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**HARMONIZATION BETWEEN THE SHARIAH GUIDELINES
AND THE PRACTICES IN MALAYSIAN SUKUK MARKET**

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BACKGROUND OF THE STUDY

Today most of the developed countries are looking seriously at Islamic banking industry mainly sukuk as one of the best alternatives to the current weak financial system. From United Kingdom and France in Europe to Korea and Japan and many more are working hard and rapidly to amend their legal and regulatory systems to facilitate the way for sukuk to be issued in their financial market. Ahmed (2007) stated that Islamic finance instruments, particularly Sukuk, are becoming an increasingly important consideration – for both Muslims and non-Muslims – from the perspective of investment and product innovation. The issuance of Sukuk is a vital mechanism for raising money in the capital markets. Sukuk have unique characteristics and offer significant benefits, unlike other Islamic banking vehicles. Undoubtedly, Malaysia is still leading the global sukuk market impressively. The Governor of the Central Bank of Malaysia Dr Zeti Akhtar Aziz, express that situation clearly:

“The sukuk market is fast emerging as the most significant form of Islamic financing and continues to receive strong interest as an avenue for fund raising and investment. The sukuk market has been gaining growth momentum, increasing at an average annual rate of 40 percent. Significantly, 90 percent of the sukuk issuance are corporate issuances. In Malaysia, the issuance of sukuk has surpassed the issuance of conventional bonds for three consecutive years, with the annual turnover in sukuk trading in the secondary market at about RM135 billion. Strong demand for sukukuks have also been spurred by the high levels of surplus savings and reserves in Asia and the Middle East.” (Aziz, 2008)

She also give a lucid diagnosis of the needs of a concrete harmonized regulation and supervision to facilitate and strengthening the Islamic financial system.

“the regulatory and supervisory paradigm continues to evolve. Indeed, the recent decade had witnessed significant global shifts in the approach to regulation and supervision across many countries. In addition, the harmonisation of standards and practices is also important. The establishment of the international standard setting organizations such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), to formulate appropriate prudential and accounting standards that would not only facilitate the process of harmonisation but also contribute to the strengthening of the Islamic financial system. The IFSB has already formulated the prudential treatment for sukuk investment by the Islamic financial institutions as stipulated in the Capital Adequacy Standards.” (Aziz, 2007).

In this regard, this research attempts to study the level of harmony between the Shariah guidelines and the practices in Malaysian sukuk market.

INTRODUCTION

Sukuk is a plural of *Sakk*. Which means “legal documents, deed, check”. It is an Arabic name for financial certificate but it can be seen as an Islamic comparable of the conventional bonds. *AAOIFI* defined *Sukuk* as: “Certificates of equal value representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity” (AAOIFI, 2004 p. 298). While the Securities Commission of Malaysia (SC) very briefly define *sukuk* (Securities) as: “A document or certificate which represents the value of an asset.” (SC, 2004, p. A4).

To give a bright light to the global *sukuk* market size and growth we used a very recent comprehensive report by International Islamic Financial Market (IIFM).

Table 1: Regional break-up of the Domestic Sukuk Market

Country	Volume (US\$ millions)	No. of Issues	% of Total Value
Asia			
Malaysia	67,872	792	66.8%
Indonesia	1,923	48	1.9%
Pakistan	1,657	31	1.6%
Brunei	740	13	0.7%
Singapore	99	2	0.1%
GCC			
Saudi Arabia	7,665	10	7.5%
UAE	7,151	10	7.0%
Bahrain	1,508	77	1.5%
Qatar	137	1	0.1%
US, Europe and Africa			
US	167	1	0.2%
Germany	123	1	0.1%
Gambia	0.388	1	0.0%
Sudan	12,614	20	12.4%
Total	101,656	1,007	100.0%

Source: In-house IIFM Sukuk issuance database

As illustrated in the IIFM (2010) report the total global *Sukuk* issuance increased from a size of just over US\$ 1 billion towards the end of 2001 to US\$ 136 billion as of 30th June 2009, a compounded annual average growth rate or CAGR of 88%. The *GCC* has been more inclined towards international issues while Malaysia has been more active in its domestic market. As can be seen from data in Table 2 below, domestic issues form a much higher percentage of the total *global Sukuk* market (74%) than international issues (26%) as of 30th June 2009 with a broad regional break-up as follows:

Table 2: Regional Break-up of Global Sukuk Issues (all figures in US\$ billion)

	GCC	Malaysia	Others	Total
Value of Domestic <i>Sukuk</i>	\$16	\$67	\$18	\$101
Share of Domestic <i>Sukuk</i> Market	16%	66%	18%	100%
Value of International <i>Sukuk</i>	\$29	\$3	\$3	\$35
Share of International <i>Sukuk</i> Market	83%	9%	9%	100%
Value of total Global <i>Sukuk</i>	\$45	\$70	\$21	\$136
Share of total Global <i>Sukuk</i> Market	32%	53%	15%	100%

Source: In-house IIFM *Sukuk* issuance database

Malaysia is undoubtedly the pioneer of the Islamic capital markets. The maturity and depth of its market has ensured a thriving local secondary market as well - a goal that still eludes the international issues. The *Shari'ah* Advisory Council of the Securities Commission of Malaysia governs the principles on which *Sukuk* should be issued. It recognizes *Bai Dayn* or debt trading as one of the acceptable principles for *Sukuk* issuances whereby *Shari'ah* compliant cash receivables arising from contracts such as *Murabaha*, *Bai Bithaman Ajil (BBA)*, *Ijarah* or *Istisna'a* are converted into tradable debt instruments. Until 2003, *Sukuk* issuances in Malaysia had been confined to instruments based on the securitization of debt arising from the contracts of *Murabaha*, *Bai Bithaman Ajil* and *Ijarah*. The former two do not have demand outside Malaysia especially *GCC*, Pakistan etc., as they are backed by debts or receivables rather than based on

tangible assets. From 2004, Malaysian *Sukuk* issuers started using the participatory contracts of *Musharakah* and *Mudarabah* and witnessed such tremendous growth that by first half of 2008, *Sukuk Al Musharakah* formed about 84% of the total market issuance. Besides being the leader in the overall global *Sukuk* market in terms of both volume and value, with 792 issues to its credit worth approximately US\$ 68 billion, Malaysia has also pioneered a whole lot of innovations in the domestic as well as international market. Some of the hallmark issues arising from Malaysia are given below in Table 3 (IIFM, 2010).

Table 3: Hallmark Sukuk Issues from Malaysia

Issuer	Amount	Year	Transaction Highlights	Tenor (Years)
Shell MDS	RM125 million (US\$33 million)	1990	World's first ringgit <i>Sukuk</i> issue by foreign-owned, non-Islamic company	-
Kumpulan Guthrie Bhd	US\$150 million	2001	World's first global corporate <i>Sukuk</i>	8
Government of Malaysia	US\$ 600 million	2002	World's first global sovereign <i>Sukuk</i>	5
International Finance Corporation (World Bank)	RM500 million (US\$132 million)	2004	First ringgit <i>Sukuk</i> issue by supranational agency	3
Cagamas MBS Bhd	RM2.05 billion (US\$540 million)	2005	World's first Islamic residential mortgage-backed securities	13
Khazanah Nasional (Rafflesia Capital Ltd)	US\$750 million	2006	World's first exchangeable <i>Sukuk</i>	5
Khazanah Nasional (Rafflesia Capital Ltd)	US\$750 million	2006	World's first exchangeable <i>Sukuk</i>	5
Nucleus Avenue (Malakoff Corporation)	RM8 billion (US\$2.5 billion)	2007	First Hybrid <i>Sukuk</i> in the world	50
Maybank Berhad	US\$300 million	2007	World's first international subordinated <i>Sukuk</i>	10
Binariang GSM	RM15.35 billion (US\$4.8 billion)	2007	Largest-ever <i>Sukuk</i> issue in the world	20

Source: In-house IIFM *Sukuk* issuance database

While the global *Sukuk* market has grown with a CAGR of 88% between 2001 and June 2009, the international *Sukuk* market has grown faster, at a CAGR of 106.8%. The growth rates seem extraordinary at first glance, however, it is interesting to note that they would have been higher had the *Sukuk* market not slowed down in 2008 and 2009 and maintained its pace of earlier years (IIFM, 2010).

Table 4: Year on Year Growth Rates of the Sukuk Market

For the Year	International Market	Global Market
2004	91.0%	86.1%
2005	71.6%	69.8%
2006	147.1%	104.4%
2007	76.1%	89.2%
2008	6.8%	15.9%
2009*	8.5%	19.4%
CAGR	106.8%	88.3%

Source: In-house IIFM *Sukuk* issuance Database

*Annualized

Table 4 shows how the biggest surge in the international market came in 2006. There were even bigger surges in the earlier years of 2002 and 2003; however, they were mainly due to a low-base effect, while in 2006 it was on the back of 16 new issues worth over US\$ 10 billion. 2007 has been the most productive year in the history of the international market though, towering over 2006 with 26 new issues worth US\$ 13.81 billion.

Guidelines

Complex *Sukuk* structures involve challenging procedures and require extensive and costly advice – both legal and religious – in addition to diverse sets of skill and resources to make them work (Ahmed, 2007). One of the issues faced by Islamic financial industry is lack of

standardization of Shariah rulings within the same jurisdictions and among various regions. The diversity provided by different schools of thoughts on same issues at times creates confusion in the minds of public, but if properly harmonized across the globe, can become a great strength for the Islamic financial services industry thereby providing different options suitable to the varying needs of customers. AAOIFI has taken a lead by preparing Shariah standards approved by 14 renowned Shariah scholars across the world. Some countries have recognized these standards in their regulatory framework, and adoption of these standards in other countries will pave the way not only for Shariah compliance but also for product innovation. In addition, the central banks/regulatory agencies monitoring the performance of Islamic financial institutions also need to establish their own Shariah Board for guiding them in formulation of policies and rules as well as for resolution of conflicting Shariah opinions (Akhtar, 2006).

In the context of Malaysia guidelines, the Securities Commission issued a guideline entitled *Guidelines on the Offering of Islamic Securities* (“IS Guidelines”). Which provides for the Shariah adviser “to advise on all aspects of the Islamic securities including documentation, structuring, investment as well as other administrative and operational matters in relation to the Islamic securities, and ensure compliance with applicable Syariah principles and relevant resolutions and rulings made by the SAC from time to time” (section 6.0).

The Guidelines issued by Securities Commission provide the criteria to be met in the issuance, offer or invitation of Islamic securities within the ambit of CMSA. The Guidelines stipulates persons who may act as principal adviser or proposal to issue Islamic Securities that can and cannot be converted into equity. As illustrated by SC (2009) The Guidelines provides for:

- (1) requirements for documents and information necessary in the offer, issuance or invitation of Islamic Securities;
- (2) requirement for the appointment of Shariah adviser to advise Islamic bank or licensed financial institutions in all aspects of Islamic securities;
- (3) requirement for the rating of Islamic securities except those which are non-tradable, are non-transferable Islamic securities;
- (4) mode of issue of Islamic Securities;

- (5) utilisation of proceeds of funds raised from the offer, issuance or invitation of Islamic Securities; and
- (6) disclosure requirement to investors.

The Guidelines provides that Islamic securities must be issued pursuant to valid Shariah principles and concepts and to be approved by the Shariah Advisory Council of the Securities Commission. For the purpose of reference, the Guidelines provides certain Shariah concepts and principles that may be adopted for the purpose of structuring, documenting and trading of Islamic securities, in Appendix 1 of the Guidelines. Appendix 1 of the Guidelines on the Offering of Islamic Securities lists down the primary and supplementary principles to be adopted in the structuring, documenting and trading of the Islamic securities. The primary principles includes deferred payment sale (BBA), sale with immediate purchase (bai' inoh), supply sale (bai' istijrar), advance purchase (bai' salam), sale and repurchase (bai' wafa'), leasing (ijarah) etc. For the supplementary principles, the concept of debt trading (bai' dayn), open bidding (bai' muzayadah), guarantee (kafalah), ownership right (hak tamalluk), gift (hibah), rebate (ibra') etc may be adopted whenever suitable (SC, 2009).

In addition to the Guidelines, the SC (2009) added, the issuer should also comply with the Guidelines on the Offering of Private Debt securities (PDS Guidelines) and the Guidelines on the Offering of Islamic Securities (IS Guidelines). The Guidelines generally provide on the rulings related to:

- (1) criteria for subject matter of securitisation transaction;
- (2) provision on originator;
- (3) requirement of true sale criteria of the asset/provisions on the SPY;
- (4) provisions on terms of trust deed;
- (5) disclosure requirements to investors of the ABS;
- (6) duties of servicer of asset;
- (7) utilisation of proceeds;
- (8) requirement that other regulatory approvals to be applied and approved prior to making any submission to sc.

Where the issue, offer or invitation of ABS is Islamic in nature, the whole process should be up to the standard and requirements of the Shariah. The Guidelines provide that in the case of doubt of any issues pertaining to ABS, the reference should be made to the Syariah Advisory Council of the sc.

An important step towards the harmonization of the Islamic finance industry was carried out on 3rd November, 2002, with the foundation of the Islamic Financial Services Board (IFSB) headquartered in Kuala Lumpur. The decision to establish such a body was taken by a group of governors, senior officials of central banks and monetary authorities of several Islamic countries, supported by the Islamic Development Bank, the AAOIFI and the International Monetary Fund. The general objective of the IFSB is “promoting, spreading and harmonizing best practices in the regulation and supervision of the Islamic financial services industry” . The IFSB serves as an international standard setting body of regulatory and supervisory agencies that have an interest in ensuring the reliability and stability of the Islamic financial services industry. It is specifically concerned with the standardization of Shar“iah committee rulings on Islamic banking practices. The IFSB also aims at standardizing the approach in Good Governance of Islamic financial institution and identifying risks in Shar“iah-compliant products and services and in assigning risk weights that meet internationally acceptable prudential standards (Antonio, 2008).

AAOIFI Among the most celebrated and an outstanding effort in harmonizing Shariah finance is the establishment of AAOIFI. AAOIFI or The Accounting and Auditing Organization for Islamic Financial Institutions is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shariah standards for Islamic financial institutions and the industry. AAOIFI was established in accordance with the Agreement of Association, which was signed by Islamic financial institutions on first Safar, 1410H corresponding to 26 February 1990 in Algiers. Then, it was registered on 11 Ramadan 1411 corresponding to 27 March 1991 in the State of Bahrain. As an independent international organization, AAOIFI is supported by institutional members (155 members from 40 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide. The objectives of AAOIFI are:

1. to develop accounting and auditing thoughts relevant to Islamic financial institutions;
 2. to disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means;
 3. to prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions; and
 4. to review and amend accounting and auditing standards for Islamic financial institutions.
- AAOIFI carries out these objectives in accordance with the precepts of Islamic Shari“a which represents a comprehensive system for all aspects of life, in conformity with the environment in which Islamic financial institutions have developed.

This activity is intended both to enhance the confidence of users of the financial statements of Islamic financial institutions in the information that is produced about these institutions, and to encourage these users to invest or deposit their funds in Islamic financial institutions and to use their services. AAOIFI has gained assuring support for the implementation of its standards, which are now adopted in the Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, Kingdom of Saudi Arabia, and South Africa have issued guidelines that are based on AAOIFI“s standards and pronouncements (Antonio, 2008).

Nature of Shariah Supervision

In general, there are at least three types and levels of Shariah supervisory officers as classified by SC (2009):

1. Shariah or co-coordinator consultant
2. Shariah Supervisory Board (SSB)
3. National Shariah Advisory Council (NSAC)

The Islamic bank and takaful companies would normally have permanent qualified Shariah staff working with them to help manage Shariah issues and to assume the role as the coordinator between the management of the companies with the SSB. Individual companies may also engage

a Shariah consultant for any matters regarding Shariah. The consultant is a person or an entity having expertise in Shariah.

Shariah Supervisory Board (SSB) is a mandatory requirement for Islamic Banks and takaful companies. AAOIFI also has issued Governance Standards for Islamic Financial Institutions (GSIFI). GSIFI No 1 defines SSB as an independent body of specialized jurists in *fiqh* mua'malat, who mainly specialise in the field itself or with the knowledge of Islamic finance. The jurists are specialists from different backgrounds such as academicians, Islamic studies expert, economists, lawyers and bankers with expertise or some knowledge of *fiqh* mua'malat.

According to AAOIFI, GSIFI No 1 members of SSB are responsible to ensure the agreements and contracts in IFIs' comply to Shariah requirements. The members are also responsible to analyse, resolve and advise (via fatwas and rulings) on any Shariah issues and concerns as presented to the SSB by the IFIs' staff and board of directors from time to time. The members of SSB are also expected to supervise and monitor the IFIs' activities and dealings are in accordance to Shariah by reviewing samples of the bank's activities and dealings.

National Shariah Advisory Council (NSAC) of BNM Malaysia has the power to issue fatwa and these fatwa resolutions are binding on all financial institutions in the country. NSAC may also have the authority to perform Shariah audit on activities such as in the case of Bank of Sudan. Thus, such NSAC has the authority to examine samples of the documents, records and dealings of these banks and financial institutions where it feels necessary and appropriate.

The first duty of NSAC is to issue rulings. Second is to ensure compliance by IFIs to the Shariah where NSAC is allowed to study and scrutinize the fatwas of the SSBs of Islamic banks and the IF Is. Third, the NSAC is to advise all IFIs of any Shariah issues related to operations and financial dealings. Lastly, the NSAC has the right to examine the laws, by-laws and circulars governing the IFIs activities (SC, 2009).

The compliance with Shariah principles is an integral feature in the Islamic banking and finance. An effective and conducive Shariah framework is imperative in assuring such compliance. It will underpin a comprehensive and wholesome development of this sector. An effective Shariah

framework will harmonize the Shariah interpretations, strengthen the regulatory and supervisory oversight of the industry and will also foster and nurture a pool of competent Shariah advisers (BNM, 2005). Islamic institutions need to have some kind of regulatory supervision in day-to-day operations in order to protect their depositors and clients. Because of the differences in their nature and operations, Islamic banks require more strict supervision of the firms' operations after the disbursement of funds. Banks' supervision, scrutiny and examination, and sometimes-participatory management in the conduct of firms' operations, are important components of the Islamic financial marketing system set in place, because of the greater risks that the Islamic banks shoulder. In most countries, there are no coherent standards of Islamic marketing regulations, and the lack of uniformity in accounting principles and *shariah* guidelines makes it difficult for central bankers to regulate such an industry (Awaida, 1998). Thanks to the new standards adopted, such as auditing rules in Bahrain, new international standards are now applied by all Islamic banks, enhancing their transparency significantly (Elfakhani, Zbib, & Ahmed, 2007).

Shariah Auditing in Practice

Rahman (2008) has classified the *shari'ah* compliance types in two categories: (i) ex-ante compliance, and (ii) ex-post compliance. The ex-ante *shari'ah* compliance is basically the SACs supervision, monitoring and control tasks that take place upon and during implementation of the bank's dealings. These activities include making sure that the banks and financial institutions comply with the *shari'ah* rules and guidelines during the designing of the contracts and agreements, during the process of transactions, during the conclusion and execution of the contract, and up to the implementation of the terms of contract and liquidation. So far, very few institutions undertake ex-post *shari'ah* compliance process. Ex-post *shari'ah* compliance process requires thorough and comprehensive shari'ah audit to review and check the transactions that took place after the execution of the contracts. The ex-post *shari'ah* compliance is basically to perform the random samples of completed transactions to ensure that these transactions conform to *shari'ah* rules and guidelines. An internal audit or external audit may be required to perform this where the result of the audit needs to be reported to the management.

Cursory examination of the Islamic financial services industry especially in Malaysia will show us an apparent gap in the *shari'ah* supervisory practices. Even though the SSCs of the Islamic banks have expressed their opinions on the *shari'ah* compliance, thorough audit or review processes of the *shari'ah* legal contracts, documentations and operations are rarely conducted properly. Without such audit and review processes, a functional gap of *shari'ah* compliance processes emerges. This gap is a serious loophole in the Islamic financial system that is founded on *shari'ah* precepts. *Shariah* advisors rarely carry out thorough internal *shari'ah* review or audit on the operations of Islamic banks due to their restricted scope of work. On the other hand, as required by the companies act, Islamic banks are also subjected to financial audit conducted by external auditors, which are normally carried out by professional accounting firms. In Malaysia, BNM as the supreme regulatory body of the local financial market also conduct supervision on Islamic banks including *shari'ah* related matters. In Malaysia at least, a comprehensive *shari'ah* audit program so far has not been developed. *Shariah* audit program means a manual-based document that clearly spells out step-by-step *shari'ah* audit procedures, policies and processes when offering Islamic financial services. The audit program should also include standard operating procedures including accounting (MASB, AAOIFI etc), regulatory requirements (BNM) and other requirements. Since *shari'ah* audit is yet to be made a regulatory requirement by BNM, there is a need for external financial auditors, internal auditors, and *shari'ah* unit or department within the IFIs to work closely with *shari'ah* advisors to ensure *shariah* compliance of Islamic financial activities (Rahman, 2008).

Since, there is no requirement for a *shari'ah* audit to be undertaken as yet, it is then too much to expect the *Shari'ah* Supervisory Committee (SSC) to effectively report their assurances. The responsibility of SSC is mainly to advise the IFI, however the main responsibility lies with the management of the Islamic banks. The Islamic financial services industry currently has not fully and systematically undertaken *shari'ah* audit. Even though BNM and the *shari'ah* advisors approve the products and services, no systematic review has been comprehensively undertaken to ensure proper *shari'ah* compliance. This implementation process should be initiated by the relevant authorities such as Bank Negara Malaysia (BNM), IFIs themselves or/and a dedicated independent institution to be established either by the industry or by the BNM. There is a

requirement for a framework that will detail out policy guidance to properly conduct both the internal and the external shariah audit which can be used as part of the routine supervision of the IFIs in Malaysia. In addition, a policy guidance paper is also needed for the IFIs themselves, for the proper undertaking of internal shari'ah audit in their respective institutions (Rahman, 2008).

Similarly Kasim, Ibrahim, & Sulaiman (2009) express that shortage of proper auditing practice by emphasizing on the absence of recognized guidelines and *shariah* auditing standards is a major problem facing the current *Shariah* auditing framework. AAOIFI and IFSB are both involved in addressing these issues. However, for Malaysia, AAOIFI standards are not mandatory. Auditors are required, professionally, to follow standards, however as at the moment *shariah* auditing standards are still lacking. In promulgating the standards and guidance, it is important that the standard-making process of *shariah* auditing to be dynamic and progressive. Most IFIs are using conventional framework of auditing because of the non-availability of *shariah* auditing framework even though the majority of respondents perceived that there is a need for *shariah* auditing to be different from conventional framework. Similarly Al-Amine (2007, p. 35) declared "Unfortunately, it seems that the existing mechanism of Shari'ah scholars' involvement in product development, harmonization and approval may not be adequate enough for a rapidly growing market that needs to expand according to international standards of best practices and at the speed of market demand." Similarly but from another angle Kasim, et al., (2009, p. 132) found that "There seems to be overdependence on the *shariah* secretariat to do *Shariah* audit as ShC members are part timers, mostly academics." There is a good awareness in the regulatory level of the important of harmonization between the Shariah decision and the real practice as stated by Aziz (2008) "The establishment of a national central Shariah Council has been important to ensure harmonisation of Shariah decisions in the Islamic financial services industry."

Documentations

The important of well-prepared documentation discussed by SC (2009) asserting that good Islamic capital market products must be backed by clear legal protection. There must be sound legal documentation to protect the interest of all parties and appropriate sanctions which are

enforceable in the courts of law. In addition, the legal mechanism should work in a manner to resolve all disputes effectively and expeditiously; and most importantly that the contracts are enforceable in the court of law. The documentations of the ICM transactions should also cover the main aspects of the transactions such as the details of the issuance process, mode of issuance, Shariah principles adapted, period of issuance, tenor of the issue, purpose of the issue and the conditions of the issue. The detail provisions on the powers (rights) and duties (liabilities) of each of the parties should also be recorded well to ensure that each party gets the necessary protection under the contract. The contractual agreement is normally subject to condition precedent that must be fulfilled and observed. Non-fulfillment of the condition precedent will amount to the breach of contract and the contract may be terminated. Subsequently they clarify more on the effective legal documentation by saying the legal documentations of the Islamic capital market products should have the following criteria:

1. the documents must be valid according to Islamic law;
2. the documents must also comply with the existing legal requirements (the various laws applicable to financial transactions); and
3. the documents should be structured in a manner that it can be enforced

Methodology

This study primarily employs a qualitative research technique of face-to-face interviews. The in-depth semi-structured interview method is chosen because it allows flexibility to get full range and in-depth information from the participants. In-depth interviews based on primary data are deemed to be appropriate when the existing knowledge base is poor and when inductive process of data generation involved in such a method is anticipated to provide a greater understanding of process and meaning (Cavana, Delahaye, & Sekaran, 2001).

The construction of the study was flexible and open. In all communications with informants, the researcher revealed no encoded thought about what responses might be anticipated. The interview guide was designed to promote participants to give their own thoughts and share their experiences as far as the subject of discussion is concerned, examples and views. Although

frameworks were shaped to allow the data to be structured and analyzed, their flexibility allowed the researcher to keep openness to all data.

Sampling Design

A sample of knowledgeable and expert, Shariah scholar from respective Malaysian Islamic banks Shariah board was chosen for the research. The justification for these choices was to explore their experience and real practice in applying and controlling the Shariah standard in Malaysian Islamic banks particularly in sukuk industry. Although time and budget constrains did not allow for a large sample to be taken, the survey of Shariah Supervisory Board (SSB) were chosen from Malaysia Islamic banks only.

Informants of the Study

The initial number of the targeted sample was thirteen, only four accept to participate after sending to all of them the objective of the study and the interview questions throw email and by hand to their office. The sample size of this preliminary study is not fully saturated and needs more respondents to confirm the findings and increase the quality of the outcomes, that will be consider in the second face of this research. The four respondents are Malaysian and males. One of them is a full professor, two are associate professors and one is assistant professor. All of them are full-time lecturers and part timer SSB. Face-to-face semi structured interview was conducted separately with each participant. The assistant of the dean of IiBF knowledge of the SSB whom has experience in sukuk practice did the initial identification of the research participants.

Data Collection

The interviews were conducted at the offices of the research participants in their respective locations. The total duration of each interview was 20-50 minutes. A list of questions (Appendix B) was used at the start of the interview to guide the informants' participation. The questions were open-ended and derived from the propositions and that have been presented in the

previously. The research participants were encouraged to express their thoughts freely on issues pertaining to their practices. All interviews were audio recorded and then transcribed at the early stages of data collection. Advance recording smart pen with very high recording quality and many other useful functions like perfect controlling the speed of the speaker and the friendly function control, used to ensure the best possible information-capturing standard. Where the quality of recording is known as one of the most important issues in interviews conducting. That will increase the quality as an aspect of rigor in qualitative research as mentioned by Poland (1995), some errors can be prevented and considered non-deliberate. Specifically, the poor quality of some tape recordings, which can result from excessive background noise, weak batteries, dirty tape-recording heads, placement of the recording device or microphone too far from the respondent, use of low-quality cassettes, and/or lack of audibility because people are speaking extremely softly. Less controllable but sometimes also a factor is the clarity, speed, and accent of speech used by interviewees.

Data Integration and Analysis

The data gathered through interviews was transcribed and then integrated. All the data obtained was examined and categorized recombining the evidence to address the propositions of this study. The identity of the research participants remained confidential in line with the ethical norms and considerations. A coding process was utilized for this purpose. For instance, participant in this study were coded as P1, P2, P3 and P4. The coding process was enforced to ensure confidentiality of the names, positions and organizations of the research participants. The observation notes and interview transcripts were imported into NVivo 8 qualitative data analysis software for coding and interpretation. Themes related to Shariah auditing practices prior and after the issuance of the sukuk were generated by constant reiteration between content nodes and the interview and field note transcripts as per the constant comparative method (Glaser & Strauss, 1967).

Results and Discussion

The structure of reporting the results of this preliminary survey has been organized in a context of the five key issues that are covered by the research questions. The main issues are: the roles of SSB before issuance of sukuk, the role after issuance of sukuk, their involvement in documentation, how they conduct the auditing and the Securities Commission guidelines. The results are presented categorically to match with the major purpose of this study.

Before Issuance

The first role for the Shariah supervisory board start before the sukuk is issued in the very beginning of building the product characteristics, because sukuk product is very complicated and usually has many dimensions and forms. In this regards some respondents involved very deeply in structuring while other just reviewing the structure and then approve it or disapprove it with reasoning. Respondent (P4) clearly mentioned that structuring is not their job:

“... we do not do the structuring this is not our jobs we simply review the structure, so the structure done by the Capital market department of the bank, so our role is reviewing and approving or disapproving not the structuring.”

Whilst respondent (P1) did not mention that clearly but we can understand from his respond that mainly his involvement is in approving and giving some recommendation at most:

“...basically is to look at the proposed structure prepared by the merchant bank ...first the bank prepare the structure and then you look at that structure and you then try to see whether its meet the requirement if it did not meet the requirement then you will propose some improvement to the structure. ... if you use a simple structure meaning the one we call off the shelf that has been done before then there is not much input to be given ... sometimes the customer want what we call plain vanilla bond or plain vanilla sukuk some things simple like conventional”.

Nevertheless, later he mentioned that if the customer requests they will involve more in the structuring:

“...if the-e-e the customer requires some things sophisticated then you will work together with the bank to structure... but if the customer is willing to explore new things then the bank will work together with the Shariah advisor to come up with the new structure...”

Conversely, respondent (P2) and (P3) have other practices. For instance, respondent (P2) stated that:

“.....of course we involved in this prior to issuance step by step in structuring sukuk ... we go in to details I mean all A B & C we highly involved even the legal documentation words by words line be line... ”.

Whereas, respondent (P3) illustrate his involvement in structuring in details:

“Yes structuring, first we start with brainstorming with the BCD from scratch from nothing and then we do product concept document in writing normally they start with asking as the idea of doing sukuk and the general idea what are the constrain the Shariah constrain the Shariah issues so when they xx inviting for the structure so they know already our directions for example what can be done and what cannot be done so they will come up with product concept document very brief information about the structures of the sukuk and then you must first give Fatwa at that stage so if the structures are fine from the prospective of Shariah then they can go ahead so normally we I mean at that stage a-a-a it take them quite long time because they have to restructure when we come up with when they table to us first structure and then and we have Shariah issue in that structure then they have to come up with another structure when another structure also have Shariah issue they have to come up with another structure so structuring is structure stage for product concepts document stage is the most crucial the most important part where if a-a-a just like building a house the pillar ahahah the pillar and the structure I mean are fine I mean from the side of the architecture side for example every things is fine then you can build the house otherwise you can't build the house because the plan must be will define and must be very very clear so the architects for example they will draw the plan according to the need of the clients so here the same with product developers those how are working on that particular product defiantly they will try to come up with the structures that Shariah complaints I mean according to our our Shariah board... ”.

This preceding discussion leads us to understand the real practice of the SSB prior to issuance of the sukuk. We can see from the above responds that their involvement is driven by the customer

needs and requirement. Furthermore, it seems that most of the customers looking for a simple structure that is very similar to the conventional with the lowest risk, liabilities and cost.

After Issuance

The Shariah challenges start here, after sukuk is issued. This is the gray area where the practice may not follow the SSB Fatwa. The utilization of the fund is one of the main issues in sukuk product. Even if the proceeds used to buy the underlying asset as approved by the SSB, but before buying the asset where the money parked is it in Islamic instruments or in conventional, then after buying the asset is the real business and details practice later still following the Shariah rolling or not. That what we want to understand closely from the participants in the coming part.

For example, respondent (P1) start criticizing the current practice loudly by saying:

“Shariah advisor suppose to look at the investment of funds which means the utilization of funds ... mechanism must be devolved in such a way that the Shariah advisor is able to look at the investment of those funds of the sukuk funds raised and to ensure that they are Shariah compliant currently I don't think it is happening because you are talking about raising of funds Shariah compliant use of funds must also be Shariah compliant use of fund of course we know they show the sukuk structure terms & condition will be used for construction blablablalbla but the money that is raise before it is been utilized for construction as an example where do they park that money do they but in conventional account do they but in Islamic account that is one question and the other one is do they place in money market and if they place in money market is it the conventional money market or Islamic money market and this is not clear and not monitored.”

This aforementioned assertion by respondent (P1) is in line with respondent (P4) who said that:

“In reality, there is no physical transfer fund between the investor to the originator. At the end of the day the fund is parked but there is a net off - at maturity- let say five years like in Ijarah Sukuk there is a kind of (Muqasah) net off. We have insisted that real amount should be transferred. Example; sukuk Ijarah; like obligor sale real assets to

SPV; then SPV should actually pay the obligor based on the original value plus the rents payment, but in reality it isn't, only profit or rental is transferred....”.

Then respondent (P2) very briefly commented from different angle:

“if the proceeds they want to use to purchase any assets so we have sale and purchase agreement if they want to lease the aaa I mean all documents related to the investment of sukuk proceeds we need to xxx them throw to approve them one by one ... Every time they want to do any transaction they need to call back to Shariah advisors in addition to the end of the year audit”.

In addition to this view, respondent (P3) very well explain the crucial of monitoring the investment:

“....because it is already concluded and all the contracts parties are bond of the terms and conditions of the contracts now we want to look at the operational side how to generate money and for example and the maintenance and also the activities for the business if you happened to hire for example the issuer for example a-a-a a big developer company for example they issue shop let for example they issue sukuk for example to finance a business a big shopping complex then you have to look at those activities what shops are operated what services are they rendering to the public and what are other business activities defiantly I mean you have to you cannot get it from the audit job because what is so special with Islamic products not only Rajhi any other banks because we clam to the public that they can have a peace of mind from non Shariah compliant issues we guaranty that the products are Shariah compliant so then monitoring and auditing is is very very crucial in order to ensure that the business and the income and the investments are Shariah compliant so doesn't stop there doesn't stop at the legal documentation even after it takes off the maintenance has to be monitored and also the income until the end but I think for the Morabaha sukuk perhaps the monitoring is not so exhaustive compare to Ijarah & Musharakah sukuk because it is a close ended ...”.

The foregoing discussion, thus, concludes that the investment of the proceeds it is very crucial issue and very doubtful and need serious care and higher attention from both the SSB and the authority agencies like SC and BNM.

Documentation

In the legal documentation the respondents has different experience and different involvement levels while respondent (P4) has very little involvement:

“It is between 50 to 150 pages. If the sukuk is across boards in different countries that will need more detail documents...” (A1).

However, respondent (P1) a bit more involvement:

“...once the structure is fixed settled agreed approved by the Shariah then the lawyer will come and prepare the documents and the role of the Shariah advisor is to look at the documents to ensure that the documents reflect what the structure wants so and then making sure that the terms the conditions used in the structure meet Shariah requirement which means that you have to go through all that documents sometimes thousands of pages to make sure that because sometimes it's not just one simple document sales & purchase agreement, could be lease agreement, maintenance agreement, management fee and so on...”

Nevertheless, a respondent (P2) and (P3) shows much more involvement:

“we go into details I mean all A B & C we highly involved even the legal documentation words by words line by line that's why we need these four days from morning to night we read line by line 14 contracts 15 contracts so A B & C we heavily involved in all these contracts. ...legal documentation normally will be prepared by lawyers but we will go through also as I said to you line by line to look into Shariah issues.... we have master sale & purchase agreement, master asset agency agreement, master commodity purchase agreement, master commodity sale agency agreement, master commodity trading agreement, master Ijarah agreement, service agency agreement, [program?] agreement, subscription agreement, tender payment ... this master master mean it is a general in nature but when they want to execute any transaction they will have different notes so we need to look (..) every time they want to execute any things we need to approve again because master will normally say we want to buy asset xyz but when they really want to buy that building at address this & this they need to have different notes so we need to approve that notes so it is a continuous process” (P2).

In a similar assertion, respondent (P3) stated that:

“...we will come up with the legal documentations and these also takes time because they have to hire a lawyers how are well trained in the field and they come up (..) again at that stage we look at those xxxxx documentations they have to table all those legal documentations sometimes up to 15 documents yah of course because we have a lot of contracts between the contractual relationships between the issuers and the subscribers or the investors the investors among them self’s and the investors with the trustees and the issuer with trustee and yah there are a lot of documentations if there is Ijara there is lease and then they will have to come up with another so have one master legal documentation and then we have sub a-a-a lot of a wide range of sub legal documentations and especially in Malaysia compare to Saudi Saudi the bigger I mean the legal documentation is very brief and Malaysia too much because the lawyer want to but every things ahaha some times unnecessary clauses so we do have trouble with them I mean it does not work if you want to come up with a legal doesn’t work so the structure must be very very clear so they build the legal document around the structures so in other words we have to issue Fatwas twice in the beginning for the structure and then secondly for the legal docs. before it takes off. ...the audit staff the Shariah audit staff they will look at the yah defiantly for example the manuals, the product manuals and the transactions the [receipts?] the documentation of the transactions like subscription of the purchase of the sukuk for example they will look at those xxxxx defiantly we have to approve in a (.) up front for the documents for example which will be use (...) even for the a-a-a advertisement and even for the prospectus info memo term sheet we have to look all those documents not only legal documentations so defiantly a-a-a for example the documents xxx shall be used for an acceptance to conclude the conflict for example same they will look at those contracts and also the operation side the calculation of the [raw feeds?] where the money comes from and how do they distribute the dividends and also any a statements and any letters issued by the banks we will look base in our experience ...”

Although these respondents have agreed to some extent regarding the seriousness of the legal documentation, their involvement varies. To this effect, we are led to the belief that it is vary depends on many factors as captured by the respondents, like the nature of the structure, the

countries involved, the customer needs, which Shariah standard they follow, and the size of the sukuk issued.

Auditing

The auditing of the banks practice and the real implication of the SSB decisions is another serious issue in Islamic banks in general and in sukuk especially. Some of the respondents are somehow satisfied to certain extent for this stage of time, while other is not that satisfied. Undoubtedly, we can feel that pain behind these lines stated by respondent (P4):

“...monitoring the sukuk after issuance will be the responsibility of the shari’ah department. If they observe any serious issues; like not implementing what was originally approved in the agreement; which they are obligated to inform us. ... But, I have to acknowledge one important issue It is a real problem in Islamic banks; the issue of transparency. We need to dig farther and farther in every single transaction order to know this is making our job bit difficult, and even some times when we asked not every things is revealed. For example, the client is kept in the dark. Many activities like that; where funds are sometime making profits and at other time, it is making losses. The issue of smoothing if the bank make losses he will take from the reserve to give the customer the same regular return in the market. Because the bank is committed to pay an indicative rate to the customer. ... in realty it is very difficult to convenes the bank to set aside millions of the profit earned they will ask for any solution in any other mathhab view or any scholar accept it in any form.”.

In the same line respondent (P1) declare the limited auditing practices and expect an improvement in the future:

“we have at least in Malaysia we have Shariah department in each bank but again this office is small they are more involve they are working with the Shariah committee the Shariah advisor aaa it should be for example later on something mandatory to have Shariah audit then the Shariah advisor can sign ... now the approach in Malaysia is they use the company’s auditors external auditors to be trained in Shariah audit they are auditors professional auditors they trained and they will pick up and they will then discuss with the Shariah advisor, because if you take Shariah people they will not know

Shariah audit so you need to get the trained auditors and then trained them in Shariah and then they will work together with the Shariah advisors in auditing....”.

Respondent (P3) asserted that they are part timer and do not have enough time to deeply audit the banks work, and they relay on the audit staff:

“Yah the audit staff will do that we are not full time we can not do that we dont have time I'm teaching here hehe I don't have time hehe only once a week and once a week is too much ...”.

Respondent (P2) how supervise the same bank stated that the current auditing staff size is not enough:

“...Yes and we have a I mean in our (Amana) we have people how are doing the compliance audit... We have two right now not enough but beter than nothing hehehehe... they will report to us we will guid them what to do next...”.

In one way or another, all respondents agreed in the insufficiency of the auditing practices, and the vital needs to support it with more well skilled and sufficient number of full timer Shariah auditors, either by the willing of the banks managements or by the authority guidelines.

Guidelines

There was a unanimous unequivocal agreement regarding the pivotal needs for improvement and more details and comprehensive guidelines from the SC to accelerate the industry and at the same time to regulate it in a very discipline manner. For instance, respondent (P3) mentioned that:

“.....I don't think there is a clear guidelines from SC especially in sukuk,.... they also need to do revision and review or revisit their guidelines because from time to time we have to improve in the SC guidelines for example there are silent about the purifications so in my humble opinion they might improve these I mean the clause of the purification at least for the Muslim investors for example they might advise them to purify the non Halal income but for the non Muslims of course its left to them perhaps they quite in the purifications because the investors in Malaysia they are not only Muslims but non Muslims also investing in Islamic products so perhaps that's why they are silent but for me in this case they have to inform the investors that they have the responsibility to

cleanse or to purify is on their shoulders shall be borne by them this is among the examples but there are for the other financial ratios Yah I mean some times of course yah from time to time they have to improve it ...”

Likewise, another respondent (P4) clearly mentioned that it is not comprehensive enough and it needs many improvements, where he said:

“Definitely not comprehensive. What we have is a very general guideline. We need to be more detailed and specific about each structure. Like sukuk al-Ijarah, Musharakah... or similar. ...it is definitely need improvement and to give the Shariah committee the ultimate authority to look into any thinks they want to look into including how much the bank is making profit how much the customer make profit and any other issues related to Shariah. It needs to show the real profit and losses.”

Similarly, another respondent commented:

“...looking at the standard maybe AAOIFI is good acceptable practical but Malaysian standard is too loose some times you want to match every things with conventional so you dont bring any things new except that you change the names you change the contracts but you do not push the industry to change...” (P2).

The assertion of respondent (P1) on the vital need of a concrete mechanism on how to monitor the use of sukuk fund cannot be overemphasized:

“...this is where I think the the may be the regulator need to come up with more concrete mechanism how do you go about monitoring the use of fund. ...example would be every year there is an audit been done so part of the audit report on the utilization of fund is given to the Shariah advisor for verification and then the Shariah advisor then sign. ...what I mint is that when they do an audit may be part of the audit would be the auditor just like the Shariah audit the auditor looks at the where the money been used because for the Shariah advisor to look at that I don't think the Shariah advisor has the capacity and the knowledge to look at the account but possibly the external auditor of the company audit the company and then one of the audit activity would be to look at the accounts money used from this sukuk issuance and then a report will be made available to the Shariah advisor for aaa approval for example, and then you can also make this as part of the annual reporting if you want to enhance farther part of the annual report of

the company that issue sukuk they can but there one page sukuk the fund raise under this sukuk is all Shariah compliant and signed by the Shariah advisor.”.

To summarize the above discussion and responses, it has been noted that almost all the respondents unanimously agreed on the seriousness of enhancing the current Shariah guidelines by the SC. In other words, the current guidelines are very brief and not sufficient especially in the current rapid growth in sukuk market locally and globally.

CONCLUSION

Islamic securities are undeniably a key instrument to facilitate the Islamic financial industry as a whole. The Shariah advisors are the backbone of the industry deprived of which the integrity of the whole industry will be at stake. It is important to remark that advisory services are an amanah (responsibility) and should be discharged with maximum professionalism and honesty. It is desired that more fundamental interactions can be generated among the Shariah advisors and the market participants so that the supervisory function will be elevated. The Shariah scholars need to ensure that all the decisions they make, are practical and serve the interest of the Ummah. Finally, it has to be acknowledged that the fast growth of Islamic securities would not have been achievable without the pioneering hard work of the regulators, Islamic financial institutions and all those who have put remarkable effort in building up a successful and dynamic industry. In spite of that, the opportunity and hope for a greater future success lied in the hand of all parties.

As confirmed by both the literature and the Shariah advisors interviewed, the regulators should review & improve the current guidelines and come up with a more clear and comprehensive sukuk guidance, to facilitate and strengthening the sukuk issuance in a concrete manner. For example the Shariah Advisor do not have the tools or the clear legislations to closely check and monitor where do the sukuk issuer park the money before utilizing the fund in the meant assets. Respondent (P1) suggested that the annual report for the companies issuing sukuk should include a section for Shariah auditing and approval base on systematic review procedures. For instant, there should be a comprehensive practical procedures & policies to apply the Shariah roles, which will significantly help & support the Shariah advisor in their mission.

APPENDIX A

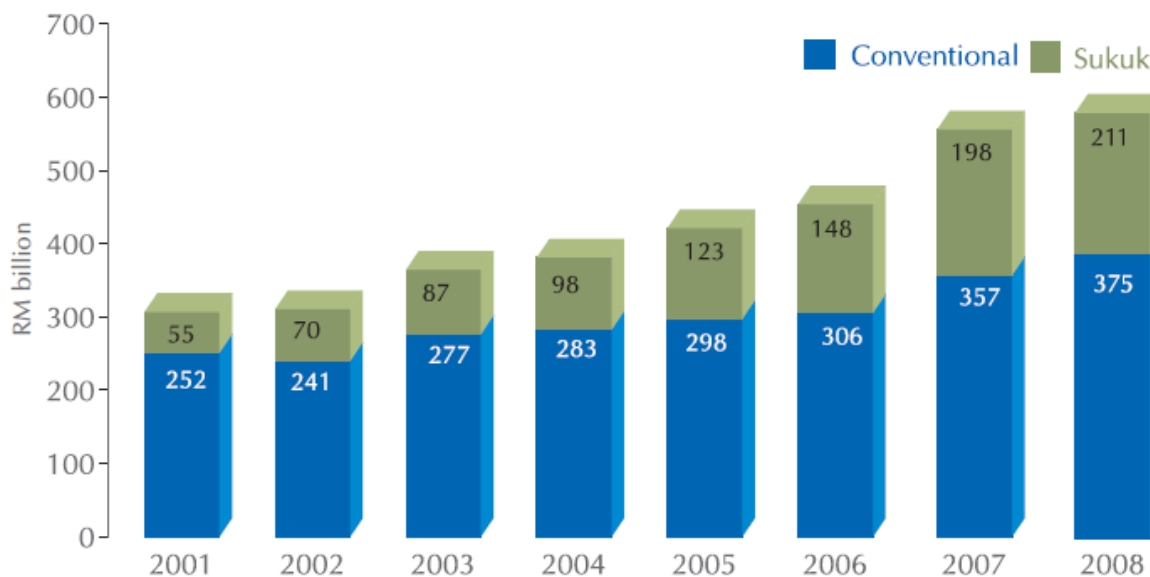
Additional Important Tables & Charts

Table 5: Members of the Securities Commission Shariah Advisory Council

Name/ Designation	1996– 1998	1998– 2000	2000– 2002	2002– 2004	2004– 2006
1. Dato' Sheikh Azmi Ahmad	✓	✓			
2. Dato' Dr Abdul Halim Ismail	✓	✓	✓	✓	✓
3. Dato' Dr Othman Ishak	✓	✓			
4. Dato' Dr Haron Din	✓	✓			
5. Datuk Md Hashim Yahaya	✓	✓	✓	✓	✓
6. Dato' Hassan Ahmad	✓	✓	✓	✓	✓
7. Dato' Sheikh Ghazali Abdul Rahman		✓	✓	✓	✓
8. Dato' Dr Abdul Monir Yaacob		✓	✓	✓	✓
9. Tan Sri Nor Mohamed Yacop	✓				
10. Dr Mohd Daud Bakar	✓	✓	✓	✓	✓
11. Associate Prof Dr Abdul Halim Muhammad			✓	✓	✓
12. Dr Mohd Ali Baharum			✓	✓	✓

Source: (SC, 2007)

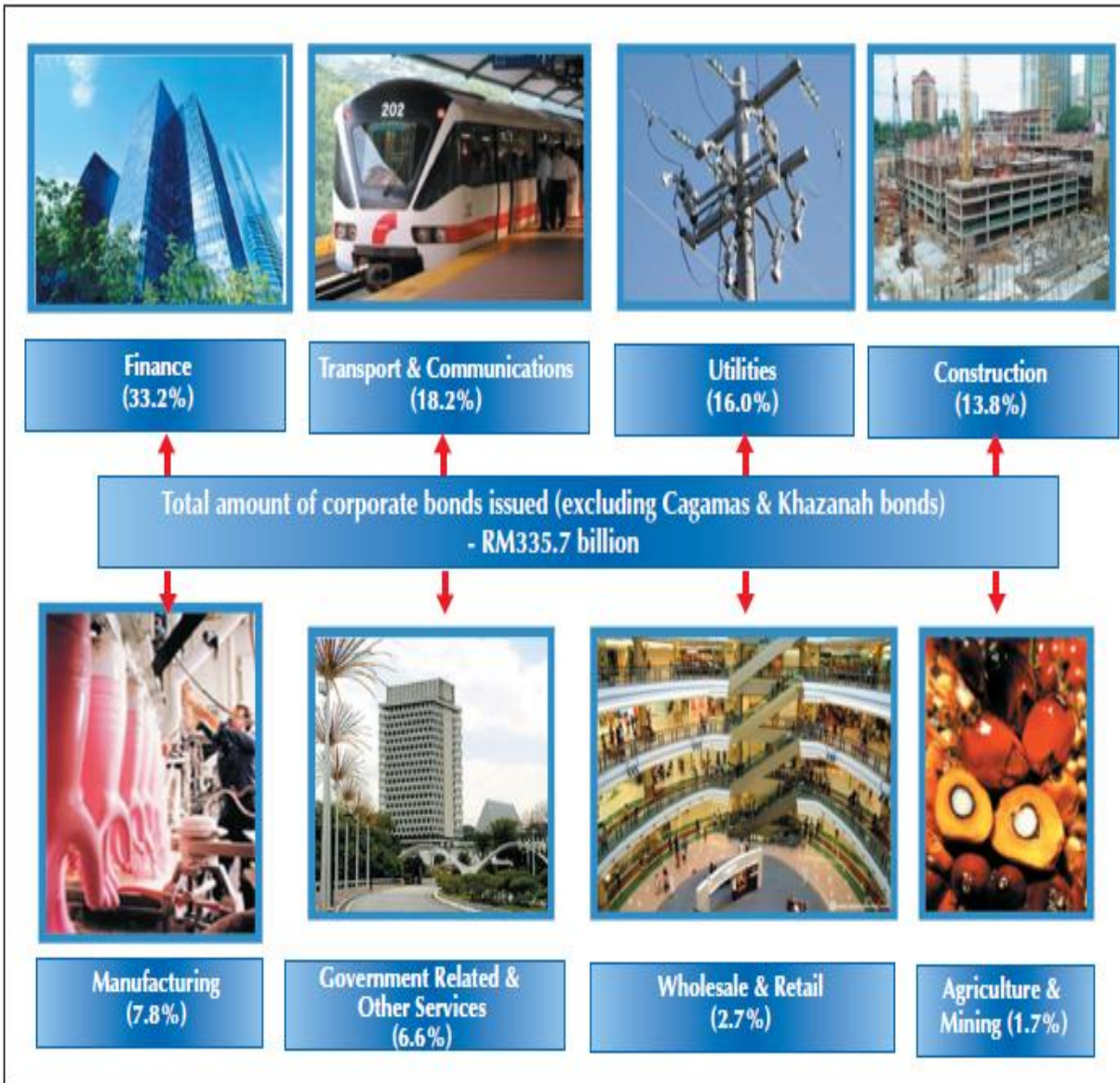
Chart 1: Outstanding Malaysian debt securities and sukuk by issuance principle



	2001	2002	2003	2004	2005	2006	2007	2008
Conventional	251.6	240.6	277.0	283.1	297.9	306.3	357.4	374.5
Sukuk	55.2	70.1	87.3	97.8	123.2	147.6	198.4	211.0
Total	306.8	310.7	364.3	380.9	421.1	453.9	555.8	585.5
of which								
Corporate sukuk	40.2	52.7	64.3	71.8	90.7	105.1	141.5	157.8
Government sukuk	15.0	17.4	23.0	26.0	32.5	42.5	56.9	53.2
Sub-total	55.2	70.1	87.3	97.8	123.2	147.6	198.4	211.0

Source: (BNM & SC, 2009)

Chart 2: Corporate bond and sukuk issued by sector in Malaysia, 2000-2008



Source: (BNM & SC, 2009)

Table 6: Shariah Compliance Framework Country wise

Country	Islamic Banking Law	Shariah Committee		Fit & Proper Criteria for Shariah Advisor/ Committee	Shariah Compliance Inspection	Shariah Standards	Accounting Standard
		At Central Bank	at bank Level				
Malaysia	Islamic Banking Law 1983	Shariah Advisory Council	Shariah Committee	Approval by BNM	Governance through Shariah Committee	All Products approved by SAC, Role of Shariah Committee defined by BNM	Accounting Standards developed by MASB
Bahrain	Regulations for Islamic Banks	Shariah Supervisory Committee	Shariah Supervisory Board	N.A	Internal and External Shariah Audit as per AAOIFI standards	AAOIFI	AAOIFI
Indonesia	Laws for Islamic Banking Introduced in 1992 & Amended in 1999	National Shariah Board	Shariah Supervisory Board	NSB approves appointment of SSB members	Internal and External Shariah Audit	Fatwa on products issued by NSB	AAOIFI
Iran	Usury free Banking Act 1983	Council of Guardian	N.A	N.A	No	Guidelines provided by Council of Guardians	Not Known
Brunei	Islamic Banking Act Cap.168	Shariah financial supervisory Board (SFSB)	Shariah Advisory Board	SFSB approves appointment of Shariah Advisory Board members	No	SFSB Approves Islamic products introduced by Financial Institutions	Not Known
Pakistan	Banking Companies Ordinance, 1962 and Policies for Islamic Banking in 2001 & 2003	Shariah Board	Shariah Advisor	Fit & Proper Criteria by SBP	Manual developed in 2004, now being implemented	Essentials for Islamic modes	AAOIFI standards are being adapted by a committee of ICAP

Source: (Akhtar, 2006)

Table 7: comparing the trading profiles of Malaysian instruments to the AAOIFI Investment Sukuk Standard

Type	AAOIFI Feature	Tradable?
<i>Murabaha</i> ³	<i>Sakk</i> represents assets purchased and intended for sale. Once the sale is made, the <i>sakk</i> represents a debt. In Malaysia, this is a short term debt security.	Such <i>sukuk</i> are only tradable under Malaysian rules.
<i>Ijara</i>	<i>Sakk</i> must lay title claim to asset. The claim may be direct or beneficial.	Such <i>sukuk</i> are universally tradable.
<i>Musharaka</i>	<i>Sakk</i> must lay title claim to asset, but this may include participation in business ownership or operations. Frequently an "undertaking" is added to make a <i>musharaka</i> operation more debt like.	Depending upon the underlying asset, these <i>sukuk</i> are tradable. In Malaysia, the underlying asset may be a permissible debt form like a <i>murabaha</i> receivable.
<i>Mudaraba</i>	<i>Sakk</i> must lay title claim to asset, but this may include participation in business ownership or operations. Frequently an "undertaking" is added to make a <i>musharaka</i> operation more debt like.	Depending upon the underlying asset, these <i>sukuk</i> are tradable. In Malaysia, the underlying asset may be a permissible debt form like a <i>murabaha</i> receivable.
Declining Balance Partnership	<i>Sakk</i> must lay title claim to asset, but this may include participation in business ownership or operations. In this <i>musharaka</i> operation one partner promises to buy out the other.	Depending upon the underlying asset, these <i>sukuk</i> are tradable. In Malaysia, the underlying asset may be a permissible debt form like a <i>murabaha</i> receivable.
<i>Wakala</i>	In this operation, the <i>sukuk</i> holders appoint the beneficiary of funds as their agent to perform certain business operations.	Depending upon the underlying asset, these <i>sukuk</i> are tradable. In Malaysia, the underlying asset may be a permissible debt form like a <i>murabaha</i> receivable.
<i>Istisna'a</i>	<i>Sakk</i> must lay title claim to asset.	This operation is a hybrid between an asset (not yet completed) and a debt (the obligation to deliver the completed asset). Therefore, the accepted view is that trading is restricted. In Malaysia, these <i>sukuk</i> are freely tradable.
<i>Bai Bithamin Al Ajil</i>	<i>Sakk</i> represents assets purchased and intended for sale. Once the sale is made, the <i>sakk</i> represents a debt. In Malaysia, this is a long term debt security.	Such <i>sukuk</i> are only tradable under Malaysian rules.
<i>Salam</i>	<i>Sakk</i> represents a claim on an asset.	This operation is a hybrid between an asset (not yet existing) and a debt (the obligation to deliver the asset). Therefore, the accepted view is that trading is not permitted.

Source: (Thomas, 2007)

APPENDIX B

Interview Questions

Thank you for making the time to meet me. My name is Badr Albadran, PhD student at Kulliyah of Economics and Management Sciences, UIA. I am here today, to get your valuable feedback, as a Shariah member, regarding some Shariah issues pertaining to sukuk market, especially in Malaysia. The interview should take less than an hour. If you don't mind I will be recording the session because I don't want to miss any of your comments. Although I will be taking some notes during the session, I can't possibly write fast enough to get it all down. All responses will be kept confidential. This means that the information you provide will only be shared with the research team members, and we will ensure that any information we include in our report does not identify you as the respondent. Do you have any questions for me? Ok. Thank you and we will proceed now.

1. Number of times you have been involved in the sukuk issuance:
2. As a Shariah advisor, what are your duties / roles you play prior to issuance?
 - a. Your role in approving or structuring
 - b. Do you think that is sufficient? Why?
 - c. What is your role in legal documentation, and if no, why?
3. What happen when you disagree with the proposed structure?
4. What is your role after the sukuk issuance?
 - a. If no, do you think its right? Why?
 - b. If yes, can you share with us how you conduct the monitoring?
 - i. During utilization of the fund
 - ii. Before utilization of the fund, where do they park the money in Islamic or conventional (account/money market)

5. If you have done the monitoring of sukuk proceeds, i.e., the utilization and investment of sukuk proceeds, can you tell us the list of documents you normally receive from the issuer?
6. Do you audit the bank real practice and implementation of your decisions?
 - a. If yes, can you explain in detail how you conduct the auditing?
 - b. If no, please state the reason. Do you think it is right?
 - c. Do you have the full access needed to all documents & information in order to monitor the real practices properly?
7. During the auditing process if you find any profit earned that is not Shariah compliant what you do about it? Do you have the authority to set aside the non-Shariah compliant profit earned if any?
8. How are the SC guidelines clear and comprehensive? What are your suggestions to improve those guidelines?

Thank you very much for your time. I will be happy to send you a copy of the study when it finalized, if you are interested.

Salam

APPENDIX C

Transcribed Interviews

Transcribed Interview: Informant P1

0:00.0 - 1:05.0 INTERVIEWER: بسم الله الرحمن الرحيم

السلام عليكم ورحمة الله وبركاته

Today Friday we want to start with you a small interview about some Shariah issue, actually we want to study the level of harmony between the Shariah guidelines and the practices in Malaysian Sukuk. Because of your experience in this area, we would like to get some of your opinion of this topic and because I cannot follow up we will record this if you do not mind will record this conversation & it will be strictly confidential within the research group and after we finish we will give you a copy of the research.

1:05.0 - 2:19.1 INTERVIEWER: at the beginning your age group is?

INTERVIEWEE: 50 and above

INTERVIEWER: and which bank you are associated with?

INTERVIEWEE: aaaah if I can say I'm with bank Rakyat a Shariah advisor but before that I was with other banks

INTERVIEWER: OK so currently we can say bank Rakyat

INTERVIEWER: and number of years as Shariah advisor in totally

INTERVIEWEE: is a combination ... I would say may be 12

INTERVIEWER: and currently in Bank Rakyat how long?

INTERVIEWEE: Bank Rakyat is only two years

INTERVIEWER: OK if we want to say the number of times you have been involved in the sukuk issuance

INTERVIEWEE: about I can't remember exactly but quite more than ten

2:19.1 - 5:32.0 INTERVIEWER: As a Shariah advisor, what are your duties / roles you play prior to issuance?

INTERVIEWEE: basically is to look at the proposed structure prepared by the merchant bank investment banks, look at the proposed structure comments and if they are not meeting the requirements how do you make the structure Shariah complaint you understand which mean that first the bank prepare the structure and then you look at that structure and you then try to see whether its meet the requirement if it did not meet the requirement then you will propose some improvement to the structure.

INTERVIEWER: OK you suggest some editing and improvement. So actually, your main role is approving not structuring?

INTERVIEWEE: normally the structuring part will done by the bank, the Shariah advisor will be looking at the structure and propose improvement if there is any.

INTERVIEWER: usually there is major improvement or minor improvement?

INTERVIEWEE: depends on the structure that Shariah contract used, so you cannot say I mean some banks are more (conversant?) some are less (conversant?) more familiar less familiar so you find that the bank that are more familiar tend to be more creative than the one less familiar so you need to get more involve in that structure.

INTERVIEWER: Do you think it is sufficient that the Shariah advisor only involve in approving the structure not going farther to structuring is it ammmm do suggest that the better way to be involve more in the structuring.

A:aaamm it's depends if the-e-e the customer requires some things sophisticated then you will work together with the bank to structure if you use a simple structure meaning the one we call off the shelf that has been done before then there is not much input to be given already the structure is there except that you look at the features of the structure you look at the terms and condition.

INTERVIEWER: so for the creative things that the bank are doing creative structures new structures usually you will be involved more in the structuring.

INTERVIEWEE: Yes but it's also depends on the customer weather the customer wants creative things or straight forward so at the end of the day it's a combination of many factors it's not just purely we say aaa the bank it also involve the customer, sometimes the customer want what we call plain vanilla bond or plain vanilla sukuk some things simple like

conventional (of course?) we use Murabaha but if the customer is willing to explore new things then the bank will work together with the Shariah advisor to come up with the new structure so it's always its depends on the kinds of requirement.

5:32.0 - 6:59.5 INTERVIEWER: What is your role in legal documentation?

INTERVIEWEE: in documentation once the structuring is ok approved then the (role?) will be to look at the documentation prepared by the lawyers because the lawyers must understand the structure before they can come up with the documentation so once the structure is fixed settled agreed approved by the Shariah then the lawyer will come and prepare the documents and the role of the Shariah advisor is to look at the documents to ensure that the documents reflect what the structure wants so and then making sure that the terms the conditions used in the structure meet Shariah requirement which means that you have to go throw all that documents sometimes thousands of pages to make sure that because sometimes it's not just one simple document sales & purchase agreement could be lease agreement maintenance agreement management fee and so on.

INTERVIEWER: so the process on reviewing the legal document may be take the most difficult and long period than just approving the structure?

INTERVIEWEE: structure required creativity documentation required (mythical? metrical?) effort meaning that you have to go throw line-by-line, page-by-page, understanding.

6:59.5 - 9:24.3 INTERVIEWER: What happen when you disagree with the proposed structure?

INTERVIEWEE: Well normally we try to introduce or propose some alternative banks will normally follow the Shariah advisor if the Shariah advisor says no they (his hand phone ring) its from Gombak... (7:20 to 8:00)

INTERVIEWER: (I repeat the question), what happen when you disagree with the proposed structure?

INTERVIEWEE: Normally when we disagree we tell the bank this is the way how to improve the structure not to say rejection xxxxx normally we tell the bank this is the problems and how it can resolved so an alternative structure will then be proposed if it's simple but if as I said again at the end of the day if the customer wants something's creative but at the same

time aaa example would be like this there was some things looks like Musharakah but the features looks like a fixed aaa fixed sukuk like Murabaha kind of features so we will tell them no, no way you cannot if you want to go for Musharakah then go for Musharakah proper if not go for simple Murabaha Sukuk so will be alternative giving to improve.

INTERVIEWER: sometimes does the bank may be go for some structures even if it is not approved from the Shariah advisor.

INTERVIEWEE: No because it's must be signed by the Shariah committee there is no such things going ahead.

9:24.3 - 13:49.6 INTERVIEWER: What is your role after the sukuk issuance?

INTERVIEWEE: This is where aaaa I think this is not that clear although the guidelines quit clear because the Shariah advisor suppose to look at the investment of funds which means the utilization of funds bear in mind the Shariah advisor is not appointed by the bank for sukuk issuance it is the company appoint the Shariah advisor not the bank say for example you have a company that issues I mean a bank that advise a company to issue sukuk as investment advisor sukuk is then issued but the appointment and the payment is made by the company throw the bank to the Shariah advisor ok so which means that mechanism must be devolved in such a way that the Shariah advisor is able to look at the investment of those funds of the sukuk funds raised and to ensure that they are Shariah compliant currently I don't think it is happening because you are talking about raising of funds Shariah compliant, use of funds must also be Shariah compliant use of fund of course we know they show the sukuk structure terms & condition will be used for construction blablablalabla but the money that is raise before it is been utilized for construction as an example where do they park that money do they but in conventional account do they but in Islamic account that is one question and the other one is do they place in money market and if they place in money market is it the conventional money market or Islamic money market and this is not clear and not monitored.

INTERVIEWER: Because your role may be very close to the bank not to the company?

INTERVIEWEE: Yes

INTERVIEWER: You don't have the authority to check after the companies for that transactions or

INTERVIEWEE: Yah this is where I think the the may be the regulator need to come up with more concrete mechanism how do you go about

monitoring the use of fund.

INTERVIEWER: So maybe you suggest that there should be a regulation from security commission a guidelines that gives the Shariah advisor some authority going to review the implication or the utilization of this fund after issuance?

INTERVIEWEE: Yes, example would be every year there is an audit been done so part of the audit report on the utilization of fund is given to the Shariah advisor for verification and then the Shariah advisor then sign.

INTERVIEWER: so is it enough to just see this report at this meeting and to sign it or

INTERVIEWEE: No no what I mint is that when they do an audit may be part of the audit would be the auditor just like the Shariah audit the auditor looks at the where the money been used because for the Shariah advisor to look at that I don't think the Shariah advisor has the capacity and the knowledge to look at the account but possibly the external auditor of the company audit the company and then one of the audit activity would be to look at the accounts money used from this sukuk issuance and then a report will be made available to the Shariah advisor for approval for example, and then you can also make this as part of the annual reporting if you want to enhance farther part of the annual report of the company that issue sukuk they can but there one page sukuk the fund raise under this sukuk is all Shariah compliant and signed by the Shariah advisor.

13:49.6 - 14:29.7 INTERVIEWER: If you have done the monitoring of sukuk proceeds, i.e., the utilization and investment of sukuk proceeds, can you tell us the list of documents you normally receive from the issuer?

INTERVIEWEE: that is why I said so far there is no documents received so some will receive some will not receive so that is a big challenge.

14:29.7 - 17:13.2 INTERVIEWER: Do you audit the bank real practice and implementation of your decisions?

INTERVIEWEE: I mean this is another issue for example as I mention in the case of sukuk issuance it is company that appoint the Shariah advisor not the bank as far as looking at the suppose the bank itself issue sukuk ok because there are couple of Islamic banks issue sukuk for example then obviously the Shariah advisor will have to monitor will have to

monitor in my bank currently we are asking for implementation report because we want to make sure that the practice followed or decision, mechanism trying to work out the mechanism.

INTERVIEWER: I think this issue mainly need not only Shariah advisor to be involved there should be some staff under Shariah advisor that can help to implement because we have Shariah advisor and let say in Alrajhi Bank in Saudi we have Shariah auditing there is a big group of people going to monitor and check after the

INTERVIEWEE: Yah we have at least in Malaysia we have Shariah department in each bank but again this office is small they are more involve they are working with the Shariah committee the Shariah advisor aaa it should be for example later on something mandatory to have Shariah audit then the Shariah advisor can sign

INTERVIEWER: Yah can work with the Shariah audit so will be another division working together

INTERVIEWEE: YES, but now the approach in Malaysia is they use the company's auditors external auditors to be trained in Shariah audit they are auditors professional auditors they trained and they will pick up and they will then discuss with the Shariah advisor, because if you take Shariah people they will not know Shariah audit so you need to get the trained auditors and then trained them in Shariah and then they will work together with the Shariah advisors in auditing.

INTERVIEWER: so this is a suggestion and it is any progress for this

INTERVIEWEE: I think some banks are trying to do this I think in my bank they are trying to do this

INTERVIEWER: another example you know another banks that are working in such

INTERVIEWEE: there (are? could?) a couple of banks in Malaysia trying to implement this Shariah audit although Shariah audit it has yet to be fully enforced xxxx the banks are slowly trying to work in this.

17:13.2 - 18:44.0 INTERVIEWER: During the auditing process if you find any profit earned that is not Shariah complaint what you do about it? Do you have the authority to set aside the non-Shariah complaint profit earned?

INTERVIEWEE: Normally when Shariah committee or Shariah advisor find income which has not Shariah complaint normally what we will do we said but a side and then each bank has their own what we call it (this?

risk?) committee will also use that money not only so called tainted income but also Zakah for distribution so they use this money so they have a say on distribution of Zakah money as well.

INTERVIEWER: But actually do you have the authority to sit aside or you just give advise that this money should go like this and

INTERVIEWEE: No authority to be given to charity, which charity normally will be decided by the bank

INTERVIEWER: that is all thank you very much for your time and we will be happy to share with you a copy of the study when it finalized, if you want to add any things before we conclude.

INTERVIEWEE: I think I have explained quit enough already.

INTERVIEWER: thank you very much Prof.

End of Interview

Transcribed Interview: Informant P2

0:00.0 - 0:57.4 Waiting for the student to leave

0:57.4 - 7:39.3 INTERVIEWER: الله بيسم

Thank you for making the time I'm here to get your valuable feedback on sukuk from Shariah prospective, actually especially Malaysian market I hope this interview will take less than twenty minutes Insha Allah, if you don't mind I'll record this session because and we will make sure it will be very confidential if you have any clarification before we start or we can proceed.

INTERVIEWEE: You can proceed.

INTERVIEWER: we need your age group is?

INTERVIEWEE: 40-49

INTERVIEWER: then which bank you are associated with?

INTERVIEWEE: currently Alrajhi bank.

INTERVIEWER: Masha Allah this is very good, for me because I have 13 years of experience with Alrajhi bank in Saudi.

INTERVIEWEE: You worked with Alrajhi bank?

INTERVIEWER: Yes in Riyadh, and I am in study leave for doing my PhD.

INTERVIEWEE: Then you are familiar with the Shariah committee their? Sheakh Saleh & Hail. AHAHAHAHA

INTERVIEWER: Yes, actually the practice of Alrajhi bank Shariah in Saudi is very good

INTERVIEWEE: Very strict hehe I just came back last night from 4 days workshop in port dickson to discus about one sukuk product

INTERVIEWER: You are planning to do one new sukuk in Malaysia?

INTERVIEWEE: Yes

INTERVIEWER: Alrajhi will be the aaa

INTERVIEWEE: Alrajhi they have their establishment here in Malaysia so they are going to I mean for liquidity or putting things in different baskets they need to have ... because all available sukuk in they say it is not Halal AHAHAHAHAHA so we need to have our own sukuk we need to arrange our own sukuk so Alhamdulelah I mean

INTERVIEWER: So it's for the Bank liquidity only

INTERVIEWEE: It is for the bank and for other banks as well so it is not, I mean if you know the history of Alrajhi they never [accrue?] any sukuk except the one in Bahrain villamar but it is not really a sukuk because Alrajhi bought all the shares all the sukuk HAHHAHAHAHAHA so it is not really a sukuk as we know but here what we are trying to do here in Malaysia it is a sukuk that Insha Allah acceptable according to Alrajhi standards but also not confine to Alrajhi it will be I mean however believe in this sukuk they can subscribe.

INTERVIEWER: And it will be on Ijarah or

INTERVIEWEE: aaaa this one will be on aaa ... it is aaaammmm what we call ... combination of Ijarah, it is Asset Base and also some cash so the asset I mean aaa I mean the asset they will buy asset the real asset xxxx xxxx they will rent it lease it and some portion will be money and they will do commodity Murabaha or Tawaruq or something's like that to get to finance

INTERVIEWER: and number of years as Shariah advisor in general

INTERVIEWEE: mm maybe I can say (long pause) since 2005 about five years

INTERVIEWER: and how long in Alrajhi bank?

INTERVIEWEE: from 2007 three years

INTERVIEWER: How many times Dr. you have been involved in the sukuk issuance?

INTERVIEWEE: With Alrajhi I have two then let me count some Singaporeans institutions maybe five

7:39.3 - 9:19.9 INTERVIEWER: As a Shariah advisor, what are your duties / roles you play prior to issuance?

INTERVIEWEE: Of course, we involved in this prior to issuance step by step in structuring sukuk we involved the structuring need to be approved by us.

INTERVIEWEE: Only approving the structure or you going in details

INTERVIEWER: No we go in to details I mean all A B & C we highly involved even the legal documentation words by words line by line that's why we need these four days from morning to night we xxxx reading line by line 14 contracts 15 contracts so A B & C we heavily involved in all these contracts.

INTERVIEWER: In legal documentation how detail you be involved?

INTERVIEWEE: I mean legal documentation normally will be prepared

by lawyers but we will go throw also as I said to you line by line to look into Shariah issues if any then we will raise our concern then the legal will look at our concerns and if they can [con****?] it they will do whatever you want, if they can't they will come back to us and give their justification and we will move from there.

9:19.9 - 27:35.5 INTERVIEWER: What happen when you disagree with the proposed structure?

INTERVIEWEE: The structure if we disagree then they can't do it, as simple as that aheheheh because we don't have (...) I mean aaa for the structure it is like *Arkan* or like pillars of the sukuk so if we do not agree of the structure of course they cannot proceed but of course before we say we disagree I mean (...) there will be a platform where we can discuss with management with the sukuk people to look at [ways? & means?] how we can remedy if any things which is in our thinking not Shariah compliant we may I mean we will discuss to suggest solutions but at the end of the day if we can find we can find solution like *Dhamn* in capital (capital guarantee) I mean there are some people how are saying capital guarantee is ok but for Alrajhi standard until know they said no (..) undertaken even though it is *Wa'ad men tarafen wahed* (one party promise) no so if the other party say we can issue sukuk without capital guarantee and without undertaken so according to our standard we will say no then *Khalas* HEHEHEHEHE we cannot proceed with the sukuk issuance that's way I mean when I'm talking I'm talking on Alrajhi standard because I'm also working with other institutions like in Singapore they are also issuing a sukuk know for data center so the standard is AAOIFI standard so but the Rajhi standard is stricter than AAOIFI standard AHAHAHAHAHA

INTERVIEWER: So know I think we have three approach may be some banks in Malaysia have more than AAOIFI

INTERVIEWEE: I mean all banks in Malaysia except Alrajhi and maybe KFH they are using Malaysian standards Malaysian standard they are following roles and guidelines of the Security Commission so most of these issue settled at this level and they say ok no more problem but we are looking at that standard we have another standard xxxx xx we have Alrajhi standard HEHEHA

INTERVIEWER: So from your experience now you are exposed to three different approach which one you think is let say better practice

INTERVIEWEE: looking at the standard maybe AAOIFI is good acceptable practical but Malaysian standard is too loose sometimes you want to match every things with conventional so you don't bring any things new except that you change the names you change the contracts but you do not push the industry to change because it is ok for them just apple and apple but this is apple with some adjustment and it is called Islamic apple and this is conventional apple hehe but now we are pushing this is orange this is not apple so we push at least if we go back to AAOIFI standard if not even higher standard of Alrajhi aaa throw my experience if we are strict but flexible in some issues we can push the industry but if we are too relax I mean that will make the industry

INTERVIEWER: No progress it will stay at the same place

INTERVIEWEE: No progress is too extreme but the progress will be slow progress even in Malaysia there are progress now they are departing away from *Inah* for example now everybody in Malaysia they are saying if you ask any bank we are trying our best to go away from *Inah* but it is a slow process

INTERVIEWER: In the third point of view what do you think of Alrajhi very strict because I worked thirteen years I know they are even if you compare Alrajhi with some other Saudi banks it is one of the most strict roles. Is it very strict that will let say destroy the business or will make it

INTERVIEWEE: I think the history indicate that (...) throw the long history of Alrajhi even in Saudi Arabia it will not destroy there business it is aaaa for me why Alrajhi is different is because of the share holder I mean in most Islamic institutions share holders aim their objectives is to gain profit of course in Alrajhi they also wants profit but they don't mind aaaa in Alrajhi they want profit but it is a pure *Halal* so they do not profit that Shariah committee say it is not *Halal* so they do not mind to give away this profit so that will be a good bases but you cannot find I mean that is very ideal one because share holders of Alrajhi only how many people Suliman Alrajhi and some others of course it is in the capital market but the main share holders still I mean those people how have this background that have this directions but for other banks I don't think they have this awareness

INTERVIEWER: but it is not an obstacle to the business to progress and

INTERVIEWEE: It is an obstacle in on way but it does not I mean go to the extent it can't make profit even Alrajhi in Malaysia they broke even and they got some profit 2009 they got 20 million something's so it's good after only three years of operation you breakeven it is a retail banking any way retail banking normally need some times but they are doing quite good.

INTERVIEWEE: I think their approach at the beginning I came here to Malaysia three years ago I think way Alrajhi following KFH going for corporate taking that very fast return but know I think KFH facing some difficulties

INTERVIEWEE: Yah I asked the same question to Mr. Ahmed Rehman the CEO he said the progress of retail it is slow but steady slow but steady once we got it then it will progress steadily but for investment banking you might on your first year get very big project but you never know your second year your third year HEHEHEHEHaaa but Alrajhi also they have their investment bank now in Malaysia but not as aggressive as KFH it is a business decision it's ok hehehehe for us hehehehe either way is nothing much different for us from Shariah point of view

17:49.0 - 20:53.5 INTERVIEWER: Next question is what is your role after the sukuk issuance?

INTERVIEWEE: aaaa after the sukuk issuance supposedly but aaa mmm we are suppose to monitor the sukuk up to its maturity of course but I have nooo (his hand phone ring) (answer from 18:06 to 19:34) so for Alrajhi I have no experience because we are yet to really issue sukuk but aaa theoretically we need to to monitor up to the maturity of the sukuk as for another sukuk in Singapore it is clearly stated in our contract that we need to audit every year so I suppose this is the role of Shariah advisor we need to monitor the sukuk up to its maturity (the door knocked) (students came) (talk with them from 20:12 to 20:53)

20:53.5 - 27:35.5 INTERVIEWER: Can you share with us how you conduct the monitoring especially the utilization of the fund?

INTERVIEWEE: (long pause) aaa I mean at the point of issuance we normally look at the as you correctly pointed out here xxxx of documents so aaa if the proceeds they want to use to purchase any assets so we have sale and purchase agreement if they want to lease the aaa I mean all documents related to the investment of sukuk proceeds we need to xxx them throw to approve them one by one and if they want to use the aaa that is why we have 14, 15 agreements every steep the asset itself will have the administrator I mean aaa the maintenance to maintain the asset then you have another aaa another document to [get?] throw for example (looking in his PC files) aa we have for example this are the documents related: we have master sale & purchase agreement, master asset agency agreement, master commodity purchase agency agreement, master commodity sale agency agreement, master commodity trading agreement, master Ijarah agreement, service agency agreement, [program?] agreement, subscription agreement, tender payment, even the tender payment I mean when they want to (.) to buy any things I mean there are several ways to buy assets so how they are going to do that there will be documents so all these trust deeds so all these you need to xxx one by one

INTERVIEWER: I mean mainly after this sukuk is issuance while utilization of the fund is it only once a year you visit the bank and review it or some time if this sukuk is aaa the bank only aa not for his personal purpose his own maybe for other customer other corporate so how you involve in this

INTERVIEWEE: aaa ok so all these you can look at this aaa this master, master mean it is aaa general in nature but when they want to execute any transaction they will have different notes so we need to look (..) every time they want to execute any things we need to approve again because master will normally say we want to buy asset xyz but when they really want to buy that building at address this & this they need to have different notes so we need to approve that notes so it is a continuous process

INTERVIEWER: So it is not once a year

INTERVIEWEE: Every time they want to do any transaction they need to call back to Shariah advisors in addition to the end of the year audit

24:43.8 - 25:01.5 INTERVIEWER: If you have done the monitoring of sukuk proceeds, i.e., the utilization and investment of sukuk proceeds, can you tell us the

list of documents you normally receive from the issuer?

INTERVIEWEE: This one we just mention it now

25:01.5 - 25:44.5 INTERVIEWER: Do you audit the bank real practice and implementation of your decisions?

INTERVIEWEE: aa Yes and we have a I mean in our *Amana* we have people how are doing the compliance audit

INTERVIEWER: So you have how many person aaa

INTERVIEWEE: We have two right now not enough but beter than nothing hehehehe

INTERVIEWER: the ideal maybe more than ten?

INTERVIEWEE: Of course its depends on the size but at the moment maybe two is good enough with about aa how many twenty branches

25:44.5 - 26:23.4 INTERVIEWER: So if we not explained in details about the auditing as you mentioned now there is a group of two person how is going to visit the bank and checking the documents and the transactions not the Shariah advisor

INTERVIEWEE: but they will report to us (.) they will report to us we will guide them what to do next up to the decision to give to the charity or to return to the customer

26:23.4 - 27:35.5 INTERVIEWER: During the auditing process if you find any profit earned that is not Shariah complaint what you do about it? Do you have the authority to set aside the non-Shariah complaint profit earned?

INTERVIEWEE: we have the authority set aside even we have the authority not to sign the financial statement unless they abide what we request now it's time for many companies for us to sign their financial report of 2009 so we say we are not going to sign any things except you have put aside this amount of money

INTERVIEWER: So this practice only with Alrajhi bank or

INTERVIEWEE: With Alrajhi bank yes aaamm I also advise Takaful company in Bahrain they are doing the same

INTERVIEWER: Do you have any things else you want to add Dr. before we finish this

INTERVIEWEE: No if you have any things

INTERVIEWER: Thank you very much for your time I will be happy to send you a copy of the study when it finalized, if you are interested Thank you very much.

End of Interview

Transcribed Interview: Informant P3

0:00.0 - 8:42.4

INTERVIEWER: Can we know your age group?

INTERVIEWEE: I'm 37

INTERVIEWER: Which bank you are associated with?

INTERVIEWEE: Alrajhi Bank from Saudi

INTERVIEWER: I'm also worked with Alrajhi bank for 13 years but I'm on study leave

INTERVIEWEE: good

INTERVIEWER: How many years in total as Shariah advisor?

INTERVIEWEE: 3 years with Alrajhi Malaysia

INTERVIEWER: Number of times you have been involved in the sukuk issuance?

INTERVIEWEE: we are working in a sukuk now bit it's not yet approved, we already approved one structure by the authority the Security Commission but doesn't take off yet so this is the first sukuk soon Insha Allah we will gone to issue but so much technical procedures and documentations because we are quite different from other sukuks our standard is very strict so we have a lot of troubles with

the taxations we have a lot of troubles with number of issues like purchase undertaken we do not approve it and then perhaps this is not in line with a-a what has been prescribe by the SC they look forward to have purchase undertaken for example so this is among the issues among the challenges actually

INTERVIEWER: What are your roles you play prior to issuance? Approving or structuring?

INTERVIEWEE: Yes structuring first we start with brainstorming with the BCD from scratch from nothing and then we do product concept document in writing normally they start with asking as the idea of doing sukuk and the general idea what are the constrain the Shariah constrain the Shariah issues so when they xx inviting for the structure so they know already our directions for example what can be done and what cannot be done so they will come up with product concept document very brief information about the structures of the sukuk and then you must first give Fatwa at that stage so if the structures are fine from the prospective of Shariah then they can go ahead so normally we I mean at that stage a-a-a it take them quite long time because they have to restructure when we come up with when they table to us first structure and then and we have Shariah issue in that structure then they have to come up with another structure when another structure also have Shariah issue they have to come up with another structure so structuring is structure stage for product concepts document stage is the most crucial the most important part where if a-a-a just like building a house the pillar ahahah the pillar and the structure I mean are fine I mean from the side of the architecture side for example every things is fine then you can build the house otherwise you can't build the house because the plan must be will define and must be very very clear so the architects for example they will draw the plan according to the need of the clients so here the same with product developers those how are working on that particular product defiantly they will try to come up with the structures that Shariah complaints I mean according to our our Shariah board so we we have four members one from Saudi Sheakh Saleh Abdullah Al-heidan and we have three local Shariah advisors so we do have frequent meeting and then defiantly for that stage it's the most crucial and its take them months to finish to come up with the structure and later on we will come up with the legal documentations and these also takes time because they have to hire a lawyers how are well trained in the field and they come up (..) again at that stage we look at those xxxxx documentations they have to table all those legal documentations sometimes up to 15 documents yah of course because we have a lot of contracts between the contractual relationships

between the issuers and the subscribers or the investors the investors among them self's and the investors with the trustees and the issuer with trustee and yah there are a lot of documentations if there is Ijara there is lease and then they will have to come up with another so have one master legal documentation and then we have sub a-a-a lot of a wide range of sub legal documentations and especially in Malaysia compare to Saudi Saudi the bigger I mean the legal documentation is very brief and Malaysia too much because the lawyer want to but every things ahaha some times unnecessary clauses so we do have trouble with them I mean it does not work if you want to come up with a legal doesn't work so the structure must be very very clear so they build the legal document around the structures so in other words we have to issue Fatwas twice in the beginning for the structure and then secondly for the legal docs. before it takes off

8:42.5 - 10:15.3

INTERVIEWER: What happen when you disagree with the proposed structure?

INTERVIEWEE: Yah we say that we disagree and then they either scrap the product or they come up with another structure there are also some cases like Musharakah Mutanaqesah yah we we we disapprove the proposal and then we come up with another proposal and then (...) where reluctant to a (.) to use that product (..) it's up to them because may be they from risk prospective those from the risk department because of a number of risk so they might see its not applicable or not workable and then they might delay or they might scrap the bank itself the management not the Shariah committee the Shariah sometimes we do a-a-a give them solutions alternative but it up to them it's up to the management either scrap it or we give other solutions and then its left to the bank to decide whether they want to use the new propose structure or just scrap it

10:15.3 - 11:45.7

INTERVIEWER: What is your role after the sukuk issuance?

INTERVIEWEE: Because there was no one case where the sukuk been issued in Malaysia but in Saudi they have Villamar sukuk in Bahrain that was the first sukuk I think approved by Alrajhi but compare with other products once it takes off once it is lunched that doesn't mean our role stop there defiantly we have to monitor we have to supervise we to do Shariah complaint work we have to audit (Raqaba Shar'iah) and then defiantly the (.) I mean those Shariah person the (Mouathafoon) the secretary they are the ones how are doing the job and they will make a report to us so we look at the report because we not a full timers maybe

in Saudi they are a full timer but here Shariah committee we are not full time working at the bank so we do have regular meeting once a week so they will table to us the Shariah issues from I mean the findings of the a-a-a their observations and also their audit for this work

11:45.7 - 14:08.0 INTERVIEWER: If you have done the monitoring of sukuk proceeds, i.e., the utilization and investment of sukuk proceeds, can you tell us the list of documents you normally receive from the issuer?

INTERVIEWEE: the audit staff the Shariah audit staff they will look at the yah defiantly for example the manuals, the product manuals and the transactions the [receipts?] the documentation of the transactions like subscription of the purchase of the sukuk for example they will look at those xxxxx defiantly we have to approve in a (.) up front for the documents for example which will be use (...) even for the a-a-a advertisement and even for the prospectus info memo term sheet we have to look all those documents not only legal documentations so defiantly a-a-a for example the documents xxx shall be used for an acceptance to conclude the conflict for example same they will look at those contracts and also the operation side the calculation of the [raw feeds?] where the money comes from and how do they distribute the dividends and also any a statements and any letters issued by the banks we will look base in our experience defiantly this is what have been done so by the Shariah I mean the Shariah audit staff these are the check list they are going to work on and they will also look at xxxx stages sequence is of concluding the contracts

14:08.0 - 21:08.2 INTERVIEWER: Do you audit the bank real practice and implementation of your decisions?

INTERVIEWEE: Yah the audit staff will do that we are not full time we can not do that we dont have time I'm teaching here hehe I don't have time hehe only once a week and once a week is too much

INTERVIEWER: But are they capable to do that?

INTERVIEWEE: Yah defiantly we (.) yah they are well trained of course we always have regular meeting almost every week there are reports and its more than enough too much because they will look at all that transactions

INTERVIEWER: What is their main roles for auditing after any product is lunched especially sukuk?

INTERVIEWEE: yah even for sukuk we have to monitor it especially when you come to the Ijarah or Musharakah sukuk, Ijarah we look where the money comes from is it from the [writers?] or is it from a loan given by the bank if it is a loan because it is sometimes it is from the issuer for example then defiantly we have to look at what mechanism used because the dividends distributed to the investors are not actually the yield or the profit from the investments so defiantly we I mean this is what we figure out we can not get it I mean from a-a-a those things for example as I just mentioned to you now we have the legal docs. because it is already concluded and all the contracts parties are bond of the terms and conditions of the contracts now we want to look at the operational side how to generate money and for example and the maintenance and also the activities for the business if you happened to hire for example the issuer for example a-a-a a big developer company for example they issue shop let for example they issue sukuk for example to finance a business a big shopping complex then you have to look at those activities what shops are operated what services are they rendering to the public and what are other business activities defiantly I mean you have to you cannot get it from the audit job because what is so special with Islamic products not only Rajhi any other banks because we clam to the public that they can have a peace of mind from non Shariah compliant issues we guaranty that the products are Shariah compliant so then monitoring and auditing is is very very crucial in order to ensure that the business and the income and the investments are Shariah compliant so doesn't stop there doesn't stop at the legal documentation even after it takes off the maintenance has to be monitored and also the income until the end but I think for the Morabaha sukuk perhaps the monitoring is not so exhaustive compare to Ijarah & Musharakah sukuk because it is a close ended and it is normally it is structures as a close ended sukuk and although in Malaysia they are tradable at the secondary market but the issue is because the the return is already fixed I mean with the profit margin you already worked out how many you want to make a profit from the sale so from the Murabaha I think the receivables are known and the percentage are known so yah but the monitoring is also important to make sure for example because if you see it is close ended it is not tradable in the secondary market because it xxx xxxxx Shariah issues then defiantly here we have to monitor that it is not traded if it is traded then xxx mechanism do not use (Takharuge xxxx) so there are mechanisms but these mechanism must be approved by the Shariah committees and we have to make sure that the bank doesn't violate those conditions described by the Shariah committees

21:08.2 - 23:36.0 INTERVIEWER: During the auditing process if you find any profit earned that is not Shariah compliant what you do about it? Do you have the authority to set aside the non-Shariah compliant profit earned if any?

INTERVIEWEE: Yah defiantly from the finding from the Shariah audit we write letters to the CEO and then to the board of directors and we tell them from our findings there is a certain amount I mean a particular proceeds from a particular products has been non compliant and then it has to be purified and of course the bank is bound so in my opinion that the Fawas the rolling of Shariah the respected Shariah council is binding to them so that is it yah because for the Shariah audit works what they are going to do the (.) I mean they (...) xxxxxx base on the Fatwas issued by the Shariah committee so defiantly they will stick I mean they will check any activities any xxxxxx against those Fatwas so those Fatwas are binding around them and here again as I said just now that when the Shariah committee decide for example how much to be purified then it is bound around the bank yah to set aside this amount and then have to xxxxxx and also the manner of purifying also must be approved by the Shariah committee

23:35.9 - 30:28.1 INTERVIEWER: How are the SC guidelines clear and comprehensive? What are your suggestions to improve those guidelines?

INTERVIEWEE: Yah very clear but to some extent they are very clear but they also need to do revision and review or revisit their guidelines because from time to time we have to improve in the SC guidelines for example there are silent about the purifications so in my humble opinion they might improve these I mean the clause of the purification at least for the Muslim investors for example they might advise them to purify the non Halal income but for the non Muslims of course its left to them perhaps they quite in the purifications because the investors in Malaysia they are not only Muslims but non Muslims also investing in Islamic products so perhaps that's why they are silent but for me in this case they have to inform the investors that they have the responsibility to cleanse or to purify is on their shoulders shall be borne by them this is among the examples but there are for the other financial ratios Yah I mean some times of course yah from time to time they have to improve it

INTERVIEWER: In term of sukuk guidelines is it also clear

INTERVIEWEE: I don't think there is a clear guidelines from SC especially in sukuk, for yah the utility or utilization of the fund but as I mentioned to you the Shariah committee of every financial institutions

or the arrangers (...) the Shariah committee for that particular sukuk for example they are responsible to determine the fund for example cannot be used or cannot be utilize to make payment to the conventional borrowing or conventional loans because this is similar to paying riba for instant but I notice that there are quite number of sukuks which were raise which were issued in order to serve that purpose where the issuers wants to pay the previous debt by raising funds throw Islamic means and in the Middle East for example they already do the commodity Murabahah then the same the will do the commodity Murabaha with the conventional counter parties and they don't need to xxxxxxx because they do directly the commodity Murabaha which is also among the major problems major issues where I think the Shariah advisor should not compromise on these because a-a-a there will be a leakage of the fund from the Islamic to conventional

INTERVIEWER: thank you very much Dr for all that and do you want to add any think before we end

INTERVIEWEE: No that's all & Muwafaqeen Insha Allah

End of Interview

Transcribed Interview: Informant P4

0:57.4 - 9:19.9 INTERVIEWER: بسم الله

I am here to get your valuable feedback on sukuk from Shariah perspective (practice vs. theory), actually especially Malaysian market. It is of course confidential if you have any clarification before we start or we can proceed.

INTERVIEWEE: Ok, In English you prefer or Arabic?

INTERVIEWER: English please

INTERVIEWER: we need your age group is?

INTERVIEWEE: 42 years old

INTERVIEWER: then which bank you are associated with?

INTERVIEWEE: Rakaia Bank and other Re-takaful Cagamas Berhad for over 3 years

INTERVIEWER: How many years as a Shariah advisor?

INTERVIEWEE: One year as a Shariah advisor. But before that also I was with Re-takaful Company -Shariah department- for about 3 years

INTERVIEWER: how many times you have been involved in sukuk issuance?

INTERVIEWEE: One year. We review over hundreds of documents and structures (mainly Ijarah sukuk). As per a particular assignment; after assigning the trustee. We have approved 4- 5 structures and confirmed their conformity to Shariah.

INTERVIEWER: What is the Shariah role (process) before the sukuk issuance?

INTERVIEWEE: we do not do the structuring this is not our jobs we simply review the structure, so the structure done by the Capital market department of the bank, so our role is reviewing and approving or disapproving not the structuring. However, if we feel that the structure need amendment so we propose that instead of doing this why you don't do it this way.

INTERVIEWER: what happened if you disagree with the structure?

INTERVIEWEE: defiantly we will reject it, and we will not accept it until it is Shariah compliant. In some case we can accept it if we see the real "dharoorah" behind it. We need to see what the bank is insisting on some specific issues; that we probably do not see the technical reason behind it.

INTERVIEWER: What is your role after the sukuk issuance?

INTERVIEWEE: monitoring the sukuk after issuance will be the responsibility of the shari'ah department. If they observe any serious issues; like not implementing what was originally approved in the agreement; which they are obligated to inform us.

INTERVIEWER: So; two angles: after and before utilization of fund; whether invested in Islamic or conventional accounts?

INTERVIEWEE: In reality, there is no physical transfer fund between the investor to the originator. At the end of the day the fund is parked but there is a net off - at maturity- let say five years like in Ijarah Sukuk there is a

kind of (Muqasah) net off. We have insisted that real amount should be transferred.

INTERVIEWER: can you please explain more; what does it mean it is not transferred

INTERVIEWEE: Example; sukuk Ijarah; like obligor sale real assets to SPV; then SPV should actually pay the obligor based on the original value plus the rents payment, but in reality it isn't, only profit or rental is transferred.

INTERVIEWER: So; only profits are transferred?

INTERVIEWEE: Yes; profit goes to investors; so contracts are separated; one sale per transaction (it is no permitted to transact two contract in one)
(نهى الرسول (ص) عن بيعتين في بيعة)

INTERVIEWER: How?

INTERVIEWEE: the value of sukuk purchased sometimes; not necessary equal to the sukuk values issued. Which I disagree; to raise more than raised. In Malaysia; they allow up to 30% over the original

INTERVIEWER: are you referring to debt-based transaction?

INTERVIEWEE: Yes like "Cagamas"

9:19.9- 15:09.4 INTERVIEWER: In sukuk monitoring; what documents; used before and after issuance

INTERVIEWEE: It is between 50 to 150 pages. If the sukuk is across boards in different countries that will need more detail documents.

INTERVIEWER: is there any master agreement or contracts

INTERVIEWEE: Yes in some of them we do; and other sub agreement or amended agreement. Example if the assets you are selling (1 billion); but the real assets may not exceed 300 million; so you have to do it 3 times. You raise the first 300 million based on one agreement; then we have to sign sub agreement (supplementary agreement); where they do not have to create term and conditions. In some other issuances can still be done in one agreement. It depends on the situation

INTERVIEWER: So; incase more expenses need to be implemented; what

happens?

INTERVIEWEE: They have to tell us to review the new terms and any others medications (i.e. rent payment to be changed - floating payment); then it has to be done on the master agreement not the supplementary agreement. It is a must. This a Shariah requirements.

15:09.4
27:35.5

- INTERVIEWER: Do you audit the real practice of your decision?

INTERVIEWEE: Yes auditing, we do to confirm implementation of the originally approved structure + our role as advisors to go over all details of the contract an check at the end of each year. What I have realized; it is not easy to know; every single deep transaction. In other way, we do not get answers from the bank; unless we ask. Example; how profits are really made in a mudarabah contract. What is the real profit amount released to clients. How far the client knows the real reserve that is building in the bank? So it is an issue of transparency. In addition in case of losses; the bank will use the client shares; and banks gets nothing. Because Bank is committed to pay an indicative rate. So; what is called smoothing to clients; to avoid they withdraw their money.

INTERVIEWER: How it is done?

INTERVIEWEE: by the Internal auditors (professional auditing done through very professional bodies), Shariah department & us the Shariah advisors. But, I have to acknowledge one important issue It is a real problem in Islamic banks; the issue of transparency. We need to dig farther and farther in every single transaction order to know this is making our job bit difficult, and even some times when we asked not every things is revealed. For example, the client is kept in the dark. Many activities like that; where funds are sometime making profits and at other time, it is making losses. The issue of smoothing if the bank make losses he will take from the reserve to give the customer the same regular return in the market. Because the bank is committed to pay an indicative rate to the customer.

INTERVIEWER: are you satisfied with auditing mechanism?

INTERVIEWEE: it is definitely need improvement and to give the Shariah committee the ultimate authority to look into any thinks they want to look into including how much the bank is making profit how much the customer make profit and any other issues related to Shariah. It needs to show the real profit and losses. The customer or client has to be aware of the all-real

transaction and fulfill its ethical obligations. That how Islamic Banks need to differentiated from the conventional counterparty.

INTERVIEWER: During auditing...how do you go about any non-Shariah compliant transaction?

INTERVIEWEE: If it happens; then we automatically address that; and find if any Islamic school of law has a different view. We consider all schools to ensure validity. If the bank does it as an error; then we should clarify the matter. This important to ensure client confidence and continuity in the market.

27:35.5 - INTERVIEWER: During the auditing process if you find any profit earned
31:53.5 that is not Shariah complaint what you do about it? Do you have the authority to set aside the non-Shariah complaint profit earned?

INTERVIEWEE: Until now that has not happened in our bank but it should be declared a void transaction and should be transfer to the charity, nevertheless in realty it is very difficult to convenes the bank to set aside millions of the profit earned they will ask for any solution in any other mathhab view or any scholar accept it in any form.

INTERVIEWER: How are the SC guidelines clear and comprehensive? What are your suggestions to improve those guidelines?

INTERVIEWEE: Definitely not comprehensive. What we have is a very general guideline. We need to be more detailed and specific about each structure. Like sukuk al-Ijarah, Musharakah... or similar.

31:53.5- INTERVIEWER: If you have done the monitoring of sukuk proceeds, i.e.,
32:58.5 the utilization and investment of sukuk proceeds, can you tell us the list of documents you normally receive from the issuer?

INTERVIEWEE: It a detailed set of documents over 150 pages; that include all relevant information to the real assets to be purchased, sources, utilization, expected returns and the corresponding business process documents

32:58.5- INTERVIEWER: Do you have any things else you want to add Dr. before
33:35.5 we finish this

INTERVIEWEE: No thank you.

INTERVIEWER: Thank you very much for your time I will be happy to send you a copy of the study when it finalized, if you are interested Thank you very much.

End of Interview

APPENDIX D

Web Resources for the Malaysian Sukuk Market

Bank Negara Malaysia (Malaysian Central Bank) www.bnm.gov.my

Islamic Financial Services Board (IFSB) www.ifsb.org

Securities Commission www.sc.com.my

Labuan Offshore Financial Services Authority www.lofsa.gov.my

Bursa Malaysia www.bursamalaysia.com

Malaysian Accounting Standards Board (MASB) www.masb.org.my

Association of Islamic Banks in Malaysia www.aibim.com

International Shari'ah Research Academy for Islamic Finance (ISRA) www.isra.my

Global provider of Sukuk information and Sukuk market data www.sukuk.net

Malaysia International Islamic Financial Centre (MIFC) www.mifc.com

Bond Info Hub <http://bondinfo.bnm.gov.my>

International Islamic Financial Market (IIFM) www.iifm.net

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