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on

Şukūk: A Panacea for Convergence and Capital Market Development in the OIC Countries

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Introduction

The main purpose of this discussion paper is to make a value-added contribution on the subject of the session as recommended by the organizers of the conference. Besides, reviewing the Sudanese governmental experience in the *şukūk* area. *Şukūk* are used in a wide manner not only to finance government, nonetheless, it is used to help in economic policy, mainly monetary policy. An additional justification is that the paper under consideration does not mention and ignores completely Sudanese experience in *şukūk*, though it is very rich as far as policy, Sharī'ah aspects, negotiation, monetary policy.... are concerned.

Terminology:

Using the term securitization as identical to *şukūk* minimizes the area covered by *şukūk*.

Securitization means: process of distributing risk by aggregating debt instruments in a pool, then using new securities backed by the pool (Dictionary of finance & investment Terms). Besides partially aggregating debt instruments in a pool, *şukūk* are used in a very wide manner. *Şukūk* can be used to generate finance to different projects in government or private sectors.

Şukūk based on *mushārah* and/or *ijārah*, *istişnā'*, *Murābah* and *salam*, could be used as a tool for monetary policy and open market operations. An important role for *şukūk* which is emerging is using them to control liquidity. Central Banks can issue *şukūk* for the solely purpose of controlling liquidity. It helps authorities to operate a tight monetary policy or to release it.

When *şukūk* are sold to public this withdraw money from the market, and has its effect on money supply. Money withdrawn will be kept by the Central Bank. If

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need arises then such money or part of it will be pour again in the market by buying *şukūk*.

Sudanese experience:

What is summarized above will be detailed hereunder. The discussion will cover government *şukūk*, their Kinds, purpose and Sharī'ah aspects,.etc.

şukūk in Sudan can be reviewed as per kinds and generations.

First Generation

The first generation of *şukūk*, is what called Shihāma, which is based on *mushārahah*, whereby, the government sells part of its pooled shares in some companies owned completely or partially by the government. The ownership of participants is equal proportionately to what they have bought of the pool. Therefore, profit generated will be distributed accordingly. Profit is calculated based on capital appreciation and normal profit generated from business.

Shihāma certificates (*şukūk*) are redeemable upon request, though the participants are theoretically- according to Higher Sharī'ah Board are permanent partners .

Second Generation

The need to finance development originates government investment certificates (GIC). These are financial papers based on *muḍārbah* for mobilizing fund from investors. Funds generated will be used by the *muḍārib* (SPV) to finance government (development) though different Sharī'ah compliant contracts, i .e. *ijārah* (leasing) *murābahah*, *istişnā'* and *salam*. To make these *şukūk* negotiable the majority should be given to *ijārah*, therefore, holders can sell them in the market. This makes the *şukūk* highly liquid .

Third Generation

Third generation is represented by *şukūk* based on assets (real estate). The main purpose of these is management of liquidity. They are *şukūk* issued by Central Bank, where money generated is kept without being used, for the purpose of decreasing money supply.

The aim is to withdraw money from market for curbing inflation down and economic stability purpose. When need arises the money will be injected into market again.

The mechanism used is similar to Shihāma and GIC as far as money is generated through *muḍārabaha* contract, to be used by *muḍārib* (SPV) with Central Bank. *Muḍārabah* Capital used to buy assets from Central Bank by SPV.

Assets (real estate) bought from Central Bank will be rent again to Central Bank for a certain period and determined value. The leasing (*ijārah*) here is an

operational leasing, at the end of *ijārah* period or maturity, the SPV has the right to renew the leasing with the Central Bank or can lease the asset to any other party or sell it at market price.

Government *Ṣukūk* (GS) Features

GS covers all generations of *ṣukūk*. They represent Shihāma GIC, and *ṣukūk* based on assets, their features are as follows:

Provide stable and non-inflationary finance to the government.

The finance covers short – medium and long term periods.

Sharī'ah Compliant.

Finances different sectors: expenditure, agriculture, services.

Highly liquid (negotiable).

GICs provide finance in real and hard assets (equipment, machines). Therefore, they are used to finance development.

GICs do not provide cash (liquid) finance (except *salam*).

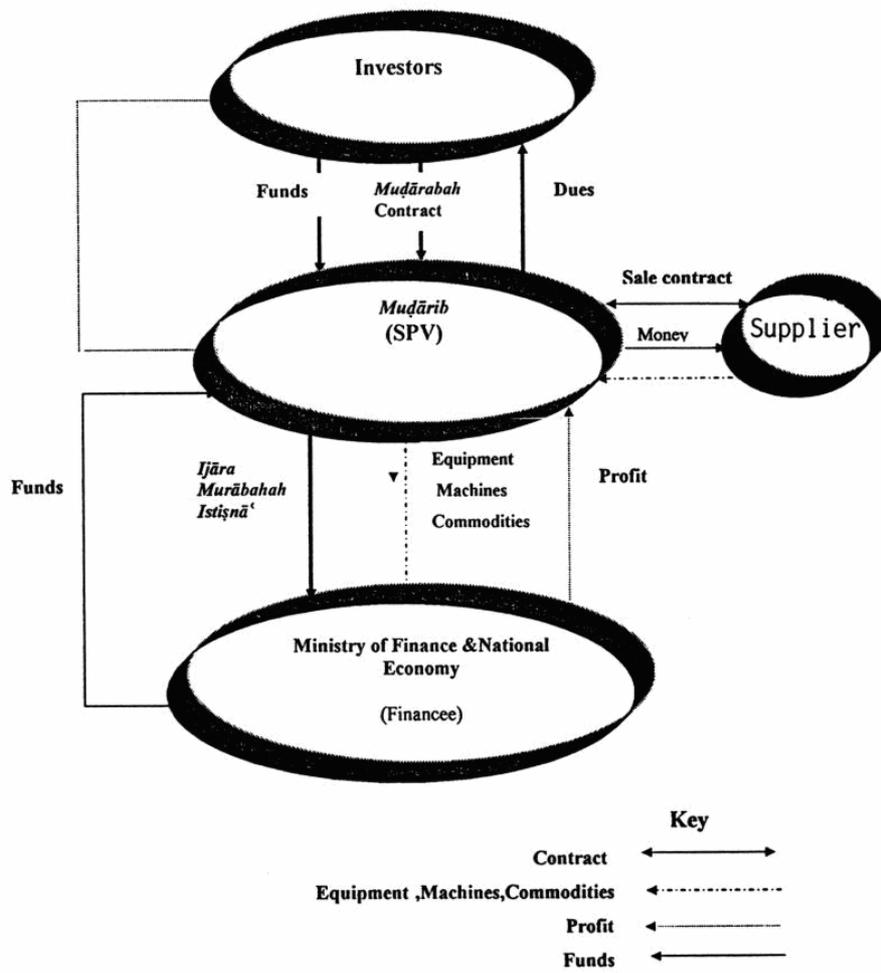
Used as monetary policy tool to control liquidity. In some cases (the third generation) they are used solely to control liquidity.

Can be used in fiscal policy to decrease taxation. Revenue in budget can be increased by *ṣukūk*, though profit should be paid, and a cost of finance should be considered.

Generates a reasonable profit for individuals and investors.

However, money generated by *ṣukūk* has self – control feature as it is owned by investors who are expecting the repayment of principal plus profit or minus loss, hence projects financed through them in public sector are looked after carefully and managed efficiently.

Diagram (1)



Sharī'ah Aspects

Issuance of *ṣukūk* is supervised by Higher Sharī'ah Board. *Ṣukūk* are issued according to a prospectus showing the main features of the issue. All rights and dues are detailed in the prospectus .

Shihāma

Shihāma is based on *mushārahah* (participation) contract. Therefore, it is negotiable, the holder can sell it in the market (Khartoum Stock Exchange). Shihāma is a profit sharing instrument. The profit generated is dependable upon the performance of the companies consisting Shihāma fund.

Governmental Investment Certificates (GIC)

Mechanism of GIC is based on *muḍārahah* contract to mobilize funds and *ijārah*, *istiṣnā'*, *murābahah* and *salam* to utilize funds for the purpose of financing the government. To make GIC Negotiable and tradable without breaching Sharī'ah rules, *ijārah* should consist the majority of GIC. *Ijārah* represents hard assets while *istiṣnā'*, *murābahah* and *salam* represent financial assets and debts. If *ijārah* represents minority in GIC then debts would be majority. Trade in debts is permissible in Sharī'ah only when it is sold with the nominal value. This makes GIC unprofitable and therefore, non-preferable and undesirable

Liquidity control *ṣukūk*

It is based on what is become to be known as operational leasing for an object to that (person) who sold it. Whereby, the Government sells an asset it owns to a fund or SPV, then the asset will be rent to the government back at a definite price and period. At maturity the SPV has the right to renew the contract or to sell the assets at market price. This mechanism is used also in GIC. The only different is that it is used in GIC to finance the government. But when it is used in liquidity control *ṣukūk* the main purpose is to manage liquidity and it is used as a tool for monetary policy.

Leasing ending with ownership for an object to the (person) who sold it

This is a controversial mechanism. It is considered Sharī'ah complaint by some Sharī'ah boards. But it is not acceptable by higher Sharī'ah Board in Sudan.

The mechanism is similar to the previous one but the asset here is to be returned back to the government. Whereby the lease is ending with the ownership to the party that sold it. The opponents argue that the agreement which consists of two contracts : Sale and leasing ending with ownership leads to *Einah* which is not acceptable. *Einah*: taking or giving interest (*ribā*) using two factious sale contracts.

The argument by advocators is that, leasing ending with ownership is acceptable from Sharī'ah point of view, therefore, if an asset is sold by any party that party has the right to lease it back leasing ending with ownership and owns it again as far as leasing is not a sale contract.

Enhancement

Ṣukūk dues are guaranteed by Central Bank. Structural enhancement and Providing guarantee could be considered such as:

- a- Guarantee offered by a third party.
- b- *muḍārib's* guarantee, (at his discretion).
- c- Leasing ending with ownership for an object to that (person) who sells it.
- d- Insurance (this decreases investor's profit).
- e- Mixing *murābaḥah* and *ijārah* ending with ownership with *Arboon* sale contract (deposit).

However, some of the above instruments are questionable from Shari'ah perspective by some Shari'ah Scholars.

Conclusions

Sudanese successful experience in *ṣukūk* issuance support the recommendation of the paper that: OIC member states would take the necessary political will and direction for the further and fast development of this useful products.

The experience shows that *ṣukūk* are not useful only in generating finance to government yet it would be used successfully in general economic policy and monetary & fiscal policy.

Expansion in *ṣukūk* issuance need structural amendment in capital market and institutional settings in the financial and banking systems. Institutions for controlling and supervising *ṣukūk* are highly recommended i.e. Security and exchange commission (SEC).

It is agreed that many parties, government, corporate, etc considering *ṣukūk* as new and ideal alternative for their financing and investment needs.

Shihāma in some respect is similar to shares it could be depicted as shares in many different companies as represented in the fund.

Salam ṣukūk though provide cash (liquid) finance to be used by financed party as he deems fit, facing a major deficiency, i.e. *Ṣukūk* are not negotiable, therefore, *salam ṣukūk* is applicable only in close end funds, or if they are issued within a fund, where, *ijārah* is majority.

Ṣukūk are financial papers (certificates) of equal value representing undivided shares in ownership of tangible (hard) assets, usufruct. This definition is acceptable only in case of *ṣukūk* where *ijārah* represents the majority in the fund, but there are many *ṣukūk* where *ijārah* is not consisting the majority, such as, *murābaḥah*, *salam* and *istiṣnā'*.

As shown *ṣukūk* could be used for other purpose than finance.

As noted *muḍārabah* & *mushārah* have not been seen in the market for difficulties and moral hazards. But Sudanese experience, using both contracts *mushārah* for financing government and investment *muḍārabah* for mobilizing funds, shows that these contracts can be used in government & well established companies.

Appendix
SELF-EXPLANATORY DIAGRAMS
Diagram (2)

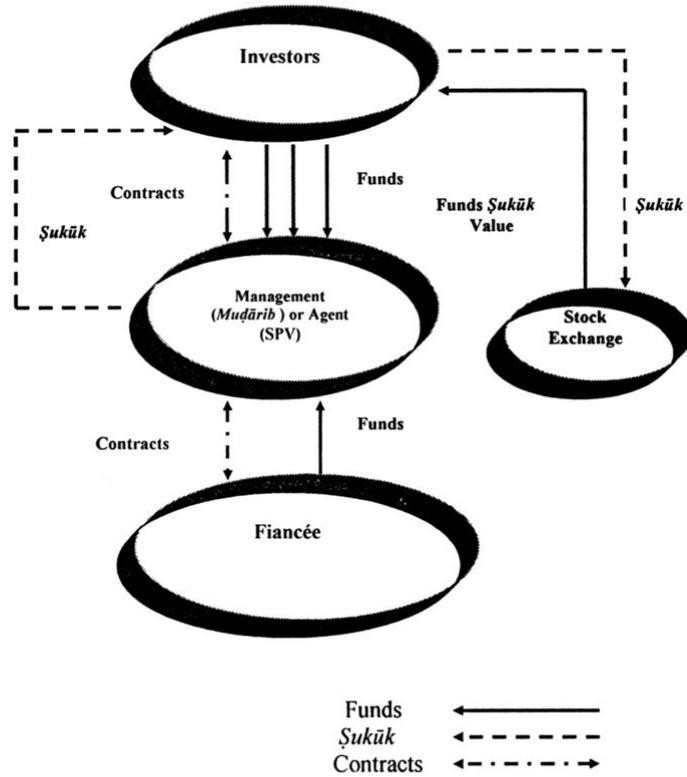


Diagram (3)
IJĀRAH CONTRACT FOR REAL ESTATE FINANCING

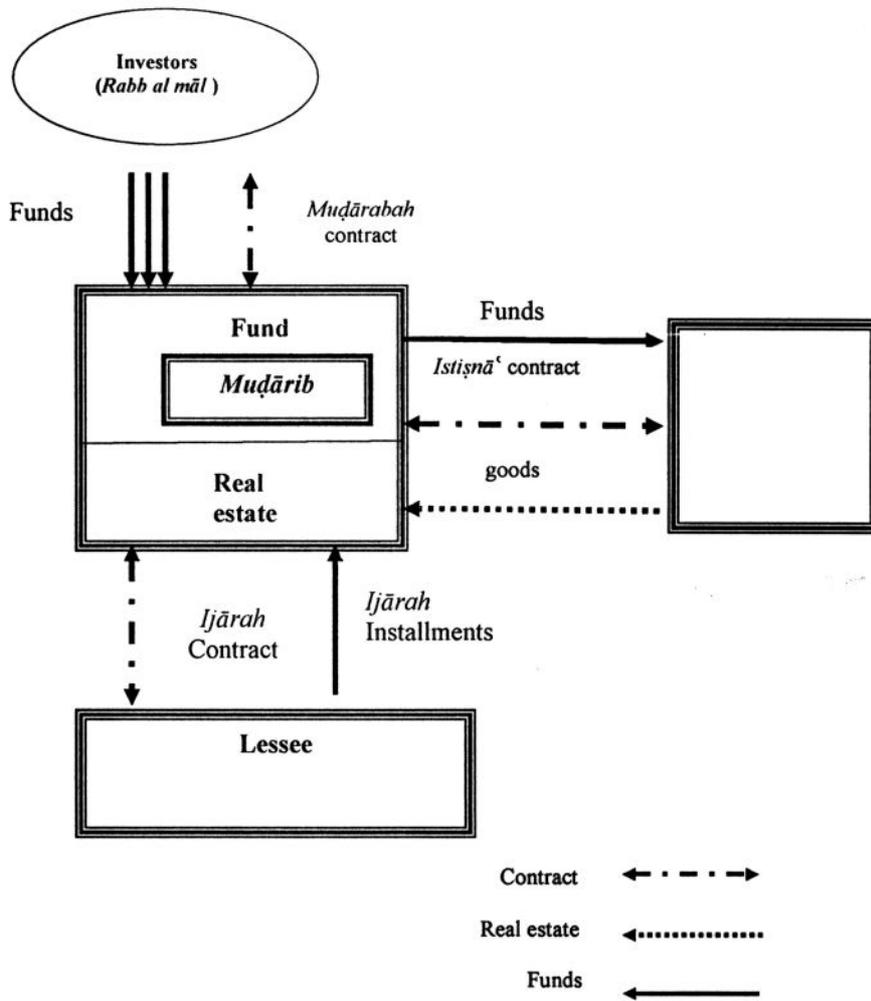


Diagram (4)

IJĀRAH CONTRACT FOR REAL ESTATE FINANCE

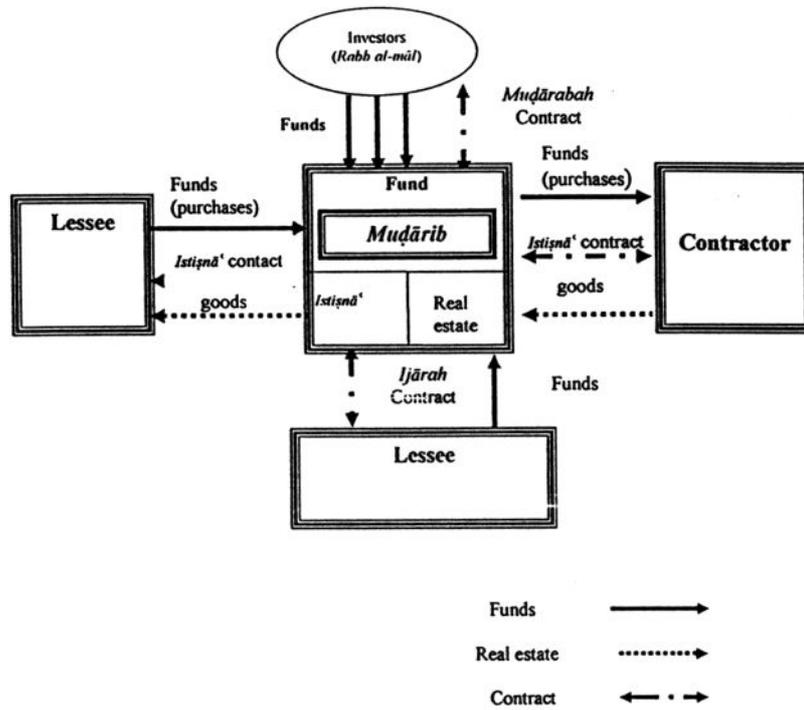


Diagram (5)

IJĀRAH CONTRACT FOR REAL ESTATE

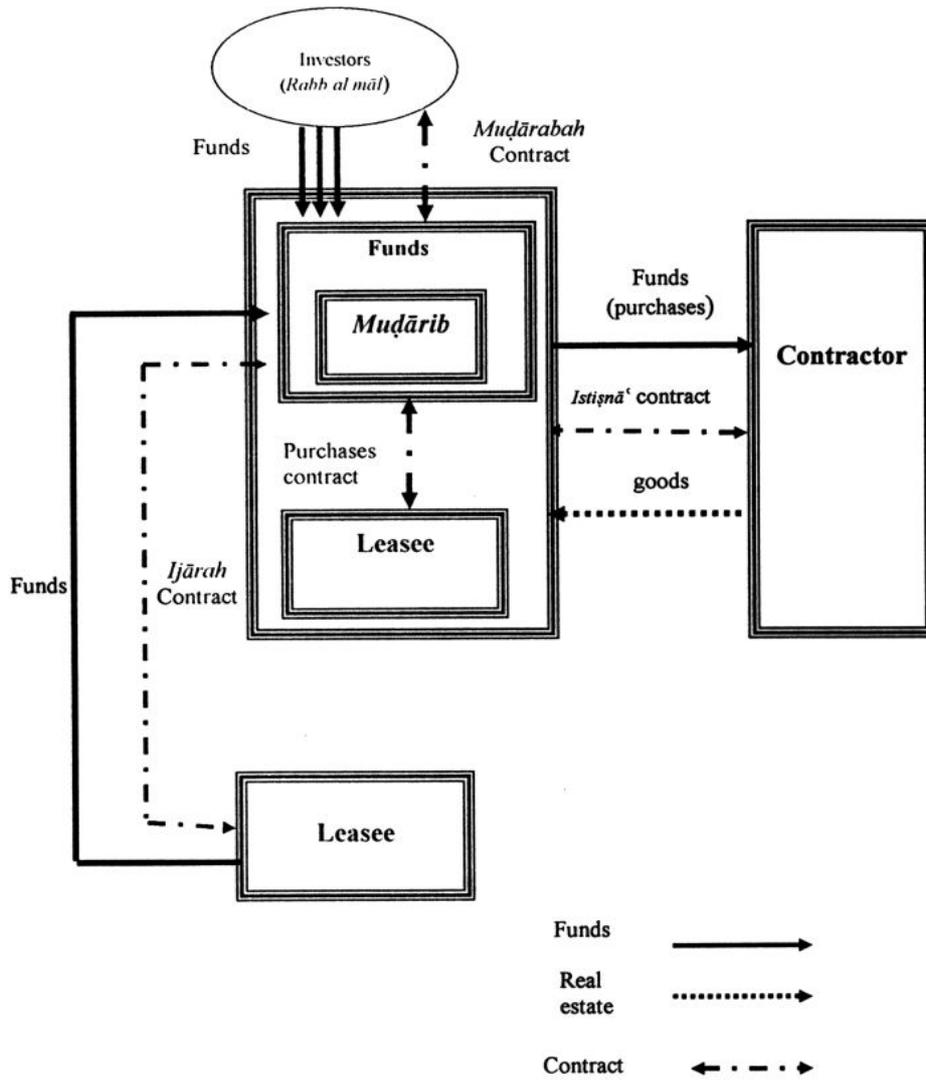


Table 1: .Participation of GIC in development (2006) budget

Billion Dinars	Projects	Finance
Agricultural sector	7	16
Water sector	3	1
Roads	4	7
Energy	9	38
Industrial sector	4	8
Others	9	9
Total	36	79

\$ 1= SD 240

Table 2: Development in shihama issuance

Year	Issuance	Growth%	Billion SD
			Shihama/GDP%
1999	2	-	-
2000	8.0	300	-
2001	44.0	45	-
2002	64.0	45	-
2003	101.0	58	2.4
2004	178.0	76	3.6

Table3: GIC issuance

Issue	Date	Amount	Maturity (year)	Expected rate of profit%	Billion SD
					Beneficiary
1 st	May 2003	6	2	16-20	Ministry of Health, higher education, general education
2 nd	August 2005	1	3	15-20	National fund for student (real estate)
3 rd	October 2004	11.8	6	15-16	Ministry of Health, Agricultural Bank, Ministry of Higher Education, others
4 ^{rt}	March 2005	22.8	5	15-16	Agriculture, river transportation corporation, states, higher education.
5 th	June 2005	20	6	15-16	Health, education, states, other

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