, look at the Jordanian government’s position as a positive one which, despite all differences, is bound to encourage people to buy an Islamic security probably for the first time ever and make them have a positive stand towards abstaining from dealing with interest operating banks and financing institutions.

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However, it seems that there are no grounds to support the opinion on which Yousri Ahmed relied in his argument especially after the Islamic Fiqh Academy’s discussion on *mudarabah* bonds where some of the prominent advocates of the Jordanian formula of *mudarabah* bonds such as Sami Hamoud were present. They have accepted the resolution that the government could guarantee the repayment of the nominal value of the *mudarabah* bonds only as a kind of *tabarru’* or voluntary commitment and not as a loan which the Ministry of *Awqaf* should repay.

On the other hand, Yousri Ahmed continues his argument by maintaining that although the issuing of *muqaradah* bonds with this incentive may deviate from some Islamic *shari’ah* rules, it would be of great educative value in encouraging people to free themselves from the clutches of usury transactions and associate themselves with *halal* ones. Moreover, Yousri Ahmed added, it is true that guaranteeing repayment of the principal value of the bond along with the payment of profit bonds has not actually succeeded in attracting the passage of Muslim investors from the former to the latter sphere. The same, however, can be said of some other controversial techniques carried out by Islamic banks such as *murabahah* sale. In brief, Yousri argues that a long-term view may tolerate certain secondary deviations for the sake of achieving high priority goals.<sup>49</sup>

Yet, it should be noted that although Yousri Ahmad suggestion that such controversial instruments could have great educative value is true to some extent, this cannot be grounds to justify what is illegal. However, his equation between guaranteeing repayment of the principal value of *muqaradah* bond along with the payment of profits, as it is in the initial *muqaradah* bond with *murabahah* sale as controversial instruments is unacceptable. *Murabahah* sale is a genuine contract recognized not only by contemporary scholars but also by classical scholars. Yet, the implementation of this contract has been sometimes abused by certain Islamic financial institutions but this does not make the contract itself controversial but rather the practice of *murabahah*.

To defend his argument, Yousri Ahmed argues that the general public in our contemporary Islamic society have become accustomed to dealing with interest. Not only that, but even some of those speaking on behalf of Islamic *shari’ah* or issuing *fatwa* have gone so far as to authorise such interest. The fact is that we are faced with great difficulty in that there is no incentive for change among great numbers of Muslims today, a difficulty which may be attributed to the gap which exists between the mainstream of Islamic thought and Islamic economics. At any rate, the Jordanian government according to Yousri has provided a potent incentive to effect a behavioural change through the guarantee it offers for the acquisition of Islamic security. From this general outpost which offers a view of the overall public interest of promoting Islamic economics rather than a partial view of maintaining the details and the terms of the contract, we find that the benefit of maintaining the guarantee offered by the Jordanian government exceeds that of ruling it out.<sup>50</sup>

His last argument does not seem to address the core of the problem, namely the legal issues raised by those who objected to the initial Jordanian *muqaradah* bond, but instead deals with the social and economic dimension of the problem which may not be the result of the claim that people are accustomed to *riba* but rather due to the lack of political will in most of the cases.

Besides the Jordanian experiment there are several other certificates or bonds which have been issued by some Muslim companies under *muqaradah* or *mudarabah* contract. Thus, in Pakistan for instance it is reported that 37 *mudarabah* companies have floated their respective *mudarabah* certificates of different types and varying maturities<sup>51</sup>.

However, in the case of the Participation Term Certificates of Pakistan due to their similarities to bonds transacted in the Western markets, doubts have arisen as to their *shari'ah* permissibility. Once again the issue of guarantee for the certificate's nominal value gives rise to objections on the same grounds mentioned in the previous section on the Jordanian *muqaradah* bonds. However, the provisions for the guarantee in the Participation Term Certificates differ from those applicable in the case of the Jordanian *muqaradah* bonds in that they constitute a legal right of foreclosure on the fixed assets. In the case of *mudarabah* contract, it is not easy to defend such a guarantee for it involves treating the certificate holders as if they were "creditors" to the project whereas they should normally be assumed as the owners of the project and therefore liable to incur any business risks. It may be argued that this arrangement was meant just to provide a guarantee for the certificate holders in case the project manager using their fund fails to observe the terms of the *mudarabah* contract. However, this is not clearly stated in the available prospectuses of such certificates. Therefore, renders the issue of guarantee questionable.

Another objection is raised regarding the preference given to participation certificate holders over shareholders involved in the same project in the case of both profits and losses. What makes them deserve such preference? It is commonly known that in the case of conventional bonds, bond holders are considered as "creditors" entitled to periodic returns irrespective of whether profits are realised from the project or not. Also holders of bonds have the right to claim the value of their bonds even in the case of loss or liquidation. Yet, what *shari'ah* justification can be given for granting holders of Participation Term Certificates the right to profits before the shareholders, or the right to be first to avoid losses? Does the nature of the *muqaradah* contract justify granting preference to a temporary contributor (the Participation Term Certificates holder) over a permanent contributor (the ordinary shareholder)?<sup>52</sup>

It is obvious that neither the *muqaradah* contract nor Islamic participation methods in general provide such a preference. Therefore, it could be said that the Pakistani Participation Term Certificates are not a genuine Islamic method of investment and a general review should be made to put them in line with Islamic principles.

The Islamic branch of Bank Misr has also issued Islamic Transaction Certificates based on the *mudarabah* contract. These bonds are issued for a nominal value of 1000 Egyptian pounds and multiples thereof. The bond is nominal and issued for a term of five years renewable. The prospectus for these bonds states that they are to be invested in Islamic projects and that the bank is mandated to act on behalf of their holders in determining the appropriate method of investment, on the basis of unlimited *mudarabah* rules. The prospectus also provides for a monthly return payable in the same currency in which the bonds have been issued at a rate fixed by the bank under the item of profit and loss with the proceeds being payable biannually after computation of the operations results as they may appear in the financial statements of the Islamic transaction branches. The certificate holder may recover its value six months after the date of its issue and may also be granted an interest-free loan (*qard hasan*) from the bank for the certificates as collateral.

It is obvious that these branches are just part of Bank Misr which is a *riba* based institution. Therefore, they are open to doubt and suspicion regarding their Islamic financial transactions. Some hold the view that these branches are nothing more than fictitious windows opened for the sake of attracting the savings of Muslims not wishing to deal with interest, and then using these savings, along with other sources that may be accumulated by the bank, in

conventional operations. The advocates of this view vindicate it through theoretical proofs based on the nature of their banking activities and their methods of mobilising resources and utilising them in addition to the fact that the conventional bank in their use of the overall resources cannot separate the amount raised through Islamic modes and those raised through conventional modes<sup>53</sup>.

Moreover, it is argued that one of the objectives of an Islamic financial institution is to replace the existing conventional system with a just and equitable system and this objective might not be possible if the two systems are mixed. In addition, if we are really committed to the Islamic alternative, why not open a fully independent Islamic bank which would be, without any doubt, much more suitable to attract more savings in a country with a Muslim majority and an established Islamic reputation like Egypt. Finally, such windows may be acceptable to the Muslim public as an Islamic alternative if there is a discriminatory law that prohibits the establishment of a full Islamic bank and therefore, such windows could be accepted as the only possible alternative so far. However, it seems that there is no such law because of the already existing fully Islamic banks in Egypt.

However, Abdul Rahman Yousri, for instance, tries to defend the idea of Islamic windows or Islamic branches in Bank Misr in particular arguing that those who are sceptical about the activity of the Islamic branches of conventional banks have failed to provide a single item of evidence in substantiation of their claims. Regarding the bank Misr branch for Islamic transactions, we have no reason to be sceptical or accusative about the nature of its activities, especially as the management of the parent bank has never failed to reiterate that the activities of the Islamic branches and their accounts are held independently and under the control of a *shari'ah* supervisory board. In addition, Bank *Misr* in particular has an excellent record and long standing experience in the field of direct investment in Egypt. Therefore, raising doubts about its commitment to Islamic banking methods in the branch set up for that purpose amounts to challenging the seriousness of a bank that is so dedicated to safeguarding its banking reputation. It may even imply challenging the ability of the Egyptian central bank to keep an eye on banking activities as such, a matter that would be denied even by those who question the seriousness of the Islamic transactions branches”.

Moreover, Yousri argues that any conventional bank in setting up an Islamic transaction branch provides tangible proof of the success achieved by the Islamic movement in penetrating the dominant traditional banking system. This matter ought to be encouraged rather than subjected to attack and scepticism. Hence, the Islamic certificates Issued by the Bank Misr branch of Islamic transactions should not be attacked on the basis that they are issued by a conventional bank.

Another institution, which has launched Islamic certificates, based on *mudarabah* contract is the Islamic Development Bank through its Unit Investment Fund. It was launched in December 1989. It marked the beginning of the implementation of a major bank policy. This policy was designed to generate additional resources for the bank on a basis compatible with *shari'ah*. The fund is to be managed by the IDB in accordance with the Islamic concept of *mudarabah* with the IDB undertaking the role of *mudarib*. The fund will be invested in a range of viable ventures in IDB member countries. All investments of the fund are being made in lease and instalment sale financing with the bulk of the investments concentrated in lease financing. The IDB unit investment fund is expected to facilitate the bank's efforts to mobilise resources by purchasing some of its medium and long-term investment, thus providing the bank with resources to invest in other ventures.<sup>54</sup>

The bank keeps a special ledger for the certificates issued. The ownership of the certificate may be transferred after recording the new holder's name in the said ledger and in accordance with the forms approved by the bank and signed by both the seller and the buyer. The statute also states that dealing in subscription certificates shall be confined to Islamic banks and financial institutions and that the bank shall work for listing subsequent issues in the stock markets of those countries whose regulations allow their listing and hence their value could be determined by supply and demand in the market. However, until such a listing is complete, the bank shall declares its readiness to buy back any certificates offered to it, and to sell those in its possession against a basic price equivalent to the net

nominal value of the certificate. Once the portfolio becomes operative, the IDB will announce the buying and selling prices of the issued certificates in the light of the financial position of the portfolio, bearing in mind also the supply and demand conditions prevalent in the market. With regard to the net returns of the portfolio the statute stipulates that they are to be distributed annually as follows: 5% for the IDB as a *mudharib*, 5% to be retained for the enhancement of the portfolio's financial position and 90% to the certificate holders<sup>55</sup>.

### **Muqaradah Bonds: An Illustration**

The elements discussed above could be further understood by the following example. Suppose the *mudharib*, ABC limited, receives a contract worth RM100 million to build an university campus near Kuala Lumpur. The cost of the project is RM60 million, which the company intends to raise using *muqaradah* bonds. If the *muqaradah* bonds are issued at RM 1.00 each, then 60 millions units will be issued to the investors. The project profit is expected to be RM40 million and the *mudharib* intends to take half or 50 per cent which is equivalent to RM20 million. So the profit sharing ratio is 50:50. If the project runs as planned and is handed over to the buyer on time, the value of *rab al-mal* capital should increase to RM80 million causing the unit value of each bond to increase to 1.33, per unit. Upon selling these bonds to the *mudharib* at 1.33, the *rab al-mal* should make a 33-cent profit. However, if the project does not go well as expected and only commands a salvage value of say, RM30 million, then the value of the *muqaradah* bond will drop to 50 per cent per unit (RM30, 000,000/60,000,000) where the *rab al-mal* will realise a loss of 50 per cent for every ringgit invested. It is apparent in the above that the *muqaradah* bonds do not need any form of securitisation since the *muqaradah* bond is a genuine asset. The sale of *muqaradah* bonds is also free from any discounting mechanism as the need for discounting no longer exists as the value of the bond will now depend on the company's performance rather than the movement in interest rates. Thus, when investors wish to dispose of the *muqaradah* bonds before maturity they will do so on the basis of the project performance, which implies that it can be sold below or above its face value. For example, if an investor feels that the project may take longer than required, it may want to sell the bond for less than RM 1.00. Similarly if the other investors feel that this project is able to provide returns above the market average they may want to purchase the *muqaradah* bonds for more than par value<sup>56</sup>.

### **Musharakah Bonds**

*Musharakah* bonds based on the *musharakah* contract are relatively similar to *muqaradah* bonds. The only major difference is that the intermediary-party will be a partner of the group of subscribers represented by a body of *musharakah* bondholders in a way similar to a joint stock company while in *mudharabah* the capital is only from one party. It should be noted that almost all the criteria applied to *mudharabah* bonds are also applicable to the circulation of *musharakah* bonds.<sup>57</sup>

Several *musharakah* based bonds have been issued by Sudan and Iran. In Iran for instance, *musharakah* certificates were devised and approved by the Money and Credit Council and used to finance the Tehran Municipality. In 1994 the Tehraan Municipality embarked upon issuing the first *musharakah* bonds in order to finance the Navab Development Project in south-west Tehran. The project consists of a thoroughfare-construction scheme passing through the Navab district of Tehran, with a number of shopping centers to be built adjacent to the thoroughfare. The *musharakah* bonds issued by the Municipality have a four-year time- span, with a 20% interim annual profit rate, guaranteed by the largest commercial bank in Iran. The ex-post profits will be realized and paid to bonds holders upon completion of the four years project, and it is expected that the ex-post profit rate will exceed the 20% being currently paid to the bond holders on an interim basis. These bonds are transferable through the Tehran Stock Exchange.<sup>58</sup>

Moreover, in 1998, a law was passed by Parliament in Iran that authorized both the government and the private sector to issue these certificates to finance productive projects. Similarly participation papers based on *Musharakah* have been floated by Iran with the objective of financing government budget deficits and as instruments of

monetary policy. Accordingly, a specific plan was formulated which was subsequently approved by the religious authorities. Based on this scheme, Bank Markazi (Central Bank of Iran) is to issue these certificates, which would address government debt to Bank Markazi. The certificate would be traded on inter bank market.<sup>59</sup>

However, it should be noted that one may have some reservations about the total or full Islamicity of these bonds when there is no detailed information about the legal aspects of these bonds. Especially if we consider the new proposal to issue eurobonds structured along the lines of the national participation certificates floated by the Tehran municipality and where Bank Markazi will offer a guaranteed minimum return in order to make it attractive to European and Gulf investors.<sup>60</sup> In contrast, in principle no minimum return shall be guaranteed in a fully *shari'ah* compliant *musharakah* contract.

In Sudan also *musharakah* based certificates have been launched. One by the Ministry of Finance based on state ownership of key profitable and large public enterprises which could be traded in the market; and the other launched by the Bank of Sudan (Central Bank) not to raise funds but to be used as a Treasury intervention and open market management tool to inject or withdraw liquidity into or from the system if and when it is required. These certificates have also been approved by the International Monetary Fund and encouraged the Fund to discuss similar measures with other Muslim countries who have "Islamized" their banking and financial systems such as Iran and Pakistan.<sup>61</sup>

On the other hand, in Turkey special *musharakah* bonds were issued in 1984, to finance the construction of a toll bridge in Istanbul costing 200 million dollars. The *musharakah* bonds received warm approval from the public and are making very good profits. They are among the most actively traded securities in the Istanbul market in the last ten years.<sup>62</sup>

### Malaysian Government Certificates

This is an experiment by Malaysia to issue Treasury Bills/ Government bonds on *shari'ah* basis. Conceptually, Government bonds are certificates showing the borrowing by the government from the country's financial institutions, etc. Effectively it is a loan taken by the government from his own citizens. The loan is usually required by the government to finance its recurrent expenditure or development expenditure for public projects.

The Central Bank or Bank Negara Malaysia, on behalf of the government, issues the Malaysian Government Certificates. They are issued under the *qard al-hasan* contract. They are of various maturities: short-term and long-term. Each certificate carries a face value in multiples of RM 10,000 and is issued at par. It is also redeemable on maturity or on demand at bank Negara Malaysia at par.

*Al-qard al-hassan* is a benevolent debt-financing contract which is distinct from the pure commercially deferred contract of exchange. Under *qard al-hassan* the borrower is not obliged, but has the option, to reward the lender for his benevolent deed. The government thus has the absolute discretion whether to reward, and if so by how much, the holders of the certificates. It may also vary the rewards for the short-term and the long term certificates.<sup>63</sup> The return of dividend rate (if any) declared by the government will be paid to the holders of the certificates on an annual basis on every anniversary date or on the maturity date. The dividend rate is determined by the Dividend Committee which comprises representatives from the Treasury office, Bank Negara Malaysia, the Economic Planning Unit and the Islamic bank. The factors that are normally taken into consideration in dividing rate are the country's economic performance, the inflation rate and equivalent returns on the government instruments etc<sup>64</sup>.

However, it should be noted that if such a reward becomes regular and is known by precedent as so, then, it will become a kind of loan with interest, because as it is generally agreed by Muslim jurists, any profit attached to a loan is interest. Thus, tax reduction, relaxation of the relevant deadline conditions for tax payment providing facilities in the sale of certain public goods may be considered as interest if they are a kind of compensation to the loan provided. Consequently, attractions for public debt must be designed carefully. Some of these may include

appealing to patriotism and religious piety.<sup>65</sup>

Thus, in some cases, the government may need to raise funds by asking its citizens to lend it money out of a love of their country and for their desire to protect and promote their nation's religious values and principles. As Islam encourages Muslims to make voluntary contributions in order to perform good deeds, to please Allah and to help one attain success in the afterlife, such bonds have a great potential for use in Muslim countries. Since the *Qur'an* calls upon Muslims to sacrifice their wealth and lives in order to support just causes, why should Muslims not sacrifice their wealth in order to help out their government, especially if such wealth is only sought as a loan.<sup>66</sup>

## Conclusion

From the above discussion, it is clear that the Islamic alternative of resource mobilization through Islamic bonds is not only possible but also has proven to be practical through the implementation of several successful projects using Islamic bonds or as tools of monetary management. However, what is more important is that Muslim jurists and economists must intensify their efforts to explore the different forms of Islamic bonds based on the acceptable types of contract in Islamic law for that purpose such as *musharakah*, *muqaradah* and *ijarah*. Similarly the possibility of having negotiable certificates based on *salam* should not be excluded totally and a systematic analysis of the possibility of reselling *salam* before taking possession needs to be explored by Muslim jurists especially at the Islamic *Fiqh* Academy level. Especially when the whole issue of prohibiting resale before taking possession is based on the argument that such a sale may lead to *gharar* or even *riba* and to what extent this possibility is present nowadays.

## Notes

<sup>1</sup> Nicholas G. Apostolou, *Key to Investing in Corporate Bonds*, Barron's, New York, 1990, p. 3.

<sup>2</sup> the New York Institute of Finance, *How the Bond Market Works*, New York, 1988, p.3.

<sup>3</sup> See, Rating Agency Malaysia Berhad's *Newsletter* vol. 5, no. 3, March 2000, p.15.

<sup>4</sup> See Mohammad Ali El-Gari, "Developing Medium and Long -Term Corporate Bonds", paper presented at the international seminar "the Economic and Financial Imperatives of Globalization": An Islamic Response" 8-9 April 1999, Institute of Islamic Understanding Malaysia (IKIM), p11-12.

<sup>5</sup> Siddiq al-Darir, *al-Gharar wa Atharuhu fi al-Uqud*, Dallah al-Barakah, Jeddah Saudi Arabia, 1995, p. 321.

<sup>6</sup> Ibn Abidin, *Rad al-Muhtar*, vol.4; p. 209; al-Buhuti, *Kashshaf al-Qina*, vol.3 p.293; al-Kasani, *Badai al-Sanai*, vol.5, p. 214; Ibn Qudamah *al-Mughni*, vol.4, p.334.

<sup>7</sup> Abu Dawud, *Sunan Abu Dawud*, Matbat Mustapha al-Halabi, 1952, vol.2, p.247; Ibn Majah *Sunan Ibn Majah*, vol.766.

<sup>8</sup> However, the *hadith* is reported to be weak. See, Ibn Hajar, *Talkhis al-Habir fi Takhrij Ahadith al-Rafi al-Kabir*, Sharikat al-Tibaa al-Fanniyyah, Egypt, vol.3; p.225.

<sup>9</sup> Ibn Rushd, *Bidayat al-Mujtahid*, vol.2; p.231.

<sup>10</sup> *Majallat Majma' al-Fiqh al-Islami* no.9 vol.3, pp. 628-629.

<sup>11</sup> *Ibid.*, p. 649.

<sup>12</sup> *Ibid.*, p. 652.

<sup>13</sup> *Ibid.*, 654.

<sup>14</sup> "Islamic Commercial Law: An Analysis of Futures", *The American Journal of Islamic Social Sciences*, vol.13. no.2 1996, p.204.

<sup>15</sup> Bait al-Tamwil al-Kuwaiti, *al-Fatawa al-Shar'iyyah fi al-Masa'il al-Iqtisadiyyah*, p.526.

<sup>16</sup> Ibid., 532.

<sup>17</sup> Ibid., p.643.

<sup>18</sup> Sudin Haron, *Islamic Banking Rules and Regulations*, Pelanduk Publications, Selangor, Malaysia, 1997, p. 75.

<sup>19</sup> Sami Hassan Hamoud, "Islamic Financial Instruments Based on Intermediary Contracts" in *Islamic Financial Instruments for Public Sector Resource Mobilization* edited by Asuaf Ahmad and Triqullah Khan, Islamic Research and Training Institutes Islamic Development Bank, 1997, p, 225; Also see, Sami Hassan Hamoud, "al-Tanmiyah 'an Tariq al-Adawat al-Tamwiliyyah al-Islamiyyah" in 'Amal al-Nadwah al-Fiqhiyyah al-Khamisah Bait al-Tamwil al-Kuwaiti held in Kuwait from 2-4 November 1998, p.227.

<sup>20</sup> Ibid.

<sup>21</sup> See, Ali Muhyi al-Din al-Qurrah Daghi, "al-Bada' il al-Shariyyah li Sanadat al-Khizanah al-'ummah al-Khassah", 'Amal al-Nadwah al-Fiqhiyyah al- Thalithah , Bait al-Tamwil al-Kuwaiti, held 27-29 1993, pp.242-243.

<sup>22</sup> See, Rating Agency Malaysia Berhard's *Newsletter* vol. 5, no. 3, March 2000, p. 19.

<sup>23</sup> Abdul Rashid Hussain, "A Yield Curve for the Local Debt Market", *Islamic Banker*, April 1998, pp.26-27.

<sup>24</sup> Ibid.

<sup>25</sup> Ibid., p. 27.

<sup>26</sup> See Saiful Azhar & Mahmood Sanusi, "The Application of bay al-inah and bay al-dayn in Malaysian Islamic Bonds", *Journal of International Islamic Financial Services*, July 1999, p.7.

<sup>27</sup> Monzer Kahf, "The use of Assets Ijarah Bonds for Bridging the Budget Gap", *Islamic Economic Studies*, vol. 4, no.2, May 1997, p. 82.

<sup>28</sup> Mohammad Anas Zarqa "Rent Sharing Certificates: A shari'ah Compatible Financial Instrument" in *Islamic Financial Instruments for Public Sector Resource Mobilization* edited by Asuaf Ahmad and Triqullah Khan, Islamic Research and Training Institutes Islamic Development Bank, 1997, pp. 317-324.

<sup>29</sup> For more detail see Monzer Kahf, "The use of Assets Ijarah Bonds for Bridging the Budget Gap", pp.83-86.

<sup>30</sup> See, Rating Agency Malaysia Berhard's *Newsletter* vol. 5, no. 3, March 2000, p.20.

<sup>31</sup> Monzer Kahf, "The use of Assets Ijarah Bonds for Bridging the Budget Gap", pp.86-87.

<sup>32</sup> Monzer Kahf, "Budget Deficits and Public Borrowing Instruments In an Islamic Economic System", *The American Journal of Islamic Social Sciences*, Vol.11, Issue. 2, summer 1994, p. 207.

<sup>33</sup> Al-Zarqa Mustapha Ahmad Aqd al-Istisna wa Mada Ahammiyatuhu fi al-Istismarat al-Islamiyyah al-Muasirah, Islamic Development Bank, Jeddah Saudi Arabia, 1995, p. 21.

<sup>34</sup> Muhammad Anas Zarqa, "Istisna' Financing of Infrastructure Projects" ", *Islamic Economic Studies* vol. 4, no.2, May 1997, p. 69-70.

<sup>35</sup> Ibid., p.71.

<sup>36</sup> Walid Khayrullah, "Al-Muqaradah Bonds as the Basis of Profit Sharing", *Islamic Economic Studies* vol. 1, no.2, june 1994,p.80.

<sup>37</sup> See, Sami Hassan Hamoud, "Islamic Financial Instruments Based on Intermediary Contracts", p. 223.

<sup>38</sup> Saiful Azhar Rosly & Mahmood Sanusi, "Financial Instruments for Project Financing in Malaysia and the Arab Countries: A Comparative Analysis", p.11.

<sup>39</sup>Frank E. Vogel and Samuel L. Hayes, III, *Islamic Law and Finance Religion, Risk, and Return* Kluwer Law International, The Hague, 1998, p. 191.

<sup>40</sup> See, Stuart R. Veale (editor), *Stocks, Bonds, Options, Futures, Investments and their Markets*, New York Institute of Finance pp. 113-115.

<sup>41</sup> See Mohamed El-Nahwi, "Potential Islamic Certificates for Resource Mobilization", *Islamic Economic Studies*, vol. 1, no.1, December 1993, p.65.

<sup>42</sup> Article 2 of the Muqaradah Bonds Act issued by the Jordanian Government in 1981.

<sup>43</sup> See Mohamed El-Nahwi, "Potential Islamic Certificates for Resource Mobilization", *Islamic Economic Studies*, vol. 1, no.1, December 1993, p.65.

<sup>44</sup> See, Islamic Fiqh Academy Resolution no. (5) d 4/08/88 on Sanadat al-Muqaradah, *Majallat Maja al-Fiqh al-Islami*, no.4, vol.3, pp. 2162-2163.

<sup>45</sup> Ibid.

<sup>46</sup> For detailed discussion on the issue see the different papers presented at the Islamic Fiqh Academy and the discussion that follows *Majallat Maja al-Fiqh al-Islami*, no.4, vol.3, pp. 1821-2165.

<sup>47</sup> See, See, Islamic Fiqh Academy Resolution no. (5) d 4/08/88 on Sanadat al-Muqaradah, *Majallat Maja al-Fiqh al-Islami*, no.4, vol.3, pp. 2164.

<sup>48</sup> See, Adul Rahman Yousri Ahmed, "Islamic Securities In Muslim Countries Stock Markets and an Assessment of the Need for Islamic Secondary Market", *Islamic Economic Studies*, vol.3 no.1 December 1995, pp.7-9.

<sup>49</sup> Ibid.

<sup>50</sup> Ibid.

<sup>51</sup> Abdul Awwal Sarker, "Islamic Financial Instruments: Definition and Types", *Review of Islamic Economics*, vol. 4, no. 1, 1995.

<sup>52</sup> See, Adul Rahman Yousri Ahmed, "Islamic Securities In Muslim Countries Stock Markets and an Assessment of the Need for Islamic Secondary Market", *Islamic Economic Studies*, p.10.

<sup>53</sup> Ibid, p.11

<sup>54</sup> Abdul Awwal Sarker, "Islamic Financial Instruments: Definition and Types", p.15

<sup>55</sup> Adul Rahman Yousri Ahmed, "Islamic Securities In Muslim Countries Stock Markets and an Assessment of the Need for Islamic Secondary Market", pp. 3-4.

<sup>56</sup> Saiful Azhar & Mahmood Sanusi, "The Application of Bay al-Inah and Bay al-Dayn in Malaysian Islamic Bonds", p. 20.

<sup>57</sup> See, Sami Hassan Hamoud, "Islamic Financial Instruments Based on Intermediary Contracts", p. 224; al-Qaradaghi, al-Tatbiqat al-Shariyyah li Iqamat al-Suq al-Islamiyyah, *Majallat Majama al-Fiqh al-Islami*, no.8, vol2, pp. 424-426 ; Abu Ghuddah, "al-Tanmiyah bi al-Sanadat al-Mashruah li-Istismar Mutawassit wa Tawil al- Ajal" in *Amal al-Nadwah al-Fiqhiyyah al-Khamisah*, Bait al-Tamwil al-Kuwaiti, November2-4 1998, p.187.

<sup>58</sup> Ali Yasser, "The Experience of Islamic Republic of Iran in *Musharakah* Financing", *Arab Law Quarterly*, Kluwer Law International, 1999, pp.231-244.

<sup>59</sup> See, *Islamic Banker* no. 43. August 1999, pp. 10-13, in special interview with Dr. Mohsin Nourbakhsh, Governor of the central bank of Iran.

<sup>60</sup> *Islamic Banker*, no. 53, June 2000, p.3.

<sup>61</sup> *Islamic Banker*, no.43. August 1999, p.9; *Islamic Banker*, no. 53, June 2000, p.3.

<sup>62</sup> Hassan Hamoud, "al-Tanmiyah an Tariq aal-Adawat al-Tamwiliyyah al-Islamiyyah", p.214.

<sup>63</sup> Abdul Halim Ismail Modern *Isalamic*, "Financial system with Particular Reference to Islamic Capital Market" paper pre-

sented in a Seminar on Islamic Financial Services and Products 27-29 August 1998 at the Institute of Islamic Understanding Malaysia.p.13.

<sup>64</sup> Abdul Awwal Sarker, “Islamic Financial Instruments: Definition and Types, *Review of Islamic Economics*, vol. 4, no. 1, 1995, pp. 8-9.

<sup>65</sup> Monzer Kahf, “Budget Deficits and Public Borrowing Instruments In an Islamic Economic System”, p. 213.

<sup>66</sup> Ibid. p.216

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