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Nidal Alsayyed

Nidal Alsayyed السيد الحميد عبد نضال د. He was the founder of Inayah Islamic finance Research Company in Jordan and Malaysia where he continues to be the CEO and Consulting Professor to University of Jordan - Islamic Banking Department. His Research activities and detailed resume and publications can be found at www.inayah.org.

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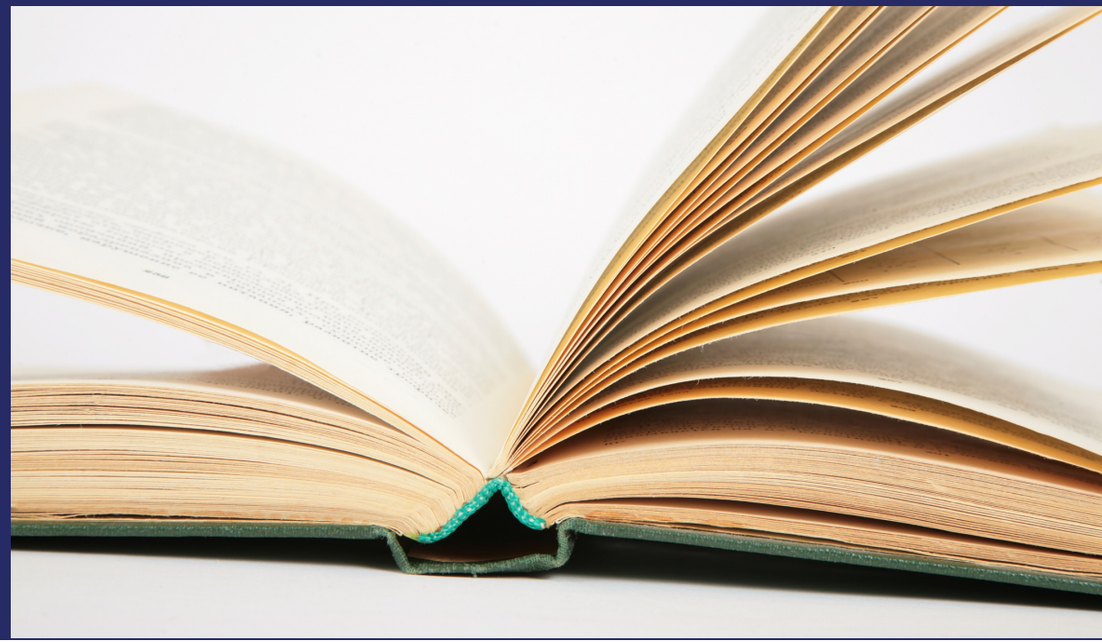
Special Purpose Company in Sukuk



Alsayyed

Nidal Alsayyed

Investigating Islamic Law in Special Purpose Company for Sukuk

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Investigating Islamic Law in Special Purpose Company (SPC) and its Role in Structuring Contemporary Islamic Finance Products: Sukuk Perspective

NIDAL A. ALSAYYED
PhD in Islamic Finance, Pebble Hills University, USA

Jan 2014

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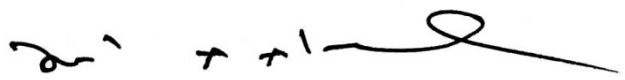
Book Topic Summary

Establishing the Special Purpose Company (sometimes denoted as SPV / SPC/ or SPE) in any legal form (i.e. a company, limited liability company, financial Trust, or offshore trust), is no longer confined to the traditional securitization and Islamic securitization (Sukukization!) purposes, but can also be used for financing different contracts, some financial derivative contracts, and cotemporary Islamic Financial compounded products. The researcher investigated the Shari'ah objectives of the SPC in this dissertation which is based on two parts: Firstly; the SPC as applied in the western financial system (interest based finance), and Secondly; The Islamic jurisprudence related issues in the process of structuring the Islamic bonds (Sukuk); which are theoretically based on the ownership of the underlying assets and non-guarantee of the project return. The study outlined the Shari'ah guidelines and standards and other technical conditions governing the structuring process combined with the SPC application; to preserve the objective of Shari'ah in protecting the investor capital away from Shari'ah ruses (*alheyal*) or any other illegal means (i.e. Gharar, deception…etc) as outlined in the Islamic law. The study analyzed, exposed the nature of the special purpose company and the jurisprudential/common law position of such a company, and discussed the results of some contemporary Sukuk cases and had drawn conclusions pertaining to the circumstances and legal environments surrounding the SPC objectivity and its legal structure to help support the design process of the Islamic Financial instruments in accordance to shari'ah objectives or as permitted by Islamic Jurisprudence.

DECLARATION

I hereby declare that this book is the result of my own investigations, except otherwise stated. I also declare that it has been previously submitted as a whole for PhD degree at AIMS/Pebble Hills University.

Nidal Abdul Hamid Alsayyed (Signature)



Date: December 20, 2013

ACKNOWLEDGEMENT

This book would not have been possible without the guidance, support, and the help of several individuals who in one way or another contributed and extended their valuable assistance in the preparation and completion of this study.

First and foremost, my utmost gratitude to Prof. Rafic Al-Masri, whose sincerity, support, and encouragement I will never forget.

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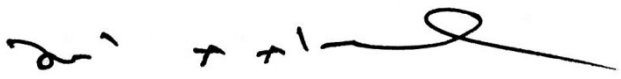
I owe my deepest gratitude to "INAYAH" Islamic Finance Research and Consulting Group for the sharing of knowledge and experience. To the wonderful AIMS administrative staff and management team; thank you. Moreover; a special thank you to Dr. Hamed Meerah for his useful hints on this dissertation topic, and Dr. Rodney Wilson for his in-depth works on Contemporary Sukuk.

Last but not the least, my wife and parents and the one above all of us, the omnipresent ALLAH (*subhanahu wa ta'ala*), for answering my prayers for giving me the strength, I did not thank him enough (*ma hamadnak haq hamdek*).

My apologies to those whom I could not personally name here.

Nidal Alsayyed



DEDICATION

To:
The Serious and independent researchers and graduate students in Islamic Banking Finance around the world

To my beloved parents
Prof. ABDUL-HAMID ALSAYYED AND MOTHER

And

MY WIFE

My Brothers and Sisters

My Sons and Daughters

I dedicate this work

LIST OF TABLES

LIST OF ABBREVIATIONS

Common Abbreviation

cf.	Compare
e.g	(*exempligratia)* for example
et al.	*(et alia)* and other
ibid	(ibidem) in the same place
id	(idem) the same below
i.e.,	that is
n.d	no date
PBUH	Peace Be Upon Him
vs. / v	versus, against

Notes on Abbreviations

AABG	Advance Al-Bait Group for Development and Construction
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ABARSI	Al-Borj al-Alamiah Real State Investment
ABS	Asset Backed Securitization
ADB	Asian Development Bank
ADIB	Abu Dhabi Islamic Bank
ARCIFI	Arbitration and Reconciliation Centre for Islamic Financial Institutions

BBA	*Bay' Bithaman A'jil (Deferred Sale)*
BCBS	Basel Committee for Banking Supervision
BCPs	Basel Core Principles
CIBAFI	General Council for Islamic Banks and Financial Institutions
DJIMI	Dow Jones Islamic Market Index
DFSA	Dubai Financial Services Authority
EBS	Equity Based Sukuk
EPM	Equity Pricing Model
FATF	Financial Action Task Force
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
GCC	Gulf Cooperation Council
IAH	Investment account holders
IAIS	International Association of Insurance Supervisors
ICM	Islamic Capital Market
ICR	Insolvency and Creditor Rights
IFAI	Islamic Financial Architecture and Infrastructure
IDB	Islamic Development Bank
IFIS	Islamic Finance Information Service
IFS	Islamic Financial Service
IFSB	Islamic Financial Services Board
IFSI	Islamic Financial Services Industry

IIFM	International Islamic Financial Market
IIFS	Institutions offering Islamic financial services
IIIIs	Islamic International Infrastructure Institutions
IIRA	International Islamic Rating Agency
IMF	International Monetary Fund
INBMFIs	Islamic non-bank and microfinance institutions
IPDS	Islamic Private Debt Securities
IRTI	Islamic Research and Training Institute
KFH	Kuwait FinanceHouse
LBS	Lease-Based *Ṣukūk*
MUIS	Majlis Ulama Islam Singapore
PIC	Purple Island Corporation
PLSA	Projek Lintasan Shah Alam
PTC	Principal Terms and Conditions
PU	Promise Undertaking
RSRED	Residential South Real Estate Project Company
SBG	Saudi Bin Laden Group
SPC/SPV	Special Purpose Company / Vehicle.
PV	Present Value
MV	Market Value
EBS	Equity Based Sukuk

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Chapter 1

INTRODUCTION

1.1 INTRODUCTION

Allah has created people to know Him and worship Him, in observance of His due lordship and divinity. That is why Islam made devotion to Allah the primary requirement of a Muslim after the two witnesses [of No God but Allah, and Mohammad is His Prophet]. Transactions are part of the religious issues that a Muslim performs for the sake of Allah Most High. Every Muslim was keen on having the best conduct in transacting within their effort to get closer to Allah Most High, and to fulfill the best life structure for mankind (Does He who created not know, while He is the Subtle, the Acquainted?)[1].

One of the distinctive characteristics of the nature of transactions, and economy in general and Islamic economy in particular, was its ability to expand, renovate and develop. It has unique flexibility that can accommodate new issues and questions revolving about the needs of people, or the requirements of their transactions. Financial transactions are one of the most important aspects of daily life. They are increasingly active and developing. The forms of doing such transactions are renewed and developed in accordance with modern life activity. One of the latest and most prominent developments was the appearance of securitization process among the financial organizations worldwide.

Lots of discussion is held at present about securitization, which means the conversion of illiquid assets to financial papers. In reality, securitization is a modern financial instrument that had initially started in the US, in particular. Many American banks worked hard to securitize their debts. Even though securitization originated in the Western World, Islam does not prohibit us from benefiting from non-Muslim inventions, so long as these inventions do not

[1] Quran. Surat Al-Mulk (67:14)

contradict with the basics of Islamic law and its roots. Interestingly, Islam was ahead of the West in using the securitization as a document to prove some right. *Al-Nawawi* discussed this issue, and declared "As-Sukak الصكاك "is a plural of "Sak صك "; it is a written document in proof of a debt. The plural can also be "Sukuk صكوك ". It refers to the document issued by a guardian ordering provisions, of food or others, to entitled holders. The holder may sell this document to others before getting the prescribed provisions (Al-Nawawi, Abu-Zakariyya Yahya M. 1971) [43].

In securitization, special purpose company is one of the important components of such process. This type of company appears with the securitization process, and plays a critical role in that process. Accordingly, in this dissertation the researcher endeavors to know the legal position of such a company and to identify the legal Islamic ruling related to such a company based on its nature, function and relationship with other components of the securitization process.

1.2 THE IMPORTANCE OF THE STUDY

This topic has its own scientific and practical importance from a scientific perspective. The special purpose company (SPC) is still a hot topic under discussion. The major issue relates to its legal position in the Islamic law. There are still controversy around its nature and function. Securitization is one of the troubling issues around the world.

From a practical perspective, the researcher posits that the concept of securitization in general and special purpose company in particular has entered all aspects of economic and societal life, while related transactions have spread in many countries, and hence become part-and-parcel of some banking financial instruments . Accordingly, knowledge of the concept of this type of company and its function becomes a communal obligation on every Muslim. Muslims should be well informed about such type of companies. If they are legally permissible, then he can deal with them with confidence; otherwise, a Muslim should turn away from such a company so long as he has the option. In case Muslims find that they are legally prohibited and find themselves forced to deal with them, the

least they can do is express their discontent of such sort of companies or hold an ideology of rejecting them.

This process of inquiry into business-related legal matters is a must in a Muslim's life. This commitment cannot happen without the knowledge of the Islamic position of everything a Muslim deals with in his/her life, even where he/she does not have the option.

1.3 THE RESEARCH QUESTIONS

The research question lies down in presenting the concept of the special purpose company, and shows its impact on the issuance of Islamic financial products and more specifically Sukuk. The researcher will try in this dissertation to answer the following questions:

First: What is the special purpose company, and what are the reasons behind its appearance?

Second: What are the characteristics of the special purpose company, and what are its types?

Third: What is securitization, its pillars and importance?

Fourth: What is the importance of the special purpose company in the securitization process?

Fifth: What function does the special purpose company play in the securitization process and the structuring of Islamic Financial products?

Sixth: What is the legal jurisprudence and Shari'ah objective position on the special purpose company?

1.4 THE GOALS OF THE STUDY

In accordance with the above, I have selected this topic in order to achieve certain goals, the most important of which are:

1) To show the concept of the special purpose company and the reasons behind its emergence.
2) To expose the characteristics of the special purpose company and its types.

3) To exert best effort to research the concept of the securitization process, and show its importance and major financing components.
4) To show the importance of the special purpose company in the securitization process.
5) To present the jurisprudential position and Shari'ah objectives of the special purpose company (SPC) in modern Islamic finance products structuring.

1.5 PREVIOUS STUDIES

As the topic is still rather new, I could not put my hands on some in-depth scientific research on the subject, except some on securitization and SPV in general. The most important of these studies were:

1. *Al-Tawreeq wa Mada Ahmmiyatahu fi Dhil Qanoon Al-Rahn Al-Aqari* [Translated as: Securitization and its importance in relation to the real estate mortgage] (Al-Hijazi, Obaid Ali Ahmad 2001) [44]. The author defined securitization, its components, development and importance. The author has briefly revealed the role of special purpose companies in the securitization process. The dissertation was limited to some restricted real estate application and lacks the *Shari'ah* viewpoint.

2. *Dawr Al-Sukuk Al-Islamiyah Fi Tamweel Al-Mashroo'at Al-Tanmawiyah* [Translated as: The role of Islamic Sukuk in financing development projects] (Mohammed Saleh and Fath- Al-Rahman Ali, 2008),. This research, presented at the Islamic Banking Symposium, covered the concept of Islamic securitization and its role in mobilizing financial resources in order to finance development projects. It also covered the risks inherited in these sukuk and how to manage them. The author has briefly touched on the relationship arrangement among the parties to these Sukuk. The dissertation was more specific to the Sukuk from *Shari'ah* viewpoint and did not discuss the SPV role in these structures.

3. *Al-Tawriq wa Baqiyat Adawat Al-Suyoolah li-sook Al-Islamiyah* [Securitization and the rest of liquidity instruments for Islamic market] (Mala'ekah, Saleh 2005). This study has touched on the concept of securitization and its Islamic ruling. It has further touched on the role of Al-Tawfeeq and Al-Ameen companies in the field of mutual funds securitization. At the end of the study, the researcher elaborated on some of the securitization problems. The study lacks in-depth analysis to the modern practice in today's contemporary Islamic banking products.

4. *Al-Sukuk Al-Isalamiyah wa Tatbeeqatiha Al-Moa'sirah wa Tadawuliha* [Islamic Securitization, and its modern applications and trading] (Muheisen, Fouad Mohammed Ahmad 2009). The researcher expounded therein on the securitization concept, its goals, motives, and the jurisprudential rules for contemporary securitization process together with its Islamic legal controls. Also, the researcher showed the parties to securitization process, and made a comparison between the traditional securitizations and Islamic ones but lacks the analysis of the SPV role in the Sukuk Structures.

5. *Al-Taskik wa Dawruhu fi Sooq* Maliyah Islamiyah [Securitization and its role in the development of an Islamic Financial Market] (Bani Amer, Zaherah Ali Mohammed 2008). In this study, the researcher elaborated on the concept of international markets and traditional securitization and its components. The researcher also presented Islamic securitization in a good way in this study.

1.5.1 What makes this study different?

In general, previous studies were concerned with historical precedence, details and comments on the securitization process in order to understand its nature, and made a comparison between traditional and Islamic securitization. No study has dealt with the concept of the special purpose company, whether from a conceptual and advantageous perspective or from jurisprudential perspective in relation to other parties to the securitization process in

contemporary Islamic Finance. This dissertation is different from previous studies on the following grounds:

1) In terms of completeness, this dissertation is more comprehensive and has covered the shortfalls in some of the previous studies, by handling the concept of the special purpose company, its characteristics and nature.

2) In terms of categorization, this dissertation presented different layout of the research components so as to accommodate the Islamic legal position together with the jurisprudential referencing for the special purpose company, in terms of its relationship with other parties to the securitization process, which is common among countries where this structure is being practiced at present. That would make this dissertation very distinctive from other previous studies.

1.6 Methodology

This dissertation assumed an inductive research method in data collection. Further, the dissertation assumed the analytical method for investigation, presentation and formulation, all the way through the conclusion about the concept of the special purpose company and its impact on securitization.

1.7 The Research Plan

This dissertation covered an introduction, five chapters and the conclusion chapter six.

CHAPTER ONE: Introduction: It covered the importance of this dissertation, its objectives, methodology, previous studies and the research plan.

CHAPTER TWO: The Company Literature: The Company in Islamic Jurisprudence and Man-made Law. It falls into two parts:

Part One: The Concept of Company in Islamic Jurisprudence

Section One: The Definition of Company

Section Two: Legality of a Company

Section Three: Categories of Companies: Communal Companies, Property Companies, and Contractual Companies

Part Two: The Concept of Company in the Man-made Law

Section One: The Company by Its General Concept
Section Two: The Company by Its Objective
Section Three: The Company by Its Business and Activities
Section Four: The Company by Its Relationship to Other Companies

CHAPTER THREE: SPECIAL PURPOSE COMPANY (SPC) ROLE IN FINANCE: What is the Special Purpose Company and Its role in finance? It falls into two parts:

Part One: Definition of the Special Purpose Company, Its Development and Reasons behind Its Appearance
Section One: Definition of Special Purpose Company
Section Two: Development of Special Purpose Company
Section Three: Reasons behind the Appearance of Special Purpose Company, and the Need for It

Part Two: Characteristics of Special Purpose Company, and Its Types
Section One: Types of Special Purpose Company
Section Two: Nature of Special Purpose Company and Its Characteristics
Section Three: The Accounting Process for the Special Purpose Company

CHAPTER FOUR: LEGAL AND SHARI'AH FRAMEWORK FOR SPECIAL PURPOSE COMPANY IN ISLAMIC FINANCE**:** It explains the Securitization Process and the Importance of Special Purpose Company for Securitization in contemporary Islamic Finance. It covers six parts:

Part One: The Concept of Securitization
Part Two: The Pillars of Securitization, Its Importance and Components
Part Three: Types of Securitization and Comparison between the Traditional Model and Islamic Model in Security Issuance
Part Four: Reasons and Prospects of Securitization
Part Five: Legal Dimension (Techniques) and Accounting Dimension of Securitization
Part Six: Importance of Special Purpose Company in Securitization

CHAPTER FIVE: SPECIAL PURPOSE COMPANY (SPC) IN SUKUK STRUCTURING: The Relationship between the Special Purpose Company and Sukuk Structuring and other pertinent rulings. It falls into two parts:

Part One: The Function of Special Purpose Company in Traditional Securitization, and the Process of Islamic Securitization

Section One: The Function of a Special Purpose Company When Established in the Form of a Company

Section Two: The Function of a Special Purpose Company When Established in the Form of Mutual Fund

Section Three: The Function of a Special Purpose Company When Established in the Form of financing Contract Based on Trust

Part Two: Jurisprudential Documentation of Special Purpose Company

Section One: Relationships Documentation between Parties to Securitization

Section Two: Legal Controls for the Special Purpose Company in Securitization

Section Three: Proposed Model of Special Purpose Company in Securitization Process

CHAPTER SIX: CONCLUSIONS, RECOMMNEDATIONS, AND FUTURE OUTLOOK: This chapter covers the most important conclusions and recommendations.

I would like to point out that any human effort is characterized by flaws and imperfections. Perfection belongs only to the Divine. Anything that is true in my writing must have come from the Gracious Lord alone; whatever flaws committed must have come from myself and the devil I ask God Most High to accept this effort as sincere for His own sake. I ask God as well to make out any shortage and fix any flaw. He is the best sponsor and best supporter. May Allah take us by our good faith and intention! He is the source of success, and all praise is due to Him.

Chapter 2
The Company Literature

2.1 The Company (*Sharikah*) in Islamic Jurisprudence and Man-made Law

From ancient times, man has been working hard to do things on his own in order to meet his basic needs. However, due to the increasing activities in commercial life and the need of business to considerable capitals, an individual may not be able carry a business on his own, due to one's limited financial and physical capacity. God declares this fact as "man was created weak"[1]. Accordingly, man started to find some way of cooperation with his fellow-human. This has resulted in the appearance of companies that can practice larger projects that need greater expenses. A company of that form is not new; it goes back to old ages.

This chapter falls into two parts:

Part One: The Concept of Company in Islamic Jurisprudence

Part Two: The Concept of Company in the Man-made Law

2.1.1 Linguistic Definition of a Company (*Sharikah*)

From an Arabic linguistic perspective, the word "company" [*Shirkah or Sharikah*] refers to an infinite verb that entails the sharing of property, engaging people in an enterprise, and creating partners (Al –Fayoumi and Ahmad Bin Mohammed Ali al-Meqri, 1987).

Further, the word 'company' from an Arabic language perspective refers to mixing among partners, (Ibn Manzoor and -Alfadhl Jamal al-Deen Mohammed Bin Mukram, 1900), and Ahmad Rida (Reda, Ahmad and Matn Al-Lughah, 1959), or

[1] Quran, Surat Al-Nisa': Verse 28.

mixing between shares and properties as held by al-Jorjani (Al-Jorjani, al-Sharif Ali Bin Mohammed , 1983).

However, according the Al-Waseet lexicon, the word 'company' referred to a contract between two or more people to do a common work. It falls under different categories, as explained respectively under each entry (Mustafa, Ibrahim and al-Zayyat, Ahmad Hasan, 1972). In defining the company, al-Jorjani added that the word 'company' refers to a contract even though there is no mixing between properties (Al-Jorjani, 1983).

Hence, the word company has two linguistic references: Mixing among a number of people or properties, or a contract.

2.1.2 Legal Definition of a Company (*Sharikah*)

Jurists define the company differently in accordance with their variant schools. A group of Muslim jurists, however, sets a general definition that is common among all types of companies, and shows its general meaning. This variance is attributed to the variety of meanings attached to this term as regards to various terms and conditions.

Among the definitions that refer to the general meaning of the company is the one identified in *Al-Lubab Fi Sharh Al-Kitab*: "the sharing of work among two or more in one place" (*Al-Medani* and Abdulghani al-Ghunaimi al-Demashqi, 1995). This definition is very generic and covers all aspects of the company; it refers to the assignment of two or more people to work on one arena, whether that arena was a debt, material, work, money, or prestige (Al-Khayat, 1988).

The author of Al-Moghni defined the company as "a gathering of people over some entitlement or action" (Ibn Qudamah, 1419 AH). This definition is also comprehensive and generic, and covers all types of companies. It covers the entitlement of an entity by inheritance, booty, or the like. It makes no difference whether the partners own both the physical item itself and the benefit generated by that item, or own just one of them. That definition also covers financial companies,

people companies, business companies, or both financial and business companies such as those of Mudarabah companies (Al-Khayat, 1988). Definitions by Muslim jurists at various schools were as follows:

The Hanafi school defined the company as “the mixing of two shares or more in a way that no share can be differentiated from the other” (Ibn Al-Hamam, Kamal al-Deen M. B. Abdul-Wahid, 2000).

This is the second definition of company at the Hanafi School, on top of that of Al-Lubab Fi *Sharh Al-Kitab* above. That was a famous definition that implies the importance of having tolerance among partners as to the mixing and indiscrimination of their shares.

The Maliki School defined the company as “an optional mixing between two or more people in order to generate profit, which may happen unintentionally” (Al-Hattab and Abu Abdullah Mohammed bin Mohammed bin Abdul Rahman, 1995). They also defined it as “permission for themselves to conduct“(Al-Dasouqi, Mohammed Bin Ahmad, 1996). That is, each partner permits the other to conduct in all of their property or an alternative thereof, or under their liability; they share whatever profit or loss. The first definition shows the voluntary mixing between two or more in order to generate profit, and hence it covers all types of contract companies. It also covers the involuntary mixing, such as that of inheritance, and it covers all types of property companies (Abu Zeid, Rushdi Shehateh, 2008). It seems that the first definition was more generic and comprehensive than the second one for all types of companies.

The Shafi’i School defined the company as the “affirmation of the entitlement to something for two or more people in common” (Al-Sharbini, Mohammed Bin Ahmad Al-Khatib, 1994); it was also defined as “the common entitlement to one thing, or a contract that implies that” (Al-Ramli, Shams al-Deen Mohammed Bin Abi al-Abbas, 1984). These two definitions have the same indication; they cover two parts as follows:

1) The affirmation of common entitlement in one thing is a generic statement, as entitlement is confirmed by a contract such as a purchase contract, or without a contract such as the case with inheritance. Three distinctions can be made here:
   a) By “affirmed entitlement”, the definition entails: Such entitlement holds true whether it relates to a property, a benefit, an abstract, and whether such a benefit or abstract were related to a property, such as the benefit of a house and a right-of-first-refusal, or related to nothing like that, such as the benefit of a hunting dog. This entitlement also holds true whether it was imposed, as in the case of inheritance, or it was voluntary, as in the case of procurement.
   b) By “In common”, the definition entails: No one alone can have that entitlement. It also excludes a pre-assigned entitlement of two or more people as in the case when partners divide a land property between them and assigns a specific part for each.
   c) However, there is no need for limiting to “one thing”, because of the commonality. This addition might exclude the case when two person share two common houses between them; there is no justification for that exclusion as it is definitely a company.

2) The affirmation of common entitlement to one thing is strictly related to a contract company. Three distinctions can be recognized there:
   a) CONTRACT: it covers any contract such as that of buying or selling. It excludes any entitlement without a contract such as that of booty or inheritance.
   b) AFFIRMATION OF ENTITLEMENT: it excludes whatever items for which no entitlements can be claimed, such as selling of a stolen property, usury or the like.
   c) IN COMMON: it excludes the purchase of a person one thing for his/her own self, and the like.

In general, it has been noticed that the definition of company at the Shafi’i School is of generic and comprehensive nature that applies to all companies (Abu Zeid, Rushdi Shehateh, 2008).

The *Hanbali* school, by contrast, defined company as “sharing of some entitlement or conduct” (Ibn Qudamah, 1419 AH). This definition has been mentioned before. It is well known at the Hanbali jurists. Sharing of an entitlement happens in such a case when two people pool money together for the price for a slave. The same case applies to someone who utters an abusive word that covers both of them; the abuser will be punished for one instance, as if the abuser has abused only one of them. Similarly, a common conduct, as previously stated, will cover all contract companies.

It is clear from the linguistic definition that the word ‘company’ refers to both mixing of parties and contract. Both of these connotations are recognized in the legal meaning of company. A company cannot exist without a grouping or a contract (Al-Musa and Mohammed Bin Ibrahim, 1999).

Further, it has become clear from the above that the legal definition is more comprehensive than the linguistic one. A company comes into being, linguistically, by the grouping of people, whereas legally, the company comes into being as a result of a human action; it also happens without a human action, such as in the cases of inherited property, or the like, including blood money, or right-of-first refusal (Abu Zeid, Rushdi Shehateh, 2008).

In brief, the linguistic meaning remained prominent in the legal one. The company in both Islamic jurisprudence and man-made law does not materialize except with a contract and a pooling of funds. In brief, the contract is the driver of such a pooling.

Accordingly, the company in Islamic jurisprudence is the contract concluded between two or more people to share funds or efforts with the purpose of achieving profit (Al Nabhani and Taqi al-Deen, 1990). Alternatively, the company is a unification of the conduct that resulted from the contract. This company may be financial, or based on physical activity; it might exist based on the trust among partners in dealing. The company may be based on the desire and willingness of the

partners. The company might as well be involuntarily established such as in the case of inheritance, gift, will or the like.

2.2 Legality of a Company

The legality of a company in Islamic jurisprudence is supported by the Quran, the Prophetic tradition, consensus of jurists, and reasonable context.

2.2.1 Firstly: The Quran

Jurists based their evidence on certain Qura'nic verses, such as:

a) "*if the man or the woman whose inheritance in question has left neither ascendants nor descendants but has left a brother or a sister, each one of the two gets a sixth; but if more than two, they share in a third*"[2].

Evidence: God made the inheritance common between maternal siblings if they were two or more; that's where the concept of company comes from. This is also an evidence of the enforced property company.

b) "*Out of the booty you may acquire, a fifth share is assigned to Allah, and to the Messenger, and to near relatives, orphans, the needy, and the wayfarer*" (Ibn al-Hammam, Sharh Fath Al-Qadeer, 1316 AH).

Evidence: God considered the gains from war common between the winners (Al-Mutei'i, Mohammed Najib, 1990). God made one fifth of that gain common between certain category, and the rest common between victors.

c) "*Alms are for the poor, the needy, alms administrators, new Muslims, setting slaves free, for the sake of Allah, and for the wayfarer an obligation [imposed] by Allah and Allah is knowing and Wise*"[3].

Evidence: God made the alms common between eight categories of people.

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[2] Surat Al-Nisa: Verse 12.

[3] Surat Al-Tawbah: verse 60.

d) "They said your Lord knows better how long you have stayed. Send one of you with your banknotes to fetch some good food from the city**"**.[4]

Evidence: Ibn Khweiz Mindad posits "this verse implied the validity of company, as the banknotes used to belong to all of them. The verse also implies the mixing of people and eating together, even though some of them may eat more than others" (Al-Qurtubi, 1387 AH).

Al-Jassas also confirmed "this verse shows the validity of mixing the money together, buying food with that money and sharing that food, even though some people have tendency to consume more food than others. That is common among people and is a typical practice when traveling in a group" (Al-Jasas, 1405).

e) *"Many partners do wrong to each other, except a very few of those who believed and did good deeds. Dawood was certain that we tested him; he prostrated on his face and repented to God"*[5]*.*

'Al-khltaa' in the verse refers to partners (Ibn al-Hammam and *Shareh Fateh Al-Qadeer*, 1990). Evidence: this refers to the existence of company, in reality, since old times. This text, though talking about Prophet Dawood's law, most jurists, who believe the religious laws of previous Prophets apply to today's Muslims, unless a specific new text has abrogated that, have taken this verse as a proof for the validity of company, so long as nothing has overridden it.

f) **"***Allah sets forth the parable of a man belonging to many partners at variance with each other, and a man belonging entirely to one master: are those two equal in comparison? Praise be to Allah, but most of them has no knowledge*[6]**.**

Evidence: this verse shows the validity of the company sharing the ownership of a slave; the Quran did not object to that.

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[4] Surat Al-Kahf:Verse 19

[5] Surat Saad: Verse 24

[6] Surat Al-Tawbah: verse 60

g) **"***Allah Most High explained (He does propound to you a similitude from your own life : Do you have partners among these whom your right hands possess, to share as equals in the wealth We have bestowed on you? Do you fear them as you fear each other? Thus do We explain the signs in detail to those who understand*[7]*".*

Evidence: This verse has included a parable God has set forth to the ungrateful ones who associate others in devotion to God. He asks whether they like to have their slaves share their property as equal partners (Ibn Kathir, 1999).

h) **"***Their bearings on this life and the Hereafter. They ask you concerning orphans. Say "Do what is in their interest; if they mix their affairs with your, they are like brothers. Allah knows the man who means mischief from the man who means good. If Allah had wished, He could have put you into difficulties: He is indeed the Exalted in Power and the Wise"* [8]

Evidence: The declaration of God "do what is in their interest" implies the validity of conducting the funds of the orphans in a way that would benefit them. This may include investing their funds in as a Mudarabah or Musharakah. As this sort of conduct is valid in the property of orphans, and even more so in the property of others.

The above verses in totality show the validity of company in general.

2.2.2 Secondly: The Prophetic Tradition

The Prophetic tradition also confirmed the validity of the company. This position has been established through the wordings, actions and the acknowledgement of the Prophet (peace and blessings be upon him).

Many Prophetic traditions confirm the legality of company. Among these are the following:

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[7] Surat Al-Roum: Verse 28.

[8] Surat Al-Baqarah: Verse 220.

a) The Divine tradition where Abu-*Hurrayrah* reported the Prophet as saying "Allah says 'I am the third of the two partners so long as none betray the other; if that happens I get out" (Abu-Dawood, Suleiman Bin A., 2003)

That means God will take care of the partners, help them, and bless their trade. This Prophetic tradition indicates that God will bless the property of partners so long as they are just loyal towards each other. This tradition emphasizes the importance of loyalty, and warns against any cheating between partners.

Ali Al-Khafif explained "This Prophetic tradition shows that the company is legal; it also shows that the company is recommended whenever needed. The company was made a means for whatever help and success Allah grants to partners, as it is the Lord who is with them" (Al-Khafif A., 1962).

b) The Prophet (peace and blessings be upon him) was reported as saying "The hand of Allah is with the two partners, so long as none cheats the other; once that happens, Allah lifts His hand off them (Al-Darqutni, Ali Ben O., 1996).

This Prophetic tradition indicates the permissibility of company; it also shows its importance, as a source of blessing and growth, because the hand of God is with partners.

As for the confirming actions of the Prophet, some jurists quoted the tradition of Al-Saeb bin Abi Al-Saeb who said to the Prophet "You have been my partner in the period before Islam; you have been the best partner. You never flattered me or quarrel with me".
By saying in Arabic 'la tudarini wa la tumarini', the reference was made to the fact that he was neither quarreling nor lenient with him (Al-Shawkaani, Mohammed bin Ali M., 2000).
In another narration, he was the partner of the Prophet (peace and blessings be upon him) at the start of Islam; at the *Fath Battle*, he welcomed the Prophet saying

"Welcome my brother and partner. You have never flattered me or quarreled with me". (Al-Darqutni, Ali Ben O., 1996).

This tradition shows the validity of company, as the Prophet (peace and blessings be upon him) had practiced it. He used to be a partner with Al-Saeb at the beginning of Islam. If such a partnership was not legal, the Prophet (peace and blessings be upon him) would have never done it. He is the best role model for us.

As for the Prophetic acknowledgement, several traditions shows that the Prophet (peace and blessings be upon him) has acknowledged the company. Most prominent acknowledgements include the following:

a) Abu Obaidah reported Abdu-Allah bin Masood as saying "I made an agreement with Ammar and Saad in order share whatever gains we get in the Battle of Badr. Saad was able to capture two prisoners of war; me and Ammar were able to get none"[9]. Evidence: The Prophet (peace and blessings be upon him) has acknowledged such a company they made. This tradition is evidence for the validity of the human-body company and ownership of non-restricted items, as per Al-Shawkani [10].

b) Abi Al-Minhal reported that Zayd bin Arqam and Al-Baraa' bin Aazib were partners. They bought some silver on a cash basis, and some on credit. The Prophet (peace and blessings be upon him) knew about that; so he instructed them to "keep whatever was on cash basis, and return whatever was on the basis of credit"[11]. The evidence here is that the Prophet (peace and blessings be upon him) has acknowledged the company of Zayd and Al-Baraa', and he explained what was legal and what was illegal.

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[9] Sunan Abi Dawud, Sales book, Bab fi Al-Sharikeh Ala Ghayr Ra's Al-Mal; Hadith No. 3388, page: 376,Al Albani said: weak

[10] Al-Shawkaani, Nayl Al-Awtaar, vol. 3, page: 655

[11] Al-Shawkaani, Nayl Al-Awtaar, vol. 3, page: 654,Al-Bukhari,Mohammed Bin Ismail Bin Ibrahim Bin al-Mugheirah,Sahih Al-Bukhari,Beirut,Al-Resalah Establishment,1st edition,1429 AH-2008AD, book of Partnership, Volume of Partnership in Gold ,Silver and Similar Things,Hadith No.2497-2498,page: 442 under the words "Take what was from hand to hand and leave what was on credit".

c) Ruwaifi' bin Thabit said "At the time of the Prophet (peace and blessings be upon him) used to take the lean camel of his brother to the battle in return for half of the spoils to be gained. Some of us would gain spears and other would gain arrows"[12]. The evidence here is for the agreement of the Prophet to their action of sharing spoils.

d) Hakim bin Hizam, the companion of the Prophet (peace and blessings be upon him), whenever he lent money to someone, he used to require that the borrower not buy any living thing as property with that money, or ship it in the sea, or download it at a water valley, in order that the borrower does not guarantee return of the principal"[13].

For evidence, this tradition gives grounds to the company considering that Hakim bin Hizam, one of the companions of the Prophet (peace and blessings be upon him), knew that the Prophet (peace and blessings be upon him) has agreed to a similar condition stipulated by Al-Abbas, the uncle of the Prophet (peace and blessings be upon him) (Al-Musa, 1995).

All the above traditions, whether by word, action, or agreement, indicate the validity of companies.

2.2.3 Thirdly: Consensus

As for consensus, one can easily note that there has been plenty of companies among Muslims in all aspects of trade since early generations to the present time.No one has objected to that.

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[12] Abu Dawud, Sunan Abi Dawud, book of purification, Volume of what is forbidden in purification, Hadith No. 36, page: 8. Al-Shawkani commented the Arabic wording "'Al-Nadhwu' is the slim camel"; 'Nasl' refers to the blade of the arrow; 'Rish' is the topping of the arrow; 'Qazh' is an arrow without any topping or blade. Al-Shawkani,Nayl Al-Awtaar,vol. 3,page: 655. Al-Albani said:"its isnad is weak"

[13] Al-Shawkaani, Nayl Al-Awtaar, vol. 3,page: 656. Al-Shawkani reported that this hadith was related by Tabarani and Bayhaqi; Ibn Hajar supported the chain of narration of this hadith. Al-albaani said: its chain of relation is valid according to the conditions of Bukhari and Muslim books of Prophetic Traditions.

The author of *Fathul-Qadeer* observed “no doubt that the validity of company in practice is more prominent than in Prophetic tradition. Companies have been in practices since the time of the Prophet (peace and blessings be upon him) to date. It does not need a specific Prophetic tradition to prove its legality”.
Further, Al-Azhari explained in his book, Al-Fawakeh Al-Dawani, “Companies were approved by consensus” (Al-Azhari, Ahmed G., 1374 AH). Furthermore, Mohammad Al-Mutai’i confirmed that “In terms of consensus, none of the scholars disagreed on its legality”.

In Al-Mughni, the author provided that “Muslims unanimously agreed on the lawfulness of companies in general; they have disagreed however, on certain types of companies” (Ibn Qudamah).

2.2.4 Fourthly: Reasonable Context

Company is a transaction that carries no legal prohibition against it. Things that have no legal prohibitions attached to them must be legally permissible. A company is a sort of cooperation required by people. Islam has urged cooperation between people in order to achieve welfare and piety; God ordered “Cooperate together to do good things and achieve piety**.”**[14].

On the premises of cooperating for the achievement of welfare and piety, Islam, the religion of no imposed hardships, has acknowledged dealings through company. Prohibition of companies would bring hardships to people. Allah Most High declares *“He did not impose any hardship on you through religion”*[15].

Islam has legalized company as a way of generating legal profit. The Prophet (peace and blessings be upon him) established that “Believers are like a constructed building; they hold each other”[16].The Prophet (peace and blessings be

[14] Surat Al-Mae’dah: Verse 2.

[15] Surat Al-Hajj: verse 78.

[16] Al-Bukhari, Sahih Al-Bukhari, al-Adab book,volume of Believers’ Cooperation, Hadith No.6026-page: 1055.

upon him) also confirmed that "The hand of Allah is with the group"[17]. From these two Prophetic traditions, we see that the Prophet (peace and blessings be upon him) used to urge Muslims to cooperate together and work in group, as this would contribute to the progress and development of life.

One side of the cooperation aspects is partnering to do some commercial or industrial activities. Companies can take up major projects and building enterprises which individuals cannot afford to take. Only when individual's team together can they take on capital projects to fruition (Al-Musa, 1995).

The wisdom behind the lawfulness of companies is self-explanatory. In simple terms, there is a need for them. Companies represent noticeable economic activity in life and business. Major commercial and industrial projects depend on companies due to the close cooperation and teamwork among their members; Companies have synergistic effect necessary to recognize mega projects, as they pool together various experiences, common vision, and management, that no one can get as individuals (Abu Zeid, 1999).

In brief, a company enables people to work together for the investment and growth of their funds. In addition, companies enable the establishment of major commercial, industrial and agricultural projects that individuals cannot achieve on their own.

2.3 Categories of Companies

Jurists held two schools as to the divisions of companies:
The first school held that companies are divided into two categories: the ownership company and the contract company.

The second school held that companies are divided into three categories: the communal company, the ownership company and the contract company.

[17] Al-Tirmidhi, Abu Issa Mohammed Bin Issa Bin Sorah, Jami` Al-Tirmidhi, Jordan,Bayt Al-Afkar Al-Dawleyah, 1st edition, 1999, Al-Fetan Book, Bab .Ma Ja' Fi Luzoum Al-Jama'ah, Hadith No.2166, Page: 360.

In agreement with the above, Dr. Abdul Aziz al-Khayyat posited "some jurists considered the common engagement of people as a sort of company, called the communal company". I tend to consider the communal company as a third type of companies, as it was clearly declared as such in our traditions" (Al-Khayat, 2001).

Legislators considered several evidences in considering the communal company as a type of company.

a) Abu Khadash related that some of the Companions of the Prophet (peace and blessings be upon him) reported the Prophet (peace and blessings be upon him) as saying "People are common owners of three items: Water, grass, and fire"[18]
b) Abu Hurairah reported the Prophet (peace and blessings be upon him) as saying "Do not deny people access to water, fire and grass"[19].
c) Aa'esha (may Allah be pleased with her) asked the Prophet (peace and blessings be upon him) about the thing that cannot be withheld from others, and the Prophet (peace and blessings be upon him) confirmed "water, salt and fire"[20].

Legislators, however, did not consider the communal company as a type of company, as it did not meet the requirements of a company. They held that a company is brought into being by sharing properties, and funds, and this is not the case for a communal company.

The author assumes the opinion that communal companies are one type of company, especially with the presence of strong and clear evidence in favor of that. A communal company, although it does not have any sharing of properties or funds, it holds the concept of acquisition and ownership. Whoever gets something, he can claim right to it before anyone else; it becomes his alone; he will be able to assign it

[18] Abu Dawood, Sunan Abi Dawoud, Al-Ejarah Book, Bab Fi Mane' Al-Maa', Hadith No.3477,page: 387, Al-San'ani, Subul Al-Islam Shareh Bulough
[19] Ibn Majah,Mohammed Bin Yazeed Al-Qazweeni,Sunan Ibn Majah,Jordan,Bayt Al-Afkar Al-Dawleyeh,1st edition,1999 AD, Al-Ruhoun Book,Bab Al-Muslimoun
[20] Ibn Majah,Sunan Ibn Majah, Al-Ruhoun Book,Bab Al-Muslimoun Shuraka' Fi Thalath,Hadith No.2474,page: 267.

to others by all means of assignment (Al-Musa, S., 2001), provided that he does not bring harm to others.
Below are details of the types of companies:

2.3.1 The Communal Company

By definition, the communal company is the sharing by the public of the eligibility to ownership, by taking or securing, of communal things that does not belong to a specific person such as water (Majalet Al-Ahkam Al-Adleyeh, 1998).

The word 'public' refer to all people, while the word 'eligibility to ownership' refers to their common right of the ownership right which empowers its user to initiate usage of all aspects of the owned item, such as consumption and benefit (Abu Zeid, 2005).

The legality of the communal company is clear in the following Quranic traditions:

a) **"***He is the One who created everything on earth for you"*[21]
b) *"He employed for you all that in Heavens and Earth"* [22]

The above two Qura'nic verses clearly indicate that all people share the right of making benefit from the goodness of the earth and heavens; everyone has the right to take benefits from this universe in accordance to his efforts and diligence, provided that does not bring harm to others.

2.3.1.1 Types of Communal Items

Communal companies cover all common things that people can share, as the legislator made it permissible for them to use and consume. Such things include the following:

a) Water: All types of waters so long as no one claims ownership of them. If someone however, preceded another to some water he can

[21] Surat Al-Baqarah:verse 29.

[22] Surat Al-Jatheyah:Verse 13.

claim ownership. The Prophet (peace and blessings be upon him) said “whoever preceded others to some water, it is his”[23]

b) Grass: whether fresh or dry, so long as it grows in a land that is not owned by anyone. Jurists are at variance. Some posit that it is common for any one so long as no specific person has contributed to its growth. Others posit that it is not common as it is owned through the ownership of the land (Al-Zarqa’, 1384 AH).

c) Fire: Fire refers to charcoal wood which people chop from trees in order to set fire, derive warmth and light. This also includes energy such as petrol and gas.

d) Metals: This covers metals that are abundant in nature such as salt, sapphire, and others, unless already secured by someone (Al-Khafif, 2003).

e) Public Utilities: This covers areas where individuals are prohibited to own, such as streets, and mosques [(2)].

2.3.1.2 Lawfulness of Communal Company

If someone secured some of the communal things in a lawful way, this acquisition becomes his lawful indisputable right; and no one can force him to drop it. Accordingly, any one of the public has the right to derive benefit from the communal properties to which no man had previously rightfully claimed. Benefit should be common to all people. No individual can claim exclusive ownership; once he secures that property, it becomes his own, where only he can derive benefit from the secured property so long as no harm is done to others (Al-Khafif, 2003).

The author posits that no one can secure any of the communal properties strictly for his own benefit. They should remain common among the public. Such items are part of the necessary needs of man, and hence they are made available to the common beneficiary. No one can claim exclusivity to them, or deny people access

[23] Abu Dawoud, Sunan Abi Dawoud , Al-Ekhraj Book, Bab Eqta’ Al-Ardheyeen,Hadith No.3071,page: 348.

to them. The Prophet (peace and blessings be upon him) had once assigned the metal salt to *Abyadh bin Hammal*; when people told the Prophet (peace and blessings be upon him) that this salt is so abundant like water, the Prophet (peace and blessings be upon him) canceled that assignment(4).

2.4 The Property Company

This is the second part of the recognized companies

The property company comes into existence when two or more people own a specific property, following an ownership means such as acquisition, gifting, or acceptance of a will (Ibn Abdeen, Mohammed A., 1386 AH).

Following are the legal evidences supporting the property company:

a) Allah Most High directs "Allah thus direct you as regards your children's inheritance: to the male, a portion equal to that of two females: if only daughters, two or more, their share is two thirds of the inheritance; if only one, her share is a half"[24]

The inheritance is common among children in compliance with this verse.

b) Allah Most High declares that "Alms are for the poor and the needy, and those employed to administer the funds; for those whose hearts have been recently reconciled to the Truth; for those in bondage and in debt; in the cause of Allah; and for the wayfarer: Thus is it ordained by Allah, and Allah is All-knowing and Wise"[25]

Allah Most High made the Zakat common among the above eight categories.

c) Jaber reported the Prophet (peace and blessings be upon him) as saying "whoever has a partner in a house or a palm-tree farm cannot sell his share

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(4) The hadith of Abyadh bin Hammal, narrated by the authors of the four Prophetic Traditions books [Sunan], and Al-shaafa'i; it was validated by Ibn Hayyan; Ibn Qattaan however weakened that hadith. 'Alma' al-'add' refers to continuously flowing water. Ibn Hajar al-Asqalani,Abu al-Fadhil Ahmad Bin Mohammed Bin Ahmad,Al-Talkhis Al-Habeer Fi Takhreej Ahadethi Al-Rafe'e Al-Kabeer,Beirut,Dar Al-Kutub Al-Elmeyah,1st edition,1419 AH,1989AD,vol.3,page: 153.

24 Surat Al-Nisa':verse 11.

25 Surat Al-Tawbah: Verse 60.

until he gives the option of buying to his partner" (Muslim, Abu al-Hussein, 1430 AH).

This tradition shows the existence of company by way of ownership of real estate or farms.

2.4.1 Divisions of the Property Company

Jurists were at variance as to the divisions of the property company as follows:

The *Hanafi* jurists believed the property company should be divided into two types:

a) Option Company: An option company is one that takes place when partners mix their properties at their will, make a gift, or accept a will.
b) Enforced Company: An enforced company is one that ensues without the option of partners, as in case of inheritance, where the company is affirmed for the heirs without any option on their part (Al-Kasani, 1421).

The *Maliki* jurists, however, believed that the property company should be divided into three types (Al-Sawi, Ahmad Bin Mohammed, 1480 AH):

a) Inheritance Company: This is an entity among the heirs of an inherited property.
b) Spoils Company: This happens when an army gets spoils after a battle.
c) Buyers' Company: This type of company takes place when more than one person agree to own one house or buy it.

The Shafi'i jurists have divided the property company into six categories as follows:

a) A company in both benefits and properties: this happens when two or more people share a land or a livestock that they own in common or by way of inheritance, sale, or gift.
b) A company in properties not benefits: This happens when someone bequeath the benefit of a land or house for someone else; when he dies, only the ownership of that specific property is passed to the heirs, not the benefits.
c) Company in benefits not properties: This takes place when a group of people rent a house in order to benefit by living in it.

d) Company in common benefits: This takes place when a deceased leaves behind a cattle dog, or farming. All the heirs will derive benefit from the guarding service of that dog.
e) Company in bodily rights: This happens when two or more people inherit the right for the prescribed punishment of a defamation or retribution.
f) Company in property rights: This happens when a group of people inherit the right-of-first-refusal, the right of rejection for defect, the right of conditional selection, lien rights, or roadways utilities.

The Hanbali jurists, by contrast, divided the property company into three categories (Mustafa Al-Sayouti, 1983):

a) Company in property and benefit: This form of company comes into being when a group of people receive the ownership of a house by way of inheritance, legacy, or gift. All of them share the ownership of the house as well as the associated benefit.
b) Company in property not benefit: This form of companies takes place when a group of people receive the ownership of a cultivated field by way of inheritance, legacy, or gift, when the testator bequeaths the benefit of that field to others. All heirs will share the ownership, without sharing the benefit.
c) Company in benefit not property: This form of companies takes place when a bequest is made for two people or more to benefit from a house. All people covered in that bequeath can share the benefit, not the ownership of the house.

2.4.2 Property Company in Islamic Law

If a property company is formed in an identifiable property, such as in the case of two or more people sharing the ownership of a house, land or a cow, no partner can conduct in the share of other partners before taking due permission. Each individual partner is like an outsider that has no control over the share of other partners, while the ownership is common among partners.

A partner in the property company may sell his share to other partners as he has jurisprudence over his property. He may also sell the same to people other than

partners without taking permission, unless the property or fund were intentionally mixed together by partners. Each pit is owned exclusively owned by one, while the other has no part in it (Al-Musali, 1999).

The property company can be in a debt, such as the case when two partners share some funds on credit, where more than one partner sells something they own to some other party on credit basis. The partners are both liable for that sort of debt. When one partner receives his share of the debt, the other partner has the right to share with him half of whatever the first partner received. That sort of debt is established for a unified purpose (Abu Zeid, 1995).

2.5 The Contract Company

This is the third category of companies in Islamic jurisprudence. In unqualified designation of a company by Islamic jurists, the reference is made to the contract company (Al-Khayat, 1998).

2.5.1 Contract Company in Islamic Law

Jurists of Islamic schools provided several definitions for the contract company as follows:

a) The *Hanafi* school: This school defined the contract company as “a contract of sharing between partners in both the principal and the profit” (Zadah and Abdurrahman Bin Mohammed, 1316 AH).
b) The Maliki School: The Maliki provided several definitions of the contract company, the most important of which is “permission by each partner to the other conduct on each other’s behalf” (Al-Hattab, 2001). Al-Dardeer, though, defined it as “a contract between the owners of two or more funds for a common business between them, while profit is distributed between them according to established norms” (Al-Sawi, 2003).
c) The Shafi’i School: The Shafi’i jurists provided several definitions, the most important of which is “a contract that establishes a common right between two or more people” (Al-Ramli, 2004)

d) The Hanbali School: Ibn Qudamah provided that the contract company is “a meeting for conduction” (Ibn Qudamah, 1374 AH).

Accordingly, a contract company can be comprehensively and concisely defined as “a contract between two or more people to share capital and profit, or to share profit without sharing capital, or to share commodities without having any capital” (Ibn Qudamah, 1374 AH).

This definition illustrates a comprehensive meaning of company and its types. This definition is self-explanatory.

2.5.2 Categorization of Contract Company

Jurists held different categories depending on their rules of inference and approved principles. Below is a brief of the jurists’ opinions:

First: *Hanafi* School:

The Hanafi jurists held two differing opinions as to the contact company:

A. The first opinion held that the contract company should be divided into four categories:
    1. Negotiation Company (*Mufawadhah)*: This sort of companies is held between people on basis of equality among them in terms of conduct, capital, profit or loss.
    2. Lease Company [*Anan*]: This sort of companies is held either in full equality or with difference between partners in terms of capital and profit.
    3. Crafting Company [*Sanae'*]: This sort of company is held between partners who contribute physically to their craft. Profit is shared according to their agreement. This sort of company is called by its nature “the bodily company”, or “the crafting company”, “trading company” or “professional company”.
    4. Prestige Company [*Wojooh*]: This sort of companies take place when two or more people, who have no money, agree to buy on credit and then sell and divide profit between them. It is also called the bankrupt company.

B. The contract company is divided into three categories as follows (Al-zayla'I, 1424 AH):
   1. Capital Company: This is based on capital.
   2. Works Company: based on bodily works of the partners.
   3. Prestige Company: based on the esteem and trust partners have among people, without contributing any money or profession of their own. However, they have experience and ability to conduct business.

Every category of the above three types can be divided into leash company [*inan*], or negation company [*Mufawadah*]. Accordingly, the contract company, for those who assume that position, is divided into six categories.

Second: *Maliki* School:

The contract company is divided into seven categories according to the Maliki jurists, as follows (Al-Sawi, 2001):

a) Leash Company: where two or more people are joined, while none can conduct anything without the permission of the other. Everyone takes the other by the leash and can stop each other from any conduct whenever desired.
b) Negotiation Company: Reference is made to the actual sharing between two or more people of capital, provided that each partner gives the other the liberty to trade, lease, and rent, whether in the presence or absence of the other partner.
c) Crafting Company: where two or more craftsmen work together, and divide their wages in proportion to their efforts. Partners in this case should enjoy the same craftsmanship. This sort of company is analogical to the crafting company [*Sanaa'*] of the Hanafi school, and the Bodily-efforts company at the Hanbali school.
d) Credit Company: where two people agree to buy something together on credit and then sell it and divide the profit between them. This is comparable to the prestige company of the Hanafi and Hanbali schools.

e) Enforcement Company [*jabr*]: where someone buys a commodity in the presence of someone who usually trade in that commodity, and did not advise that trader that he wants the commodity for his own use, and the trader kept silent. He shall have the right to share the commodity with the one who bought it, and force the buyer to make a company with the trader.
f) Prestige Company: This sort of company takes place when a man of prestige works with another unknown person who has no prestige, provided that the man of prestige sells the commodity of the unknown party. The esteem and trust people hold for the prestigious man make them buy commodities from him. The prestigious man gets part of the profit. This sort of company is unlawful for the Maliki jurists, as it is based on the illusion created in the minds of people. If something wrong happens, the prestigious man will get a wage comparable to similar others; the buyer who got the commodity from the prestigious man will have the option either to return the commodity or keep it; if the commodity is no longer available, he will be liable to pay the least of either the price or the value.
g) Mudarabah Company: This is an agreement to share the profit, where one party contributes capital, while the other contributes effort. Jurists have consensus on the lawfulness of such type of company.

Third: Shafi'i School:

The *Shafi'i* jurists (Al-Shafi'i, 1939 AH) posit that the two permissible types of the contract company are the leash and the *Mudarabah* companies. Other types of companies, as categorized by other schools, are not lawful.

Fourth: *Hanbali* School**:**

The Hanbali jurists (Ibn Qudamah, 1374 AH) believe that the contract company is divided into five categories: the leash company, the negotiation company, the prestige company, and the Mudarabah Company. They imposed a common restriction on these categories: they stipulated the permissibility to conduct, as that sort of company is basically a contract to conduct in the capital. Hence, the

company will be invalid if permissibility was not given to conduct the buy and sale transactions.

2.5.3 Preferred Categorization

The contract company is divided into five categories:

First- The lease company: when two people share a capital, contribute physical efforts and share profit. This sort of company is lawful in accordance to the Prophetic tradition and the consensus of the companions of the Prophet (peace and blessings be upon him). It has been in practice since the days of the Prophet (peace and blessings be upon him) and his companions[26].

Second- The Bodily-Efforts Company: when two or more people share efforts, rather than capital. This sort of company is lawful based on the tradition narrated by Abu Obadiah, where Abdul Allah bin Masood said "I made a sharing agreement with Ammar and Saad to share any gain we get on the day of *Badr*. Saad was able to capture two prisoners of war, while I was not able to get any" [27].

Third-The Prestige Company: where two people share the funds of others; that is when someone contributes his funds to two or more people as *Mudarabah*, a contribution to get profit. The two partners share the profit that was generated using the funds of a third. This sort of company is lawful based on the fact that if the two partners shared the capital of a third, it will be considered like a *Mudarabah* company, which is established in the *Sunnah* and by consensus. On the other hand, if the two partners shared the property they take from other

[26] The meaning of Leash company [inan] is agreed between the Hanafi, Shafi'i, Zaydi's, Ja'fari, Zahiryah and Hanbali. According to one version of their statement, the company does not arise except following one's conduct in the capital through buying. According to the Maliki, as well as one of the weighted opinions of the Hanbalis, The fund company comes into valid existence once the contract between partners is concluded (Al-Khafif, 2003).

[27] Abu Dawoud,Sunan Abu Dawud, Sales Book; Bab fi Al-Sharikah Ala Ghayr Ra's al-Mal; Hadith No.:3388, page: 376. Al- Albani said: weak.

people, that is what they buy using their prestige and credibility, it will be like the bodily efforts company which is established in the Prophetic traditions.

Fourth-The *Mudarabah* Company: where both capital and bodily-efforts are combined together: capital from one partner, and effort from the other. Sharing is for profits only, while loss is carried only by the contributor of the funds. This sort of company is lawful. Hakim bin Hizam, the companion of the Prophet (peace and blessings be upon him) used to make a condition whenever he lends money to someone for trade. He used to require the borrower not to buy any living thing for property with that money, or ship it in the sea, or download it at a water valley, in order for the borrower not to guarantee the principal[28].

Fifth-**The negotiation company**: where two people share all types of the above mentioned companies. An example of that would be when one person provides funds to two engineers, for trade; the latter also provide funds for trade, in order to construct a building for the purpose of later selling and trading. They agreed to employ more capital than that on hand, and started to take commodities from other traders on credit.

The contribution of efforts by the two engineers is a Bodily-Efforts Company. The contribution of their craftsmanship and the capital make it a leash company. Taking funds from others for trade is a Mudarabah company. Sharing the commodity they buy on credit is a prestige company(2). This company is lawful, as the Prophet (peace and blessings be upon him) said “Negotiation is a source of bless”.

2.6 Company in Man-made Law

The law does not mention any definition of the company in its general meaning. The law takes into consideration only companies that are based on a contract. By this,

[28] Al-Shawkaani, Nayl Al-Awtaar, vol. 3, p.656: Al-Shawkani reported that this hadith was related by Tabarani and Bayhaqi; Ibn Hajar supported the chain of narration of this hadith. Al-albaani said: its chain of narration is valid according to the conditions of Bukhari and Muslim books of Prophetic Traditions.

the lawmakers tend to follow the French law, which does not mention any definition of the company in its generic meaning.

However, there are different definitions that together would define the meaning of a company. Consider the following:

First: The Roman law defined the company as “a contract by which two or more people abide. These people are called partners. They commit to contribute certain funds in order to carry out lawful transactions and share resulting profits (Maskouni, 1971).

Second: The French law define the company, in Article 1832 as “a contract between two or more people sharing the ownership of something between them and share in the resulting profit”.

Third: The Egyptian civil law defined the company in Article 419/511 as “a contract between two or more people by which the contractors commit themselves to provide some capital in order to carry out a certain project and then divide the resulting profit among them[29]. The French law is considered the reference from which civil laws in Arab countries were based. That’s why we find the above second and third definitions to be so similar.

Fourth: The Article 505 of the Civil Law defined the company as “a contract by which two or more people commit in order to share funds or efforts in an enterprise, and divided the resulting profit or loss (Younus, Ali Hussein, 1988).

Accordingly, a company is a contract that should meet the general requirements of a contract, that is, mutual acceptance, place, and objective. Other special

[29] Al-Haafiz Al-Zaylaee commented that this hadith is strange and baseless. AlZaylaee then tried to find some basis for this hadith; so he reported that I Ibn Maajah has related this hadith in his book of Sunan by way of Sohaib. He reported the Prophet (peace and blessings be upon him) as saying "Blessing is in three: Sale on credit, borrowing, and mixing of wheat and barley for home not for sale"; Ibn Majah reported the word “bargain” instead of ‘borrowing’. Al-Zaylaee Jamal al-Din Abu Muhammad Abdullah bin Yusuf bin Muhammad, Nosb Al-Rayah Li-Ahadith Al-Hidayah, together with Hashiyat Boghyat Al-Almaee Fi Takhrij Al-Zaylaee, Beirut, Dar Al-Qiblah for Islamic culture, 1st Edition, 1418H., 1997, vol. 3, p.: 475.

requisites should be available, that is, the contract should be done by two or more people; each one should contribute funds or efforts, and that each of them should share the resulting profit or loss. Another requirement can be added, that is, they all should have the intention to share, or the desire of the shareholders to cooperate in order to achieve the purpose of the company. The core concept behind forming a company is the cooperation of several people and sharing the results of that cooperation. Such mutual efforts results in a synergistic effect that cannot be achieved individually for carrying out mega projects (Taha and Mustafa Kemal, 2005).

The Origin of Companies in Man-made laws:

In reality, the origin of companies in man-made laws can be attributed to three branches (Mahmasani, S., 1967):

First: Latin Branch: At the top of that branch is the French law which was very influential in Europe, South America and the East.

The civil law of Napoleon is still in effect to this day, except for few changes that have been made to fit new circumstances. It contains 2,280 articles.

The French laws, especially the civil law, played a major role in establishing legal codes in the European countries. Accordingly, we find the Belgian law almost the same as the French law. Other countries, however, made more changes in accordance with their circumstances.

Second: Anglo-Saxon Branch: This covers all the laws and regulations that have not been written down. Countries such as Britain, and US did not write down their laws; instead they kept their unwritten constitution based on norms, habits and precedents, what is known as public norms.

For example, personal companies are governed by English habits, save for the Will law of 1508. For the capital company, several laws were issued, the most important of which was the 1907 General Act. A new law was introduced in 1930, and a recent modification was issued on 1948.

The main incentive for the British not to write down their law was their keen desire to maintain their famous British habits. Further, the British Empire contained lots of factors and religions, which entails more laws and variant habits.

Third) German Branch: There are considerable differences between the German, and French laws. The basic rules among the two were different, despite the fact that the Germans benefited a lot from the Napoleonic law. However this benefit did not affect the national identity of the German branch.

Germany issued its first commercial law in 1896. It was only put into effect in 1900. The second book of that law contained the companies' regulations. Arab laws sourced their company rules from the above references.

Arab rules that addressed companies were divided into civil and commercial, as follows:

First: For the civil laws, the most important of were:

a) The Egyptian Civil Law: It contained the general rules for companies in articles 505-537. For civil companies that took a commercial form were controlled basically by the civil law, and at the same time were subject to the general form-related rules of the commercial law.
b) The Iraqi Civil Law: It discussed companies in articles 626-683.
c) The Syrian Civil Law: It discussed companies in articles 473-505.
d) The Libyan Civil Law: It discussed companies in articles 494 – 536.
e) The Lebanese Law of Contracts and Obligations: It discussed companies in articles 823- 949.

Second: For the commercial laws, the most important were:

a) The Egyptian Commercial Law: It discussed the rules of the commercial companies in articles 19-65, most of which were taken from the French commercial law.
b) The Syrian Commercial Law No. 149 for the year 1949: It discussed companies in articles 55-337.
c) Company Laws in Saudi Arabia:

The commercial law in Saudi Arabia issued on 15 Muharram 1350, discussed the companies recognized in Islam, in articles 11-17. For other companies, the law referred them to the norms of merchants. A new royal decree was issued for the company code. This code had literally abolished all the previous rulings that do not agree with its provisions. The most prominent provision was that related to the commercial court of companies, as provided by Article 233.

d) The Egyptian Public Institutions Law, No. 32 for 1966.
e) The Lebanese Commercial Law No. 304 for 1942.
f) The Jordanian Commercial Law, No.12 for 1966, articles 9 and 20.
g) The Jordanian Companies Law, No.12 for 1964.

Companies are like individuals. For example they either assume commercial activities, where they are called commercial companies; or they may assume civil works, where they are called civil company.

It should be noted, first, that companies in man-made law have been divided into different types based on several grounds.

Divisions of Company According to General Concept (Nassif, E., 2006)**:**

The company in general may be divided into two categories, namely, Contract Company and Property Company.

First: Contract Company

The contract company refers to the legal concept of company, where partners voluntarily opt to engage in order to get profits by achieving a common purpose.

The company usually has s a legal personality, and is established by the free will of the partners. It has a fixed and constant term that is determined in the memorandum of association.

Second: The Property Company

Property Company, or semi-company, or common company, is a situation where the thing or right is common or belongs to several persons, as described by Article 824 (obligations and contracts) in the following text: "a legal entity results therefrom called “the property company, or a semi-company, which may be either voluntary or enforced”.

The property company, even established among several common partners, usually the establishment of that company is inevitable, such as the case when such a company is established as a result of a death where the deceased has a legacy to be handled under the inheritance law. In this case partners have no option to engage in that common legacy.

Despite that, the property company may rarely be established out of the voluntary action of partners, such as the case when they agree to buy something in common. In all cases, the property company or the common status is temporary, because any partner is entitled, at any time to request his share of that property. No partner can be forced to be kept engaged in that common ownership. Any partner can request to get his share.

However, the court may issue a temporary injunction to stop the division of shares temporarily in untoward circumstances. Similarly, partners can agree to keep that common sharing of property for a maximum period of five years. No consideration is given to any agreement above a 5-year term. The court may, during that term, stop that common sharing, in case of an emergency situation that may justify such an action.

It is worth noting that the contract company was distinct from the property company, or semi-company, or the common company. This distinction is clear especially in the following areas:

First) the contract reflects the will of the partners in establishing the company that is the company is optional for partners.

The property company, however, may be a result of a voluntary action; such is the case when one buys a share in a property that has not been subdivided. Engagement in Property Company may be compulsory, such as in the case of

the death of the testator, where the heirs become common owners of legacy without any option on their side.

Second) the contract company continues for the agreed term of the company, unless the company is immaturely dissolved for unexpected reasons. Partners are free to determine the term of the company.

On the contrary, partners may not agree to extend the term of the company for more than 5 years. Yet, they can agree to renew the agreement on maturity. This is due to the different perspectives the lawmakers have about Contract Company and Property Company. The lawmaker supports the first and lay down governing rules that ensure its sustainability and investment of its funds. However, the lawmaker views the latter as a contingency, and hence lays down rules that facilitate the removal of the same.

Third) the contract company acquires the legal identity as soon as it is established. By contrast, commercial companies do not have any established legality except after their publication. That entails such companies will have their own liability independent of that of partners. The implication of such independence is that partners will not have the right to disburse the funds. The company alone has that right. Similarly, the personal creditor of a partner may have no claims against the company similar to that of company creditors. On the other hand, in the property company every partner owns his shares in full, has full control over that company, can take its fruits, and use them in a way that does not harm the rights of others. Further, direct creditors of the partners can claim their debts from that company, because common property is represented by the ownership of its partners.

Fourth) in the capital company, the shareholder can remove himself from the company by selling his shares, while in the people company partners may not remove themselves by assigning shares except after the approval of all the partners, and only to the limit where assignment is permissible in the contract. In the property company, however, the partner is free to assign his share without depending on the consent of the other partners, even though assignment was not provided for in the underlying contract.

Fifth) the right of the partner in the contract company is a personal one that can be transferred even if the contributed share was real estate. The right of the partner will be an annual percentage of the profits, and in getting a part of the company's assets at liquidation. The assignment of a partner of his share in the company does not refer to assigning the funds that he has contributed but rather the personal right the partner has in the company. The assignment in the property company is related to parts of the common property within the shareholding limits of the partner. If the control over the disposition of property was related to one subdivided part of the common property, and that part was not under the control of the distributor of the funds at the time of disposition, the distributor's right will be transferred to him from the time of disposition, for the part under disposition through division. If the assignee was not aware that the assignor did not have the right to dispose of the property, he shall have the right to revoke the action of disposition.

Sixth) The Property company does not have any personal dimension, compared to the people's companies. Accordingly, such a company does not dissolve at the death of a partner, or issuance of an injunction freezing his assets, his insolvency or bankruptcy.

Seventh) The who gets a share in the property company is considered an owner since the time he was assigned that share, and that he does not have any ownership in any other share. This explains by the retroactive effect of the share assignment.

On the other hand, in the contract company, at the time of liquidation, assignment entails that shareholder receives the ownership of his part from the time of assignment, not earlier. That is because the assets were available until the time of the assignment of the ownership. It represents a legal person that is distinct from the people of the company. It is a legal entity distinct from the people of the company.

2.7 Goals of the Company Structure

The company according to its goal can be divided into two parts: the company and the society.

First: The Company

The company is a system that aims at generating profits for distribution among partners. This process requires the contribution of all partners in capital formation.

Second: The Society

The society is designed to achieve social purposes, implement an idea, or serve political or other humanitarian activities, in addition to a material purpose, other than that of generating profit.

The company is similar with the society in that both forms represent a sort of collective activity resulting from the contract concluded among members. Once constituted, the company or society will enjoy a status of a legal entity. Additionally, the rules of the society management are similar to those of public holding companies in particular.

However, due to the above major difference, it is worth noting that the law governing companies is different from that of societies. Following are the most important aspects of difference:

First) In terms of Foundation: the provisions of company establishment and announcement are different from the provisions of society establishment and announcement. There are no restrictions in companies, except for the fact that public holding companies are subject to a pre-approved government licensing procedures. Commercial companies should be announced by depositing their contract at a court, and registering them in the Commercial Register of companies. Societies, however, are announced directly before the government (Ministry of Interior) where all relevant information becomes public.

Second) In terms of Qualification: The company enjoys full legal status, like any other natural person. This status allows the company the right to acquire funds

and rights, and to conduct such acquisitions without limits. Societies, however, do not enjoy this full status. Unless they are part of public utilities, the qualification of societies is restricted to litigation and defense before courts, as well as acceptance of subscription fees from members in addition to fixed assets necessary to achieve the required purpose (Eid, A., 1969).

Third) In terms of Management: The management system and tax transactions are different between companies and societies.

Fourth) A withdrawing member of a society may take no funds with them, while a withdrawing partner of a company can take the value of his/her own shares.

Fifth) on dissolving a company, the assets are distributed among shareholders. On dissolving societies, however, the funds are distributed among the parties specified in the society bylaws, or to another society that carries a purpose closest to its own purpose.

Societies tend to achieve for a wider range of purposes. Such purposes may focus on humanitarian aspects purely for charity and public benefit. Among these societies are ambulance societies, the Red Cross, the Red Crescent, the animal welfare, and the world.

Societies may focus on religious purposes such as those of Quran memorization, or preaching. Further, societies may focus on economic purposes such as agricultural societies, or social purposes, such as the Women's Union. Societies can carry scientific, sports, technical or political purposes, as well. One society may aim at achieving two or more purposes at the same time.

Societies include various cooperatives and unions. The cooperative societies are based on the utilitarian purposes; the material benefits are for members; the recognition of such purposes is recognized by way of cooperation. There are varied forms of cooperation. Some cooperation appears in the form or consumption where members can have access to the cheapest price for consumer goods. There is

cooperation in production, where members can have access to means of production such as agricultural machinery, seeds, etc. There is cooperation in credit, where members obtain loans and the like from cooperative societies.

Trade unions are groups each of which contains people who belong to the same profession and are organized under one union in order to defend the interests of its members, and to organize its work and attend to its affairs. These include lawyers, doctors, engineers, and teachers unions among others.

Despite the clear difference between the company and the society, there was some difficulty in determining the meaning of profit that differentiates between the two. One opinion considered that profit is the cash gains that are distributed to shareholders on a regular basis. Another opinion expanded the meaning of profit as encompassing every advantage to the person concerned that can be estimated in money. At the end, this advantage can be negative in nature, the effect of which is restricted just to relieving some of the burdens or harm. It is not necessary for the profits to be in cash. Profits may come in other forms of monetary gains.
Confusion may arise when profits come in the form of various benefits and services, rather than in cash. In cooperatives that aim at making profits through cutting out brokers' commissions, the profit of a shareholder in these cooperatives is represented by getting consumer goods at a lower price, production at a lower cost, or borrowing at a lower rate. That is the reason why cooperatives are subject to special laws, and are not governed by company codes, but rather by society codes.

Accordingly, the French Cassation court has ruled that profit covers any cash or material gains that are added to the wealth of the shareholders. Although this position required profit to be of a positive nature that increases the wealth of members, it did not require profit to be in the cash form. The adoption of this opinion does not cover companies and societies that are formed to defend the interests of consumers of electricity or water in order to reduce the price of sale; it also excludes insurance cooperatives and consumer cooperatives. That is due to the lack of positive profit in advanced cases.

In contrast, agreements between two or more persons, under which each party contributes a number of cattle for farm breeding, and then shares the resulting livestock, are considered a sort of companies. In this case the gain is considered positive, even though it was in kind not in cash.

The Company by Its Business and Activities:
In terms of activity, companies can be either civil or commercial. The Criterion of Distinction between These Two Types of Companies:
The standard distinction between civil companies and commercial companies is the nature of the major work assumed by the company, together with the purpose to achieve. It is the same standard that is used to differentiate between individual traders and non-traders. However, the assignment of ‘civil’ or ‘commercial’ designation is more easily to companies than individuals, because companies announce their nature and purpose in their articles of association.

As such, if the purpose of the company was to conduct commercial transactions, such as credit purchases for sale purposes, or to conduct banking transactions, transport, insurance, or industry, then the company is designated as commercial. If, however, the purpose of the company was to conduct professional civil works, such as farm utilization or professional practice such as that of a lawyer or management of and institute of education, then the company is designated as a civil company.

If the company had multiple purposes, some civil and some commercial, the important factor in designation will be that of the main activity. If the commercial activity was more important than the civil activity, the company will be commercial. An example of that includes a sugar company, which converts sugar cane to sugar and at the same time distributes extra cane purchased from farmers. Conversely, if the company's main activity was civil, it will be designated as civil, even though the company might carry out commercial transactions to a lesser basis. An example of that includes Education Company that buys foods, tools and books to sell to students (Abu-Zeid, 1987).

Less value is attached to the designation of the company so long as it is the purpose of the company that determines whether the company is commercial or civil. Accordingly, the company may be commercial although partners are non-traders. The opposite is also true. Further, there is no importance to form of the company; the company may carry a civil purpose while choosing to have a commercial appearance (Al-Qalyoubi, 2003).

Some economists in France went on to conclude that it is enough for a company to have one purpose of commercial nature to be considered as a commercial company (Redwan, 2005).

The researcher, however, believes that this view has no importance in identifying the type of company. The researcher believes that designation of a company as a civil or commercial depends on the nature of the principal activity as well as the importance of other works prescribed by the articles of association and its commitment to the principal activity.

The distinction between commercial and civil companies is important in several ways including the following:

First) Commercial companies are subject to the legal regime governing traders. They must be listed under the commercial registration, and they must observe bookkeeping. Once unable to pay their liabilities, companies should declare bankruptcy. By contrast, civil companies are not subject to such a thing.

Second) Legal cases against commercial companies fall under the commercial jurisdiction, while those against civil companies fall under the civil jurisdiction. Jurisdiction in this context specifically relates to the general judiciary system. Hence, it is not disputable.

Third) the lawmaker has subjected commercial companies to announcement procedures that make the company public. For civil companies, however, the law did not require them to do any of the like, though they must have a written

contract in accordance with Article 507 civil. Both types of companies are required to have a written contract.

Fourth) commercial companies may not stand against any third party except after announcement of the same in accordance with the provisions of the law, while civilian companies may invoke third parties once established, as the lawmaker did not require any specific action of announcement for this type of companies.

Fifth) cases against partners in commercial companies, as related to company activities, become obsolete after five years from the dissolution of the company or from dissolution announcement date. For cases against civil companies, however, such obsoleteness comes into effect after 15 years.

Sixth) the provisions governing the responsibility of partners for company liabilities are different in commercial companies from those of civil companies. In civil companies, partners are personally responsible for company liabilities, even if those liabilities exceeded the value of a partner's shares. Partners are not jointly responsible, however. In commercial companies, such a responsibility is different according to the type of company in question. Partners are individually and jointly responsible for liabilities in joint liability companies. Partners are jointly responsible in the commanded company. Such a responsibility, however, is limited for commanded partners, partners in a limited liability company and for shareholders in a public holding company.

2.8 Commercial Companies

There are six types of legally recognized commercial companies (Al-Khayat, 2003):

1. Joint Liability Company.
2. Partnership in commendams.
3. Joint Venture Company.
4. Joint Stock Company.
5. Partnership Limited with Shares.

6. Limited Liability Company.

These six types of companies have been specifically listed in law and relate to the general legal system. Hence, any other form of companies will be null and void. Partners are free to choose the appropriate format. A company may not assume more than one format, however, as they stand in contradiction to each other. If a commercial company is established by a number of individuals without specifying a specific form, it must be regarded as a joint liability company; solidarity is the norm in commercial materials.

The reason behind requiring the company to choose one of these formats is the protection of the public and creditors. Each type of companies has specific rules. It is enough for one to know the type of a specific company in order to identify applicable provisions and the extent of liability of partners without the need to inspect the articles of association. The reason behind limiting the types of commercial companies is to prevent any confusion that would arise in dealing with a large number of company formats. The sixth form, in particular, must be sufficient to respond to all economic needs.

The above six types of companies can be grouped into two divisions: the people companies and the capital companies.

First: People Companies:

People companies are based on account of personal and mutual trust between partners. This implies the following results:

a) Error on the side of a partner is considered a gross error that would result in relatively nullifying the company contract.
b) A partner may not conduct in his share without the approval of other partners. Such a conductor may not have secured the trust of other partners.
c) The company ends with the death of a partner or with a freezing injunction against the partner, or insolvency or bankruptcy. This is because partners have put their trust in a specific person. This trust may not be transferred to the heirs or legal representative of a partner.

People companies may take the following three forms (Al-Qalyoubi, 2003):

a) Joint Liability Company: a company where each partner is jointly responsible without limits for the liabilities of the company; such a responsibility extends the value of shares in the company to the personal funds of a partner. Each partner acquires the designation of a trader. Joint Liability Company is suitable for small projects that do not require considerable capital. Meanwhile, the inadequacy of capital is supplemented in order to guarantee the rights of creditors jointly between partners.

b) Partnership in Commendams: This type of company is comprised of two teams of partners: Joint partners, and limited partners. Joint partners are subject to the same legal system of partners in the joint liability company. That is, they are jointly responsible for the company liabilities without limits, even at the expense of their personal funds, and carry the designation of a trader. Limited partners, on the other hand, are not responsible for the company liabilities except to the limits of their own shareholding. They do not acquire the status of a trader, and have no right to manage the company. Partnership in commendams is good for traders and craftsmen who lack capital. Efforts and technical expertise play a primary role, where capital plays a secondary role.

c) Joint Venture Company: a company with no legal personality and does not exist in relation to third parties. The effects are limited to its own parties. Joint venture companies are good for a partner who wants to invest without showing his name to the public. People companies, in their variant forms, have common traits, such as the following:
   a) Partner's Personality: the personality of a partner is one of the pillars underpinning the company's composition and survival. Thus, unless otherwise agree, the company will stop to be if this personality was subject to death, bankruptcy, insolvency, or simply withdrawal from the company.
   b) The shareholdings of partners in these companies are shares. As such, they are not assignable except with the consent of all partners. This stands true whether assignment was for another partner or for a third party.

c) Cancelation of company as a result of a fault on the part of one partner. Such a cancelation will affect all other partners, not only the faulty one.
d) The company contract may not be modified without the consent of all partners.
e) One or more persons, called general manager, assume the management of this company. Such a person is often selected from among partners. People's companies do not recognize the management structure common among capital companies, known as the Board of Directors.
f) Except for joint venture companies, the title of such companies often includes the name of the partners who are individually and jointly responsible for the company.

Second: Capital Companies:

These companies are based on financial, rather than personal, considerations. The personality of partners in this type of company has no importance. Consideration is attached to the financial contribution of each partner. Thus, the error on the part of one partner is not considered gross and does not nullify the contract. Also, the partner may not dispose of his share without the need for consent of the partners; and, finally, the death of a partner or a freezing injunction, or insolvency or bankruptcy do not entail dissolution.

Partners may change by way of shareholding disposition, or as a result of death. However, funds remain unchanged. This is the fundamental consideration of such companies. In other words, the pooling of funds is more important than the pooling of people.

The shareholding in the capital of such companies is called 'shares', while partners are called 'shareholders'. These shareholders are not dealers and carry no responsibility for the liabilities of the companies except to the extent of the value of their shares. Capital companies include stock companies as well as partnership limited with shares.

a) Joint Stock Company: This is a company where the capital is partitioned into equal negotiable shares. The ownership is transferred on death. It includes only one type of shareholding partners that do not carry responsibility for company

liabilities, except to the limits of their shareholding value. This form of company is suitable for large projects requiring large capital. The life of such companies is more stable than other forms of companies; and hence it becomes more suitable for ongoing projects.

b) Partnership limited with shares: Such form of companies consists of two teams of partners: joint and limited partners. Joint partners carry absolute joint responsibility for the company liabilities; they are considered as traders, and are entrusted with company management; their shares are not transferred on their death to heirs; they may not assign their shares to third parties. Limited partners, however, carry responsibility within the limit of their shareholding.

This company is different from the partnership in commendams. The shares are negotiable and ownership is transferred on death. This is because no importance is attached to the personality of the partner in the partnership limited with shares. Partnership in commendams is just the opposite; no assignment is permitted, and the company is dissolved with the death of the partner due to his considerable personality for the partners.

In addition to these five types of companies, there is one more represented in the limited liability company. This company is similar to the people's company. The number of partners may not exceed 50; it may not be established through public subscription; it may not issue negotiable shares or bonds; transfer of shares is subject to recovery by partners. This company also resembles the capital company in terms of establishment procedures, management, assignment of partners' responsibilities, as well as the transfer of shareholding to heirs after death. According to this nature, this company may be considered among the mixed-nature companies that combine characteristics of people's companies as well as capital companies. It is not a purely capital company.

The researcher, however, tends to consider this company among capital companies despite its mixed-nature combining characteristics of people and capital companies. This company is regulated under law No. 159 of 1981 concerning stock companies,

partnerships limited with shares as well as limited liability companies, as provided in the book of "Commercial Companies" (Taha, 2001).

The Company by Its Relationship to Other Companies:
A legal relationship may ensue between two companies, the result of which would be for the first to have full or partial ownership of the other. Accordingly, the first company enjoys the right of direction, control and supervision over the other.

The first company is called '**the parent company'**, and the second is called the 'subsidiary'. This relationship may become more complicated. The parent company may have several subsidiaries, and the subsidiary may control other subsidiaries.

These companies may have an integrated nature where each company does an activity, or a group of activities, that complement the activity of other companies. In totality, such a group of companies represents a complete integrated economic loop. The parent company assumes the power of control, direction and supervision in order to achieve the best level of investment. These companies may extend as a geographical investment loop, beyond the limits of national states. A Malaysian company, for example, may become a parent for other companies, or subsidiaries, of different nationalities.
One of the features of a subsidiary company is the enjoyment of a legal personality that is independent of the parent company. This entails enjoyment of an independent capital, and an intrinsic right over the funds it manages. It also entails enjoyment of an independent nationality. For example, it may acquire Malaysian citizenship if established in Malaysia, and become subject to the legal provisions of Malaysia, regardless of the nationality of the parent company and its controlling state laws.

The subsidiary company is different from a branch; the branch is not recognized as a company, and has no entity separate from the original project. Rather, a branch is an extension of the original project and is fully controlled by it, as one of its constituent parts. Therefore, management of a branch is entrusted to the party in

charge of main shop, and must be under its control. The branch has the right to represent the main shop, and is answerable to it in meeting its commitments. The branch can hardly be different from the original project. However, it takes an independent external form in order to facilitate shopping by customers without having to go to the main shop.

The branch is subject to certain legal rules. These rules are meant either to advise third parties of such a distinction so as not to confuse the party they are dealing with, or to facilitate proper identification in case of dispute between the branch and the parent before third parties.

These were the types of companies provided by the man-made laws. They fall into different forms and types in accordance with their respective considerations. It should be noted here that the main distinction between one company and the other is the nature of the activity and sought purpose. If the company was held in order to achieve profit for shareholders, then company is recognized by its goal; and vice versa, if the purpose of the company was the cooperation between members, then the company is recognized as a society.
If the purpose of the company was to practice a trade profession, the company is recognized as commercial. If the purpose of the company was to practice civil works, the company is recognized as civil.

In summary, these companies approved by the man-made law are no stranger to the rules of Islamic jurisprudence; they are and is compatible with the companies' systems recognized by jurists; they are, however, advanced in accordance with the need of the age and prevalent norms. Accordingly, people companies are recognized as a sort of Mudarabah in Islamic jurisprudence with difference in some of the provisions of the Islamic Shari’ah and the law as required by the public interest and the nature of evolution. Capital companies are often recognized as a sort of leash companies. They combine some traits of the negotiation companies in case of solidarity, and some traits of Mudarabah companies when the responsibility of a partner is restricted to his share.

Chapter 3

SPECIAL PURPOSE COMPANY (SPC) ROLE IN FINANCE

3.1 Introduction

Securitization method is summarized in the following steps according to Ahmed Mohammed Ghanim, (Ghanim, 2009), in his book entitled “Securitization”: First, the financing foundation sells some of its Guaranteed Assets with less sum of money to a company whose mere purpose of establishment is to buy assets of the foundation would like to securitize. This company is termed a Special Purpose Company (SPC) and is intended to obtain these assets out of the Foundation’s Estates, with the purpose of avoiding Bankruptcy Risks which may inflict the Selling Financial Foundation.

Second: assets which are Mortgage or Property- Backed debts of the debtors for the finance foundation will be transferred with their guarantees from the Finance foundation to the Special Purpose Company.

Third: Special Purpose Company called The Source; issues securities with a money value equivalent to the Relevant Debt Value; to obtain the Cash Money thru selling these securities to investors.

Fourth: The Special Purpose Company must use the Cash Money of Securities Selling for paying Assets Value to the Foundation.

Fifth: the interests charged on the securities must correspond with the Debt Fund Interests.

This is deemed a summary for procedures the traditional securitization process goes through. It is observable that Special Purpose Company is regarded a fundamental Pillar in the securitization Process; therefore its existence is vital for achieving the financial estates separation condition of Securitized assets from the Entity issuing Sukuk. Moreover, the Special Purpose Company is an intermediary in Asset Transfer Process from the Originator to the investors.

In the course of this chapter, the researcher tries to identify the Special Purpose Company identity and characteristics through the following two topics:

First Topic: Special Purpose Company's definition, establishment, emergence reasons, and role in Finance.

Second Topic: Characteristics and types of the Special Purpose Company (SPC).

3.2 Definition of Special Purpose Company (SPC)

With this title; namely the Special Purpose Company, the company will have no legal roots. For example this phrase hasn't been given a mention in either the "Definitions Book" for Al – *Jorjani*, or in "the Kuwaiti jurisprudence encyclopedia", or even in the dictionary of "Monetary and Economic Terminology in Jurisprudents' Language' for Nazeeh Hammad. Further, there is no a definition for the Special Purpose Company either in the jurisprudence or in the law; due to the fact that there is no existence at all for a company with that title either in jurisprudence or in law. However, it could make sense from the linguistic perspective – as being mentioned in the introductory chapter – that it is meant to be a contract between two or more persons or a type of money mixing between two individuals; for the purpose of carrying out an issue with Specific activity and purpose.

It is highly probable that non– existence of a definition for the company either in Jurisprudence books or in Objective Law or in any modern Law books can be attributed to some of reasons most prominent of which are the following:

1. The Special Purpose Company term is a recently coined term which appeared in parallel with securitization process emergence. Moreover, it is one of the contemporary topics revolving around thinking and contemporary money applications.
2. There are variations amongst authors regarding naming of the company conducting securitization process; where some authors name it an establishment, others name it a company, others name it an organization and finally others name it a vehicle. Consequently, variations of terms given for the Special Purpose Company may push the authors no to be interested in searching a definition for it.

3. Concentration upon a main process such as the securitization process wherein the company is a party. This concentration may distract authors away from assigning a title for the Special Purpose Company; owing to their sheer involvement in defining origins and details of Sukuk processes; to identify Securitization Process and hold comparison between the Islamic and Traditional Securitization Models and the like.

The researcher has encountered various definitions for the Special Purpose Company through his ongoing researches on the World Wide Web and through his readings in the western literature books; he could coin a definition for the Special Purpose Company. Most important definitions are the following ones:

1. Wikipedia defines it as a Special Purpose Entity; while in Europe it is defined as a Special Purpose Company: it is deemed a legal entity (it is usually a Limited Liability Company or a Limited partnership which is established for achieving narrow or limited Specific or temporary aims [74].

2. It is a Bankruptcy Remote Entity whose processes are confined to processes of buying and financing Specific assets.[1]

3. The Special Purpose Company title is given to Entity with a single, Specific and narrow purpose [74].

4. This Entity is established to achieve a Specific purpose such as financial risks management or to obtain a Special organizational dealing treatment or a taxation treatment for Specific Portfolios of the financial assets. [2]

5. It is a legal entity which is established to conduct a Specific aim and purpose of another Entity. In other words, the company is the entity which guarantees this aim and purpose.

These are some definitions for the Special Purpose Company which have managed to explain the company definition specifically. Furthermore, it is evident that the aforesaid definitions are similar; and of these various definitions the following could be comprehended:

[1] Investopedia, (1997). Special Purpose Vehicle/ Entity, http://www.investopedia.com/terms/s/spv.asp , 21/10/2013.

[2] Unicredit, (1999). Special Purpose Vehicle(SPV), http://www.unicreditgroup.eu/bilancio.php?area=04_622&ln=en, 21/10/2010.

First: this type of companies is given S.P.C abbreviation in English language which stands for the Special Purpose Company; while in America this company is given S.P.E abbreviation which stands for the Special Purpose Entity and holds the previous meaning.

Second: the Special Purpose Company is a legally accepted company.

Third: the Special Purpose Company is a Bankruptcy Remote Entity; and this means that the Special Purpose Company can't lawfully go bankrupt.

Fourth: the Special Purpose Company is an entity established for conducting a Specific and narrow purpose in a definite time.

Fifth: processes of the Special Purpose Company are confined to selling and financing Specific and definite Assets. [3]

Sixth: the Special Purpose Company is intended to achieve an aim of another company. So; the main aim of its establishment is to achieve benefit of another company.

Seventh: the Special Purpose Company has more than one form: it can be a limited liability company or a company with a limited participation and so on.

Therefore, it becomes clear that the Special Purpose Company is of much importance for the Parent Company or for the company desiring to achieve its aim through the Special Purpose Company. In turn, this clearly proves that without assistance of Special Purpose Company, there will be no viable projects and processes for those types of companies.

This is a general introduction for the company which is deemed the essence of this study. Based upon this introduction, it becomes evident that the Special Purpose Company is a legally accepted company; not to mention, it is established for achieving a Specific aim and a narrow purpose in a limited time frame. Further, the Special Purpose Company is affiliated to another company in addition to being a company with a Special nature, limited liability and finally it is established for a Specific purpose which explains reasons behind dubbing it a Special Purpose Company.

[3] Gorton, Gary, Souleles , Nicholas S. (2010). Special Purpose Vehicle and Securitization, http://www.nber.org/papers/w1190, 21/10/2010.

3.3 Emergence of the Special Purpose Company

It is known that the Special Purpose Company is a part or a party of securitization process parties; due to the fact that emergence of the Special Purpose Company coincides with emergency of securitization process. Therefore, there is a must for stating the securitization emergency with reference to emergence of the Special Purpose Company.

The international financing world has witnessed substantial changes in all finance types which have been named after a Specific era. The capital flows have taken numerous types ranging from Credit Aids, Bank loans, Direct Foreign Investments to financing through issuing securities; namely the securitization process.

Eighties have witnessed a remarkable orientation towards this type of finance. As a matter of fact, roots of this process date back to the industrial revolution that necessitated availability of huge sums of money. Consequently, the joint stock companies have turned into main channels for gathering money perquisite for financing the gigantic projects then. Furthermore during capitalism, these companies have evolved till it has become the main instrument of it (Firoun, 1989).

The Joint Stock Companies have managed to finance the industrial revolution; owing to their capacities to divide the capital into portions with small values in a manner that has enabled the small savers to have a share in the industrial revolution; not to mention, limited reliability of the shareholders in relation to their shares in the company's capital and calculability of shares have provided ample investment chances for Investors with Money surplus in Joint stock Companies and have simultaneously constituted novel channels for mobilizing prerequisite resources which the individual capacities couldn't provide for huge projects.

Since then, companies, different institutions and even countries have been utilizing this method for long decades. However in the early eighties there has been a trend towards using the financing type of securitization; for political and

economic conditions. Further, various factors and variable have had a share in taking this trend.

The time eras and advantages of international finance are as follows:

Firstly: Time intervening post World War Two and the late sixties: The Formal Credit Aids have been the prevalent mode at that time. However the Direct Investment Aids which have been largely concentrated in the developing countries of the Latin America, have come second in importance Moreover, the commercial Banks of the industrial countries haven't played a significant part on that respect.

Secondly: Time period from the early seventies till early eighties: There has been a change in the International Finance Types during the time period between 1873s and 1982s; due to explosion of the International External Debt Crisis. The hike in Petroleum prices has been accompanied by a gigantic growth in the Capital Liquid volume; especially in countries with petroleum surplus which haven't been in a position to accommodate and invest all these surpluses internally nor externally; due to the lack of expertise and inexistence of organizations able to do that in a manner that led to flow of these surpluses to the International Gigantic Commercial banks in United States of American and Western Europe.

With this huge volume of liquidity, these banks have sought to find investments outlets. The developing countries have been the optimal areas for the External Finance; due to harsh external circumstances resultant from hiking prices of the imported energy and deterioration of exchanging rates that have urged the commercial banks into the developing countries finance ring.

Then, the consolidated Loans have emerged and attracted a big number of Commercial Banks without former experience in the International Lending Field. The Consolidated Loans refers to a process whereby a host of banks provides a loan or a number of loans for a debtor or a group of debtors provided that a leading bank or a few of huge banks assume responsibilities of consolidating and managing loans. Furthermore, growth of the Bank Loans in the developing countries has ensued from dissemination of the Offshore Banks Phenomenon. These banks are allowed to provide all banking services all over the country

where these banks are available except for opening Bank Accounts for residents in this country. Moreover, these banks deal in huge sums of money which the commercial banks may not be able to deal in, and they are also called External Bank Units which could provide Long Term Loans without regarding ratios imposed by the Proper Banking Traditions.

The Banking Loans constituted 65% of the International Financing Resources versus about 35% for the Credit Aids, while the Banking Loans constituted 25% of the International Financing Resources versus 75% for the developing countries.

The Direct Investments have appeared as a type of the international financing with the explosion of the external debt crisis after Mexico had declared that it would stop paying in 1982s. This crisis has had a great effect upon all levels. For example, the direct effect of crisis was shrinking of Bank Loans provided by the American Banks, not to mention these loans necessitated satisfying hard conditions to be received. Moreover, this crisis changed structure of international lenders and borrowers. The American banks have no longer been finance offering banks but Finance claiming banks. Many bodies have come into the International Loan Field, such as some Western Europe countries and Japan which tended to provide loans through debt securitization.

In addition, not only did this crisis affect assets types of those banks but also it affected their Credit Appraisals; where only one American bank obtained AAA level from Standard & Moody, Poor's Rating which is deemed the highest Credit Assessment Level, while nine American banks obtained this level in 1980s[4]. The following table indicates these levels at Standard & Poor and Moody Rating[5].

Appraisal Agency	
Standard &Poor	Moody
AAA	Aaa

[4] Hung, The Securitization of International Finance, page:200-202

[5] Arnold, Glen, The Financial Times Guide to Investing: A definition introductive to investment and the Financial Markets, Prentice Hall, 2004, page: 109

AA+	Aa1
AA	Aa2
AA-	Aa3
A+	A1
A	A2
A-	A3
BBB+	Baa1
BBB	Baa2
BBB-	Baa3
BB+	Ba1
BB	Ba2
BB-	Ba3
B+	B1
B	B2
B-	B3
CCC+	Caa1
CCC	Caa2
CCC-	Caa3
CC	Ca
C	C

Not only have these reflections kept institutions, companies and even countries away from the direct bank loans but also they have made them look forward to the international markets where they could obtain prerequisite money with their own conditions not with the traditional banking institutions' conditions.

The formal Credit Aids have been impacted by these crisis consequences; where they have become subject to novel conditions. For example, agreement with the International Monetary Fund has become prerequisite for obtaining new financial resources or even Rescheduling of Current Debt.

There have appeared loans called “Structural Corrections” Loans. These loans have been introduced by the International Bank and have been based upon the debtor’s compliance with conducting the Structural Corrections. Therefore, the Formal aids have become subject to various conditions which may haven’t been in conformity with the dominant directions. However, if so, doubts will be raised around how beneficial the corrections are as well as their side effects. This, in turn, leads to refraining from this type of finance and turning to the Direct Foreign Investments; due to their advantages in comparison with other finance resources. Of these advantages are the following:

A. This finance isn’t intended for debt; due to the fact that it doesn’t generate contractual obligations like those generated by loans.

B. It enjoys a big deal of flexibility; as the transferred profits go up and down in relation to the business boom and depression. Consequently, they don’t add burden to the balance of payments.

C. A level of technology conveyance may accompany the direct investments; so this may constitute an incremental edge for these investments.

Late of Eighties: The type of finance through securities; i.e. securitization, has been enhanced in the late eighties. That period has witnesses a real revolution which yielded radical changes in instruments and tools of Money Transfer from the Surplus Units into Deficit Units, in addition to freedom of Capital Flows across national, country and continental borders without barriers. This is mainly represented in removing ceilings of Interest prices, reduction of taxes charged on the banking and financial operations and assisting banks and financing institutions to supply various services out of their traditional domain.

This has been escorted by a liberation wave and another phenomenon called Globalization of Monetary and Financial Markets where the markets have assimilated the International and Regional Integration and have become a single

field for capital activity. Due to diversity of the Financial Institutions working in the International Financing Markets, The Monetary creativities have augmented and have been represented in huge alteration of Monetary and Banking Instruments towards emergence of manifold variety of bonds and shares which possess some of the Property and Debt right characteristics, in addition to emergence of Future Transactions based Financial Instruments.

As for Country Based Securitization Emergence, Securitization Processes in United States of America have dated back to Seventies, when this type of finance has been linked to the Real Estate Mortgage. When the Housing crisis have worsened in the U.S.A and the securities institutions have been disabled to satisfy the market needs of Real Estate Loans, there has been a form of coordination with Freddie Mac Institution which is a market for Real Estate Mortgage. This institution consolidates all Bought Real Estate Mortgages and then issues securities for them with guaranteeing these securities.

Due to the fact that Freddie Mac Institution hasn't issued securities with time period less than thirty years beforehand, the new securities can't be issued with less than this time period. This, in turn, restricts numbers of investors; because they prefer securities with less time period, and simultaneously calls on another type of securitization called Collateral Mortgages which are based upon turning Mortgage Basis into a series of annual money flows with dividing them into independent trenches with maturity dates ranging from a year till thirty year. There have been legal developments which have managed to turn Securitization System into a Multiple Trenches System.

After that the securitization system has extended to include different types of loans other than Mortgage based Loans. The Special Purpose Company plays a significant role in this process; because it is deemed the only outlet for this process.

3.4 Emergence of Special Purpose Company

Securitization implies transfer of receivables by the originator. Due to fact that these receivables are in various types similarly as investors themselves; transferring directly these receivables to investors isn't sufficiently profitable.

Consequently, there is a must for instrument to reserve these receivables for other investors. For that purpose, this entity has been established to carry this deal or procedures and has been dubbed the Special Purpose Company. Further, the Special Purpose Company's role in Securitization Process extends from being a pure channel or an intermediary to more active role represented in Reinvestment or Reformation of the cash flows originating from the transferred assets; however this matter is based upon aims behind practicing Securitization Process.

The Originator transfers assets to the Special Purpose Company which manages these assets on behalf of investors and issues their securities for investors. So; this company is called the source as well.

This company is usually used by companies; to avoid the financial risks. Furthermore, some company transfers its assets to the Special Purpose Company; to manage or use these assets in financing a huge project with a purpose of achieving a narrow group of aims without jeopardizing the whole company. The Special Purpose Company is usually used in the Complex Financing operations; to separate different Trenches of Capital Pumping. Further, the Special Purpose Company is also used to possess single assets with all their permits and contractual rights such as a residential building or power station; to facilitate Assets Transfer Process.

Any establishment or even instrument whether for Special or general purpose isn't required in Assets Selling Process. However; it is required for Securitization Process (Sukuk); due to that there is a must for a channel or an intermediary to conduct the Securitization process; consolidate assets transferred by the originator and create these Assets Based Securities. So; existence of a channel is necessary to play role of the broker between the originator and the investors. This explains why this process in need of an establishment or an instrument; but why is the Special Purpose Company?

The point from establishing a Special Purpose Company is to give assets corporate uniform; in order to make owner of the synthetic securities the real assets holder. Furthermore, the General Purpose Company or a Working Company isn't suitable for holding the Transferred Assets; because it has assets different these ones and is burdened with obligations in a manner that such

assets and obligation with their inclusive rights may interfere with assets the process would like to give to investors.

In case that the Working Company possesses assets, it may encounter expenses or obligations or it may go bankrupt at the end in a way that spoils the process at all. The Special Purpose Company per se is a legally accepted entity where the originator transfers Specific assets to it. Moreover, these assets are either usable assets by investors or guaranty assets for the Company's Securities; not to mention, it is out of any official's business to learn about them. Although the Special Purpose Company is a legally accepted entity, it is only an on paper entity. This is why the Special Purpose Company is a Bankruptcy Remote Entity.

Thus, it becomes evident that establishment of the Special Purpose Company under the Objective Law System Umbrella is for the following purposes:

1. Implying transparency and guaranteeing rights of financers or investors. For example, during Debt Securitization Processes, if a Crediting Bank would like to securitize its due Debts to obtain the current cash money in a manner that qualifies purchasers of these debts to have priority of taking debts at maturity over other debtors, it must establish a Special Purpose Company where Crediting Bank could transfer these debts with a price usually less than the Nominal Value of these debts. Therefore, the Special Purpose Company will be the owner of these debts and then can issue securities for investors; where outcome of selling these securities is considered the price of debts bought from the Crediting Bank. With this process, the Security Purchasers will avoid Loss Risks of any Financial Deficit which may encounter the bank through the Special Purpose Company. Moreover, Security Holders benefit from the Price Difference and interests charged on Debt Fund.
2. Risks Distribution: if the company wants to distribute risks of some project or assets, it transfers ownership of project or assets to a company to be established for this purpose, for the sake of attracting partners sharing risks of the project with the Parent Company.
3. Selling The Unsalable Products: Properties which are hard or even impossible to independently sell; will be transferred to the company after establishment till selling of this company with its properties.

4. As one of Financial Engineering Methods, Parent Company resorts to establishing this type of companies in want of evading taxes paying or manipulating Financial Data of the Parent Company through Factitious Selling of Parent Company's properties to the Special Purpose Company; for example.
5. For the sake of avoiding some legal obstacles - for example some laws legalize possession of the foreign companies - the Parent Company resorts to establishing a Special Purpose Company in that country for justifying that.
6. As a method of Lending Costs Reduction or Finance Obtainment eSpecially On Credit Rating Reduction of the Parent Company as a result of its Financial Insolvency for example, where Lending or Finance obtainment of Established Company will become costly as a result of the feeble trust the Financing Institutions have in it, the Parent Company resorts to establishing a Special Purpose Company in hope that this newly established company with its clean register will obtain a Credit Rating higher than its own Credit Rating. Consequently; the Parent Company can obtain a finance or loan through the Special Purpose Company in a manner that reduce the Finance Costs for it.

Under Finance and Islamic Investment Umbrella, Purposes of establishing the Special Purpose Company include the aforementioned purposes with the exception of Illegal purposes such as Securitization of the forbidden Borrowing with interest and the Financial Manipulation. The Special Purpose Company is also established for the following purposes[25]:

a. To be used in the Securitization Processes: the Islamic Financial Institutions establish the Special Purpose Company; to transfer their assets to it. Then the Special Purpose Company begins to issue Islamic Sukuk to be repaid later as known in Sukuk Process. Further, tasks of this company or Authority in Sukuk Operations are confined to the following:

b. Protection of Sukuk Holders' rights.

c. Management of Properties and investment of non- invested properties.

d. Obtainment of Income through profits, leases and the like.

e. Issuing Periodicals for notifying the Sukuk Holders with developments to their properties; namely Sukuk Properties.

f. Distributing its net income to the Sukuk Holders Successively.

g. Liquidating all properties at the end of Sukuk Period and distributing Liquidation Outcome amongst the Sukuk Holders.

Justifying what is lawfully forbidden in terms of providing all types of guarantees and warranties for investors on the ground that the Guarantor is separated from the Entity conducting the Investment Operations; such as the case when the guarantor is for example the Parent Company and the Entity conducting The Investment Operations is the Originator or vice versa.

Justifying what is lawfully forbidden; such as selling and repurchasing as the case of Selling Assets to investors and then repurchasing them by this company. Furthermore, Sukuk Sectors, Investment Portfolios and Corporate Finance are the most common applications of this company in Finance and Islamic investment.

It is worth mentioning that the Special Purpose Company has in common with any other company that there is a need for guarantor or a sponsor. The sponsor mostly transfers assets or activities from the rest of companies to the Special Purpose Company. This isolation of assets and activities is prerequisite for providing comfort and peace of mind for investors. Moreover, these assets and activities are separated from the Parent Company; and consequently Work Flow of this New Entity won't be positively or negatively impacted by the Original Entity's Work Flow. The Special Purpose Company will set the example for risks reduction and provision of more comfort for borrowers. The most important point here is that the distance between the Sponsor and the Special Purpose Company; because absence of a sufficient distance between Sponsor and New Entity, the latter won't represent the Special Purpose Company but an affiliate.

To sum up**,** the main role of the Special Purpose Company is to be a communication channel amongst various investors and one or more originators. However, if there is only one originator and one purchaser of receivables, the channel won't be necessary. This matter stresses the point

that the basic role to be exercised by the Special Purpose Company is to lawfully facilitate Securitization Transactions and Operations thru qualifying different trenches of investor to have shares in some of receivables without any discrimination; till all investors have many lawful shares.

In other words**,** the Special Purpose Company is like a Joint Authority where investors can keep their undivided interests. When this company receives interests of these receivables, Property of these receivables won't be monopolized by one investor but all investors must be the real owners and beneficiaries of these undivided receivables

3.5 Types of Special Purpose Company

The Special Purpose Company has different types for achieving its aims. For example, Aviation Company which needs an airplanes fleet or Gas Company which needs a pipes line, can depend upon the Special Purpose Companies to finance such projects. Further, this off balance Sheet Entity will possess these assets to be used in fields Sponsor or Guarantor determines and to be also used as a guarantee for pooling money necessary for financing. As long as these arrangements are in conformity with Principles of Accounting, It won't be necessary for the Sponsors to abide by enhancing these assets and their relevant Debts.

These off balance Sheet Arrangements will be in types of synthetic Leases or Take or Pay Contracts or Throughput Contracts or Sukuk. However, there are other types of transactions that could be achieved through the off balance Sheet Entities, including property rights backed investment, joint Speculation research, Development project arrangements and low income housing project investments. Of these arrangements are the following ones:

1. the synthetic Leases: On Synthetic Leases, Sponsor establishes the Special Purpose Company; for purchasing or financing What the Guarantor determines field of its use. The Special Purpose Company could be established for Sale –Lease Backs, Build to Order or for Buy – Lease Transactions. The Special Purpose Company takes the Property Deed and receives the rents from Lessee or Sponsor. These

arrangements have been known after the Real Estate Crisis in 1980s, When Direct Purchasing and Prerequisite Assets Financing have become less attractive for companies.

The Synthetic Leases can serve two important purposes:

A. Synthetic leases can be used in financial accounting Purposes and enable Lessees or Sponsor to turn Leases into Operational Leases where payments are registered as Rents. Moreover, Basic Assets and Relevant Obligation will be Off General Balance Sheet. This Transaction of Leases provides the company with a chance for submitting more effective Budget Statement in comparison with the case when the Lease is regarded the Main Contract.
B. Synthetic Leases can be used in income tax services. These leases are synthesized in a manner that Lessee or Guarantor is Owner of the leased estate. Consequently, sponsor or landlord regards payments as Debt services, can cut interest charges and reduce Assets. It is worth mentioning that any company can be a Lessee for Financial Accounting Purposes or an Owner for Taxation Purposes.

2. Take or Pay Contract: Take or Pay Contract is based upon the Purchaser's agreement to pay Specific periodic payments for some products or services. Further, Purchaser must pay these Specific periodic payments even if these products or services will take much time to be delivered. Two gas companies established a Special purpose company for building a refinery and agreed to pay Specific annual payments for refined or pure petroleum. These payments must be paid irrespective of actual product delivery.
3. Throughput Contracts are based upon first party's agreement to pay Specific periodic payments for another party in return for transferring or preparing the product. For example, two Gas Companies established a Special Purpose Company for building a Network of Pipe Lines and agreed to pay Specific annual payments for transferring petroleum through these pipes. These payments must be paid irrespective of actual pipe delivery.

4. Securitization transactions are regarded the last most common applications of the Special purpose companies; where there a host of financial properties such as mortgages, car loans, commercial receivables, credit card receivables and other types of accounts which will be transferred to securities.

Non- financial Assets could be securitized, for example patent rights, copyrights, concession fees and even Medals of cabs. In the traditional Securitization process, Originator establishes the Special Purpose Company. This Entity usually takes the shape of Trust Deed to transfer a host of Financial Properties to Cash Money on behalf of Sponsor or Guarantor. Moreover, the Sponsor sells a host of assets to the Special Purpose Company to be kept. Then, the Special Purpose Company issues Securities; to obtain Cash Money which will be used later to Pay for Sponsor Money Value of Transferring Assets[27].

After that, the Sponsor serves debt through cash Flows being generated from assets which are transferred to Securities. Consequently, Originator securitizes Assets for the Special Purpose Company and turns these assets from being Debts into Debt Instruments.

The company must dispose of Financial Assets to activate Securitization Process. Moreover, it must synthesize the transaction structure; to sustain non-controlling Policy of off Budget Statement Assets. However, if it keeps controlling the Transferred Assets, this Transaction will be handled as the Guaranteed Loan.

Therefore, the Special Purpose Company has different types, each one of them has its own advantages and different consequence. Securitization Process is a deemed one of the most processes where the Special Purpose Company is of significant importance[27].

3.6 Characteristics of Special Purpose Company

The Special Purpose Company is of a unique type. In other words, the Special purpose is defined by the constitution which specifically determines domain of the Special Purpose Company; for merely direct parties of this purpose. As for

Financial Accounting Standards Boards, the term of a Special Purpose Company is a term with a limited domain. So; it couldn't be applied to operating trades with officials and providing the Sufficient Cash Capital for Work, without support of another Commercial Entity. Most of the Special Purpose Entities turn their most important activities to formerly programmed activities; because they are usually dubbed "Brain Death Cases".

The Special Purpose Company is usually a bankruptcy remote company; owing to the fact that borrower is being already isolated from bankruptcy risks or failure to Pay debt by sponsor. Reduction of the credit risks leads to Lending Costs Reduction. Further, the Special Purpose Entity usually receives efficiency from Taxes through transferring tax deductions (receivables items) to investors who are in better positions to get best of them. All these unique characteristics enable the Special Purpose Entities to serve lawfully accepted commercial purposes.

These unique characteristics of the Special Purpose Companies along with The Uniform accounting standards of Financial Statements which represent attraction dimension for Special Purpose Entities; enable Sponsors to remove these Entities from their Financial Data. The Special Purpose Entities can be off Balance Sheets as long as they have Specific Purposes. Till 2003s, The U.S General Accepted Accounting Principles have utilized voting right based Unilateral Dominance Policy; to determine whether or not Assets and debts are uniform. However, the Special Purpose Entities; in nature, don't accept voting dominance; because their activities and operational structures of contracts are determined by the constitution. In other words; their programs are formerly programmed. So, the Sponsor controls works of the Special Purpose Entities; despite absence of voting supervision in such entities[28].

Briefly, off–balance sheet Special purpose companies have the following characteristics:

1. They are thinly capitalized.
2. They have no independent management or employees.
3. Their administrative functions are performed by a trustee who follows pre-specified rules with regard to the receipt and distribution of cash; there are no other decisions.
4. Assets held by the Special Purpose Companies are serviced via a servicing arrangement.

5. They are structured so that, as a practical matter, they cannot become bankrupt.

In short, Special Purpose Companies are essentially robot firms that have no employees, make no substantive economic decisions, have no physical location, and cannot go bankrupt.

Generally speaking, the Special Purpose Entities are established to meet the following aims:

1. Financing assets or Specific services and keep the relevant debts off – balance – sheet of sponsoring companies.
2. Second: transferring Specific Cash Assets such as commercial receivables, loans and Mortgages to Cash Money securities.
3. Third: Involvement in Tax – exempted commercial trades

The sponsoring companies may get benefit from such off –balance –sheet entities thru two ways as following:

A. First way: such entities enable Sponsor to remove debts from Balance sheet; so Sponsor can repay debts with Specific proportion or according to loan guarantees.
B. Second way: such arrangements protect Sponsor against any potential financial failure ensuing from the Special Purpose entities; in a manner that if the project established for Special Purpose entity fails and Special Purpose entity is no longer able to serve its debts, Sponsor won't be risked unless in fields sponsor designates for the Special Purpose entity. Further, Sponsor will pay these off – balance – sheet arrangements, however; sponsor will remove debt related assets which are transferred to the Special Purpose Entity from the Balance sheet.

For example, if Sponsor serves a Special Purpose entity for financing a cash Capital project, no debts or assets of this project will be included in Balance sheet[27].

There are a number of main characteristics and features differentiate the Special Purpose Company from the traditional companies. Such characteristics and features have been developed over a couple of years by the Rating Agencies. According to rating terminology, the Special Purpose Company is a bankruptcy remote entity.

Basically, the Special Purpose Company has a basic connection with a series of activities and conditions the Securitization Company must abide by prior to voting or rating any obligations. These issues are as following:

1. Protection Against risks of circulation out of Assets Financing and Security Services; in a manner which qualifies the Special Purpose Company to protect either a Transaction or a Process against novel and different risks.
2. Entering into Subcontracting of all services prerequisite for keeping the Special Purpose Company with its Assets. For example Corporate Receivables Management and Secretarial services.
3. It isn't permissible for the Special Purpose Company to have an official or any Credit Responsibilities with a third party; for example assuming responsibilities of the Trustee.
4. Any one enters into any contracts with the Special Purpose Company is bound not to sue the company in case of failure to perform provisions of contract unless this person is of higher rank and power.
5. All present and future obligations of the Special Purpose Company should be subject to Quantitative Measurement. Moreover, the Special Purpose Company should indicate much more ability to satisfy such obligations from available resources including corporation tax or Advance Corporation Tax or Value Added Tax.
6. Money pooled by Special Purpose Company must be separated once taken

Via such methods, it is possible to find, count and put assets which form a part of the Company's Balance Sheet in a controlled environment. As long as The Special Purpose Company doesn't possess any employee, there is a must for subcontracting for running its assets.

The administrative agreement is deemed one of the main documents which organize the Special Purpose Company. This is conventionally the type of contracts which is supposed to be entered into between Special Purpose Company and the Originator who exerts a role administratively as well and which describes all various tasks deemed necessary for qualifying the Special Purpose Company to assume its responsibilities. Such fields include the following:

a. Daily Cash Sum
b. Operational Bank Accounts
c. Fulfilling agreements with the Basic debtors; such as pooling of Securities and Chasing Insolvent Debtor.
d. Secretarial Services of the company; such as Permit Management and Production of Legal Returns.
e. Accounting
f. Tax Levy.
g. Submitting reports to investors and, Rating Agencies and Trustees.
h. Management of bases and consolidations (Transactions of additional Financial Resource Requests), Asset Contract Variations and the like.
i. Relevant Insurance Department of Building Insurance, Defense and the Like.

If the Special Purpose Company is obliged to invest or reinvest cash flows, there will be a must for it to hire Investment Manager Service or Investment Guide Service. The Special Purpose Company possesses functions of any company, such as holding meetings, preparing a formal report of meeting minutes, accounting sheets, auditing and the like[30].

3.7 Bankruptcy Remoteness of Special Purpose Company

The most prominent and substantive feature of the Special Purpose Company is that it is a Bankruptcy Remote Entity. In other words, this entails that the Sponsoring Company must introduce Bankruptcy Procedures. Moreover, this means that the Special Purpose Company isn't legally bankrupt.

What makes the Special Purpose Company a Bankrupt Remote Entity? In law, there is no any guarantee for any entity neither against being bankrupt nor against sustainability too. This can be attributed to domain and structure of this company which reduce Bankruptcy opportunities and hold it Bankruptcy Remote. Therefore, the Special Purpose Company is entitled "A Bankruptcy Remote Entity".

The Special Purpose Company is an entity without materials, profits, losses, liabilities and financial coverage. Moreover, the Special Purpose Company neither has a financial coverage the minimum limit of Financial Coverage as a

company nor debtors except for investors who buy securities from it. Those investors have nothing but Assets the Special Purpose Company holds. The Special Purpose Company is a deemed a structure without fortune. It is a corpse free of worries; due to being a Bankruptcy Remote Entity.

There is another condition for the Special Purpose Company to become a Bankruptcy Remote Entity that is availability of Consolidation Opportunities either with the originator or with any interested body. This point is highly stressed during establishment of the Special Purpose Company as an independent company[27].

Bankruptcy Remoteness Standards have been developed by Rating Agencies over the time. The Basic rule of rating bonds which are called Asset backed Securities is power of these assets not power of the source. This is a general background for "Bankruptcy Remoteness" feature of the Special Purpose Company. It is worth mentioning that there is need for worry as long as the Special Purpose Company is a bankruptcy remote entity. Standards & Poor's Rating counts the following features for the Special Purpose Company to be Bankruptcy Remote[30]:

1. Limitations of things and powers:

The main feature of the Special Purpose Company is that limitation of things and powers of this entity to most possible quantity of activities necessary for merely conducting transactions. The purpose of such limitation is to reduce insolvency demands ensuing from irrelevant activity of Assets Securitization and Estimated Securities Issuance.

Credit Rating Agencies require that the basic documents of that entity limit the Special Purpose Company to the required activities; to make sure of Cash flows Capacity to pay Estimated Securities. These basic documents are deemed the optimal location of limitation; due to the fact this limitation is available for the public and provides some general observations on this limitation. This basic limitation is highly used in reminding the Special Purpose Company management of compliance with constitution.

In brief, the Special Purpose Company mustn't abide by irrelevant commercial activities[29].

2. Reduction of Debt:

The Special Purpose Company mustn't bear additional debts except in the case that these debts have no effect on assessment of Current Debts. The current assessment can be affected as long as creditors have incentives to reach Cash Flows and Assets of the Special Purpose Company. So, these additional debts will be frankly placed in a lower rank or in an equal rank with the current debts as long as they don't affect assessment of the current debts in principle.

These additional debts include any Cash obligation or any other obligation including Cash Payment; such as Attachment Removal, Damages and Insurance Contracts of the Special Purpose Companies.

3. Non – petition Agreement:

The Credit Classification Companies usually require non petition language in any agreements between the Special Purpose Company and Work Creditors where creditors mustn't file a bankruptcy petition against the Special Purpose Company or even participate in filing the bankruptcy petition. These creditors include those persons who serve the Special Purpose Companies as Auditors or Trustees.

4. The Independent Manager:

The Special Purpose Company works through its Board of Directors or general partner or management Committee or Management Member of some company. Therefore, the Special Purpose Company's commercial works are being done under committee supervision whatever their daily management burdens which board usually deputizes officials in charge to carry out.

Members of Board are nominated by Shareholders who are proprietors of the company. The decisions which include filing a Bankruptcy Petition can be made by Board. This is the anxiety point which results in necessity of an independent manager for the Special Purpose Entity which takes on a form of a Company or other equivalent forms. The parent Company depended on the Special Purpose Company despite being established for a Special purpose in various organized transactions. Sometimes, this Parent Company is neither an Assessor nor a Rater and its Credit Rating Source may be lower in comparison with its subsidiaries. Further, Board Members give good services for the Parent

Company and so do the Board Members for its subsidiary. The closely intertwined board of directors may submit a contradictory benefit.

If the Parent Company is bankrupt or insolvent despite the fact that the subsidiary regularly pays its debts or being in a reasonable financial status, there may be a an incentive on part of the Parent Company which urges the subsidiary to satisfactorily go bankrupt; for paving the way of consolidating its assets with the Parent Company[29].

5. Non –consolidation or Reorganization:

This condition tries to confirm that while securities can't stand Bankruptcy Remoteness status of the Special Purpose Entity, they won't be damaged due to a consolidation with an entity other than the Special Purpose Entity or due to a rearrangement or dissolution and liquidation of Assets. The Credit Rating Agencies usually require non modification of the Special Purpose Companies and their organizing documents without a prewritten consent of agencies. The Credit Rating Source for the Consolidated Entity must be lower than assessed or evaluated obligations. Further, Rating or Assessment of the Special Purpose Company may be negatively affected.

6. Separate Charters

Separate Charters have been intended to make sure that the Special Purpose Entity manages itself and to stress for the whole word that the Special Purpose Company is an independent entity. This matter follows the theory that reads if this entity doesn't work as an independent entity; the court may use Principles of piercing the corporate veil or Alter Ego or Substantive Consolidation to force the Special Purpose Company and its assets to file bankruptcy lawsuit against the Parent Company. Moreover, excessive subscription of the Parent Company poses a threat for sustainability of the Independent Special Purpose Entity.

Piercing the Corporate Veil is deemed the solution the court resorts to when the controlling entity such as the Sponsoring Company or the Parent Company of the Special Purpose Company disregards Independent Identity of the Special Purpose Company; however their projects are dealt with as effectively mixed projects. This solution can be researched by Creditors through filing a lawsuit against the insolvent Parent Company. Moreover, Creditors think that there are

financial resources which can be correctly allotted to the subsidiary. As for Alter Ego Theory, it is used when the subsidiary is not more than a coincidence and its activities are verily conducted by the Parent Company. The substantive consolidation permits authority or government to unveil the independent legal Entity which separates the Special Purpose Company from the originator as a uniform entity.

The most important element of analyzing the feature of Bankruptcy Remoteness by the Credit Rating Agencies is that the Legal comfort which is the Special Purpose Company won't be truly consolidated to the Parent Company. In this regard, entity must designate the separate charters which are according to Standard & Poor's Rating as following[29]:

1. Keeping records and ledgers out of the reach of any person or entity.

2. Holding separate accounts.

3. Non consolidation of assets with other persons or companies' assets.

4. Conducting its own works in its own name.

5. Separating financial statements.

6. Paying its own obligations from its own Cash money.

7. Supervising all companies or partnerships or any types required by membership documents.

8. Paying salaries of employees and retaining sufficient number of employees in the light of expected commercial operations.

9. Non- guaranteeing or paying Other Entities' debts.

10. Non – obtainment of members or partners or contributors' obligations or securities.

11. Allocation of fixed charges according to joint office areas.

12. Using tools of writing, bills and separate checks.

13. Not making its assets at another entity's disposal or providing any loans or advances to other entities.

14. Working as an independent entity.

15. Clearing any misunderstanding of independent identity.

16. Keeping sufficient Cash capital in the light of the expected commercial operations.

7. Non – use of free short term assets and Non – Cash Coverage: The Special Purpose Entity's transfer of all their assets to investors or payment of security interest on all assets of Securities Holders; is regarded one of Bankruptcy Remoteness conditions. Aim of this general security interest is to reduce incentives of conducting Insolvency Procedures against the Special Purpose Company by the potential third party creditor. As long as there are no free short term assets and current assets to be taken or shared by the potential third party, possibilities of such action are limited[29].

Generally speaking, the Special Purpose Company must be limited to the cash assets and mustn't include the real assets. In other words, the Special Purpose Company must neither possess nor hire real estates. In some of Capital Market transactions, the Special Purpose Company has been established for earning money. Further, in case that the Special Purpose Company possesses cash money, this will mean that that this company has additional fortune; due to fact that cash money or real estate's value excesses cash money due for securities. The Seller usually processes this matter carefully; because the increment on money due for cash securities of real estates' value belongs to the seller itself[29].

Therefore, it seems that the Special Purpose Company has numerous characteristics and features, most of which differ from companies known in the Islamic Jurisprudence and objective laws. Moreover, the most important characteristic of the Special Purpose Company is being Bankruptcy Remote Entity. However, this characteristic necessitates Specific requirements and conditions; because it isn't an invariably attached characteristic to the Special Purpose Company. In other words, the Special Purpose Company must satisfy Specific requirements to be a Bankruptcy Remote entity.

3.8 Accounting Process for SPC/SPV

Special-Purpose Vehicle /Company [SPV/SPC] needs to prepare its own accounts whatever its kind is. The SPC's Primary Assets are represented in Equity-Based Securities or an essential part. The Primary Assets are usually provided and transferred by an Originator. If these Assets which are transferred by the Originator to the Special-Purpose Company are transferred by way of True Sale rather than transferred by way of providing guarantees including third-party's guarantees, such Assets include Receivables, Overcollateralization Receivables and Cash Retention. The Special-Purpose Company, in turn, offers these Assets to investors in the form of Debts, Assets and Beneficial Interests Certificates or Mercantile Quotas Paper in a collection of Receivables transferred to it (the Company).

There may be circumstances where an Originator retains Receivables in its Balance Sheet Statement and it is improper for the Special-Purpose Company that it removes the acknowledgement of these Receivables from its Balance Sheet Statement. When, for example, an Originator retains the significant risks and returns in Receivables, it could not be said that the Special-Purpose Company does not want to calculate the contra Assets or Liabilities on its Balance Sheet.

A key question for the Special-Purpose Company is: Is the Company being transacted on or off the Balance Sheet?

As this is an accounting matter, the question is to be: How Receivables are transferred by a Sponsor to a Special-Purpose Company, is it a selling transaction or a loan transaction? This question is addressed for the purposes of accounting. The requirements of dealing with such this Transfer as a selling transaction, and therefore getting the transaction off-balance-sheet, are determined according to the Financial Accounting Standard No. 140: [Accounting for Transfer and Serving of Financial Assets and Extinguishment of Liabilities]. The Financial Accounting Standard No. 140 has been issued in September 2000 A.D. and has set two broad requirements for the True Sale process:

1. Special-Purpose Company shall be qualified;

2. Sponsoring Company shall relinquish control over Receivables.

The Financial Accounting Standards Board [FASB] has relied upon "Financial Accounting Standards Board Interpretation No. 46 (revised December 2003 A.D.): Consolidation of Variable Interest Entities – Interpretation of Accounting Research Bulletin No. 51".

By this interpretation, Financial Accounting Standards Board [FASB] aims at enhancing Financial Reports and identifying Special-Purpose Companies and Variable Interest Entities. Basically, FASB thinks that the current Accounting Rules, which determine whether or not a Special-Purpose Company is to be consolidated, are not adequate. As FASB finds it difficult to identify the nature of Special-Purpose Companies, it has come up with the idea of Variable Interest Entities. The Financial Accounting Standards Board Interpretation No. 46 states a new standard for regulating money. This standard is not based on majority voting for a share but rather on the party that caries most of the residual risks or obtains most of benefits or the both – independency of the power of voting.

A Qualifying SPV (Special Purpose Vehicle/Company) is the company which meets the requirements stated under the Financial Accounting Standard No. 140. In other words, it's the company which is treated as a Variable Interest Entity in accordance with the Financial Accounting Standards Board Interpretation No. 46. However, this interpretation is not applied to the Qualifying SPV. The requirements must be fulfilled by a Qualifying SPV are as follows:

A. To be clearly featured by the Sponsoring Company;
B. Its activities are to be limited to the permissible activities which are identified in the relevant legal documents under which existence of such activities are determined.
C. To hold only passive receivables on which there is no any decision taken.
D. To have the right to sell or dispose of non-monetary receivables, but in an "automatic response" only in consequence of the occurrence of certain occasions.

The expression "be clearly featured" abovementioned means that a Sponsor could not be able to unilaterally dissolve a Special-Purpose Company. This

means also that at least 10% of the Net Value of the Company's Beneficial Interests must be received from Irrelevant Third Parties.

The second requirement stipulated in the Financial Accounting Standard No. 140 states that the Sponsor cannot keep actual control over the assets transferred. The Sponsor has no the capacity needed to unilaterally make a Special-Purpose Company (Qualifying SPV) return certain assets.

The Financial Accounting Standard No. 140 states that: a Sponsoring Company does not need to record in its Consolidated Financial Statement the debts of a Qualifying SPV on the basis that the Qualifying SPV is a subsidiary of the Sponsoring Company.

The Qualifying SPV is to be an entity legally independent and distinct from the Sponsoring Company. For accounting reasons, a Sponsoring Company may not be merged / consolidated with a Qualifying SPV. A Qualifying SPV must be an automaton in the sense that there are no substantive decisions for it to ever make; which is a simple rule that must be followed. It must be a bankruptcy-remote entity. This means that bankruptcy of the Sponsor has no implications for the SPV and the SPV itself must, as a practical matter, never be able to become bankrupt.

The Current Accounting Process of the Special-Purpose Entities: International Financial Reporting Standards [IFRS]:

According to the International Standards, there are two key stages required for a Special-Purpose Entity to get Off-Balance-Sheet treatment. The first stage: the Sponsoring Company must determine whether or not it needs Special-Purpose Entities to be consolidated. The second stage: identifying the assets, such as Mortgage Loans, transferred to a Special-Purpose Entity and determining whether or not such assets can be excluded by the Sponsor.

A Special-Purpose Entity is to be merged or consolidated when essence of the relationship between a Sponsoring Company and a Special-Purpose Entity indicates that the Special-Purpose Entity is controlled by the Sponsoring Company.

According to International Financial Reporting Standards [IFRS], Standard Industrial Classification 12 [SIC-12] governs such theses stages.

For identifying essence of the relationship between a Sponsoring Company and a Special-Purpose Entity, the following factors should be considered by using the Standard Industrial Classification 12 [SIC-12] since there may be circumstances indicating that the Sponsoring Company controls the Special-Purpose Entity:

A. Activities of the Special-Purpose Entity are controlled by the Sponsoring Company depending on Specific trade needs of the Sponsoring Company which obtain benefits (profits) of the Special-Purpose Entity work.

B. The Sponsoring Company has decision-making authority since it obtains the majority of benefits got by the Special-Purpose Entity. Also, through creating "pilot" mechanism, such authority may be delegated to the Sponsoring Company.

C. The Sponsoring Company has the right to obtain the vast majority of benefits of the Special-Purpose Entity, as a result, the Sponsoring Company may expose to the risk relevant to the Special-Purpose Entity's activities.

D. To obtain benefits of the Special-Purpose-Entity's activities, the Sponsoring Company retains most of the residual risks or the possession risks related to the Special-Purpose Entity or to its assets.

The Standard Industrial Classification 12 [SIC-12] in itself may not necessarily indicate the control, but all the relevant signs, facts and circumstances indicate that equilibrium in the control over a Special-Purpose Entity is needed.

The Standard Industrial Classification 12 [SIC-12] is an interpretation of the International Accounting Standards 27 [IAS27] which provides principles of consolidating/emerging the entities that are not closely identified. The [SIC-12] is written to be an anti-misuse-of-power arrangement for combating manipulation

and, particularly, preventing entities from manipulating Financial Statements by using Financial Engineering. Applying the Standard Industrial Classification 12 [SIC-12] has produced the consolidation of many entities and on other hand, led to off-balance-sheet transactions.

Cancellation of the recognition granted to the assets which are transferred to a Special-Purpose Entity is governed by the International Accounting Standards 39 [IAS39]. This Standard, [IAS39], is based on the principle that a Transferor has to retain neither a high degree of risks nor cash flows bonus related to the transferred assets.

Second Standard: United States Generally Accepted Accounting Principles [US GAAP]:

[US GAAP] provide two models for receiving an Off-Balance-Sheet Transaction of Special-Purpose Entities. One of those models deals with the process of cancellation of the recognition or exclusion of assets. The second model deals with process of the consolidation of Variable-Interest Entities.

Process of cancellation of the recognition of assets is governed by the Financial Accounting Standard No. 140. For cancelling the recognition of or excluding assets, such assets must be isolated from the Transferor involved, and placed out of reach of creditors and receivers. This standard is often attributed to the True Sale Criteria. Determining and identifying the True Sale need a legal analysis and an opinion of the legal counsel engaged in the transaction concerned. Accountants have relied on such opinion on the True Sale, considering it as a single indicator of carrying out a sale transaction under the Financial Accounting Standard No. 140.

For preparing sale to be a True Sale, the Transferor is to relinquish the actual control over the transferred assets. A Transferor may relinquish such control only if the following three conditions shall be fulfilled:

I. The transferred assets are completely isolated from the Transferor in case of bankruptcy.
II. A Transferee or a Beneficial Owner of Equity has the right to pledge or exchange assets.
III. A Transferor does not retain actual control over assets.

On the contrary, the Transferor shall retain actual control if it:

i. Qualifies or binds to buy back or recover assets prior to maturity.
ii. Enables the Transferee to unilaterally return the assets.

Most of qualified Special Purpose Entities are, now, being treated as Off-Balance-Sheet Entities provided that the following requirements shall be fulfilled:

a. SPC must be demonstrably distinct (It cannot be unilaterally dissolved by a Transferor).
b. SPC must be significantly limited in its permitted activities.
c. SPC may hold only the assigned assets.
d. SPC may sell assets in automatic response to the occurrence of certain circumstances which include:
    - Any event/circumstance specified in the legal documents defining the Qualified Special Purpose Entity (SPC), which is outside the control of the Transferor and causes the fair value of the Financial Assets to decline by a Specified degree below the fair value of those assets when the SPC obtained them.
e. The holder of securities (of the beneficial interest) may exercise its right to put that beneficial interest back to the SPC.
f. Using a request by a Transferor or readiness for "removal of accounts provision" [ROAP] Specified in the legal documents of the Qualified Special Purpose Entity.
g. Dissolving the Qualified Special Purpose Entity or claiming securities issued on a date Specifiable or Specified from the outset.

The Qualified Special Purpose Entities can get off-Balance-Sheet treatment when it's not stipulated that they must be consolidated as Variable Interest Entities according to the Financial Accounting Standard Board Interpretation No. 46.

Changes in Accounting Process as for Special Purpose Entities: In June 2009 A.D., the Financial Accounting Standard Board [FASB] issued the Financial Accounting Standard No. 166, and the Financial Accounting Standard No. 167. The Financial Accounting Standard No. 166 amended the guidance of the Financial Accounting Standard No. 140, while the Financial Accounting Standard No. 167 amended the consolidation model of the Financial Accounting Standard

Board Interpretation No. 46. Those amendments or revisions eliminate the concept of the Qualified Special Purpose Entity and modify the conditions under which assets may be excluded or the recognition of assets may be cancelled. Those conditions are related to the legal isolation and the efficient regulation. Both the Financial Accounting Standard No. 166 and No. 167 have come into force as of 2010 A.D.

As a result of the elimination of the Qualified Special Purpose Entity [QSPC], the Financial Accounting Standard No. 167 [FAS 167] will change the determination of whether consolidation of a Variable Interest Entity [VIE] is required from a quantitative to a qualitative analysis. The proposed standard will require a company to consolidate a VIE if it has a Controlling Financial Interest in the VIE. A company will be deemed to possess a Controlling Financial Interest if it:

a) Has the power to direct matters that most significantly impact the activities of the VIE, including its economic performance;
b) Has the obligation to absorb losses from the Variable Interest Entity [VIE] that could potentially be significant to the VIE or has the right to receive benefits from the VIE that could potentially be significant to the VIE.

The International Accounting Standards Board [IASB] has published ED 10, "Consolidated Financial Statements" which is expected to replace the existing International Accounting Standards27 [IAS 27] and the Standard Industrial Classification 12 [SIC-12]. The Consolidated Financial Statements propose a Uniform Control-Based Model as the basis for consolidation and expansion of the disclosure requirements. The model defines control as being made up of two components: power to govern an entity and exposure to returns both positive and negative from that entity. Those proposals are expected to result in little change in the scope of consolidation for operating companies, but will introduce a new term "Structured Entity" which is similar in scope to Special Purposes Entities as defined in the Standard Industrial Classification 12 [SIC-12]. This Uniform Control-Based Model may change consolidation decisions for SPCs where a Sponsor has currently the majority of risks and rewards but has delegated significant decision-making power, such as the right to operate distressed assets, to a third party. In such circumstances, a Sponsor may be

considered not to control a Special Purpose Entity [SPC], when such Sponsor does not have any power to govern significant decision-making processes related to such Entity.

3.8.1 Taxation

Special Purpose Entities [SPCs] are usually structured to be tax neutral, that is, so that their profits are not taxed. The failure to achieve tax neutrality would usually result in taxes being imposed once on the income of the Sponsor and once again on the distributions from the SPC. This "double tax" would most likely make SPC unprofitable for the Sponsor. There are a number of ways to design a SPC to achieve tax neutrality.

Many SPCs are incorporated in a Tax Haven Jurisdiction, such as the "Cayman Islands" where they are treated as "exempted companies". An exempted company is not permitted to conduct business in, for example, the Cayman Islands, and in return is awarded a total tax holiday for twenty years, with the possibility of a ten-year extension.

A Finance Trust-Based Agreement (Investment Trust) that issues pass-through certificates is tax neutral; that is, the Trust is ignored for tax purposes and the certificate owners are subject to tax. Pass-through certificates represent Equity Shares or Pro Rata Interests which, in turn, represent Underlying Securitized Pool of Assets. To maintain this tax-neutral status, it is important that the SPC not be reclassified as a corporation. To avoid such reclassification, Trustees must have no power to vary the investments in the Assets Pool, and its activities must be limited to conserving and protecting the assets for the benefit of the beneficiaries of the Trust.

More common than Pass-Through Structure is Pay-Through Structure. Pay-Through Structure bonds are issued by Special Purpose Company [SPC] that is corporation or owner of a Trust. In these structures, the SPC issues bonds, but this requires that there be a party that holds the residual risk; an equity holder. If the SPC is a corporation, then the Pay-

Through Bonds have minimal tax at the corporate level because the SPC's taxable income or loss is the difference between the yields on its assets and the coupons on its pay-through bonds.

One of the most crucial tax issues in a securitization transaction is taxation on a Special Purpose Company. The ultimate cost of a securitization transaction would be increased if the taxation on a SPC leads to a double taxation of the originator's income. In some cases, the treatments may be economically blocked; a matter which makes investors at a loss whether or not the tax burden on SPC damages assets available for investors.

3.9 Securitization of Special Purpose Company (SPC)

3.9.1 Definitions

Securitization in its widest sense implies every such process which converts a financial relation into a transaction. Securitization is deemed the best financial instrument which provides liquidity for assets. It starts with a company collecting and pooling a set of standardized homogeneous assets, converting them into credit-enhanced tradable securities and selling them to investors. Therefore, Securitization is basically defined as the conversion of yielding assets into tradable securities and transferring ownership of assets from the originator (the original owner of assets) to investors. Securitization depends heavily on technical innovations in an ongoing process of restructuring and reclassifying assets. This helps evaluate performance and diversify subsequent funding to achieve an income and evade risk of bankruptcy.

Experts believe that Securitization Sector will witness a world and regional revolution as it's considered an alternative financial solution. In this regard, they rely, as evidence, on a remarkable development in this sector in some countries such as: USA, UAE, India and Russia. That is why, the researcher, in this Chapter, discusses the essence and characteristics of this important process to come up with the definition, elements and significance of this process as well as

the importance of Special Purpose Entity which plays a role, as an intermediate, in transferring assets from an originator (the original owner) to investors.

In this chapter, these matters mentioned above are explained in the upcoming sections as follows:

- The Essence of Securitization.
- Elements, Importance and Parties of Securitization Process.
- Types of Securitization & Comparison between Traditional and Islamic Models With Regard To Issuance of Securities (Sukuk).
- Justifications of Securitization.
- Legislative Dimension (Methods) and Accounting Dimension of Securitization.
- Role of SPC in Securitization.

Some researchers have called the process of securitization as "*Taskik (Sukukization)*" or "Tawriq", therefore, we will explain here the meaning of each.

Taskik: Linguistically: In Arabic language, "*Sakk* صك" has more than one meaning: severe beatings or a document/instrument written as a trust, as an acknowledgement of money or for purposes of transactions. Sakk is an Arabized word meaning "money instrument" or the like.

Terminologically (in Islamic Law)**:** There are some different definitions leading all to the meaning of *Taskik.* The following are the most important of such definitions:

(a) Issuing documents or financial certificates of equal values representing Undivided Shares (Equity) in ownership of Assets (Realties, Usufruct, Interests/rights, or a mixture of realties, usufruct, money and debts) which are really existent or will arise from the outcome of Underwriting. Such documents/certificates shall issue under a contract entered into according to *Shari'ah* and provisions of such contract shall be applied to them.

(b) Creating assets which generate income, as a collateral or basis against issuing securities which are considered financial assets.

(c) Pooling and rating secured (mortgage-backed/collateralized) and unsecured (non-mortgage-backed/uncollateralized) assets, converting such assets into securities (Sukuk) and selling them to investors.

The Securitization, in the light of Islamic Investment, is defined as: documents/papers of an equal value, representing undivided Shares (Equity) in ownership of Real Estate, Usufruct, Services, or in Assets of a certain project or of a private investment activity, whereas the value of such papers, namely securities (Sukuk), are to be firstly collected, underwriting is to be closed and then securities are to be used in the purpose for which they are issued.

On the other hand; Tawriq (Linguistically): is a word derived from "papers الورق".

Terminologically: Economically, Tawriq is defined as:

(a) Conversion of debts into tradable securities (bonds) of equal values.

(b) Conversion of loans and illiquid debt instruments into liquid marketable securities (stocks or bonds). Those are Mortgage-Backed Securities (Collateralized Securities) or Asset-Backed Securities (securities guaranteed by financial assets of expected cash flows). They are not solely backed on Credit Rating (the solvency / the expected debtor ability-to-pay) through the debtor's obligation to pay debts.

(c) A new Financial Instrument whereas a Financial Institution collects a set of Homogeneous Collateralized Debts as a Pool of Assets. These debts are placed in a form of a Credit-Enhanced Consolidated Debt and offered as Securities for public by a specialized underwriting foundation (Underwriter) for reducing risks and ensuring a bank's continuous liquidity flow.

(d) Transforming a deferred debt for the period between the establishment of the debt and the maturity period into papers which can be treated in the secondary market.

There are other convergent but different-in-formulation definitions of Securitization. All of them deal with the fact that transferring the securitization underlying assets to a Special Purpose Vehicle which issues bonds and offers them to be bought by investors through underwriting. Therefore, "Tawriq" is referred to as "*Tasnid*".

"Tawriq" is called "Tasnid" on the basis that the issued Securities are Bonds. "Tawriq" is the Arabic translation of the term "Securitization" which is derived from the term "Security/Securities" and means: "The process of converting loans into tradable securities". Therefore, "Tawriq" is linguistically, derived from the Arabic language word "ورق" (paper) not from the Arabic word "ورق" (silver) which phonetically has a similar pronunciation but different meaning. Of course, persons who coined the word "Tawriq" did not think of the second but the first derivation (paper ورق) and therefore, they derived the word "Tawriq" as a meaning relevant to "Securities أوراق مالية", particularly, "debentures/bonds سندات الدين" from which the term "Tasnid" was derived. "Tasnid" is, therefore, a term interpreting the process of converting the value of Assets wanted to be securitized into securities (bonds/ debentures) and selling them to people. Therefore, these securities represent documents proving co-property of assets desired to be securitized (Undivided Shares/Equity).

It's noted that the terms "Taskik", "Tawriq" and "Tasnid" are synonyms, namely, terminology used as the-same-meaning terms. However, "Sukuk" is implanted in the audience mind as a term specifically meaning Islamic investment which is in conformity with "Fundamentals and Dictates of Islamic Law [*Shari'ah*]". For both the terms "Tawriq" and "Tasnid", they are not commonly used by researchers in the field of Islamic economy since those terms are related to the traditional investment.

According to "Standard No. 17" from "*Shari'ah* Standards" issued by [Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI], the terms "Taskik" and "Tawriq" are synonyms. "Tawriq": it's a term referred to as "Taskik" and "Tasnid", which means "dividing assets, represented in real estate or usufruct or both of them, into units of equal value and then, issuing securities at their values". The final statement of Al-Baraka 22nd Symposium held in 2002 A.D./1423 *Hijri* recommended choosing the term "Taskik" instead of "Tawriq"

which practically means the process of converting debts into bonds; such process which is actually applied in the Islamic financial institutions.

The researcher believes that the securitization process in the Islamic financial institutions does not differ, in terms of steps and benefits, from the Tawriq process in traditional Non-Islamic institutions, but differs in terms of nature of securitized assets. Assets arising from selling, such as Murabaha (Pre-agreed Profit) or Istisna'a (Contracting), may not be securitized because these assets are debts due from debtor, which means that these assets may not be sold and securitization is a process of selling. For assets arising from Ijarah Contracts (Assets Rental), Musharakah (Partnership) or Mudarabah (Profit-sharing), they permissibly may be securitized, since real assets owned by financial institutions, and do not represent debts owed by such institutions, may be securitized.

The difference between the two terms, "Tawriq" and "Taskik", is a linguistic difference. "Taskik" (securitization), in its simplest sense, is the process of issuing Sukuk which are defined, as it has been mentioned above, as "the assets which may, according to Islamic Law (*Shari'ah*), be securitized". "Tawriq", in its simplest sense, is the process of issuing securities which are represented in either stocks or bonds which are both of them not allowed in Islam. For the objectives, approaches, benefits and importance of each of them (Tawriq and Taskik), they do not differ from each other.

Based on this conclusion, it has been understood that those both terms, Tawriq and Taskik, show their meanings directly, as they well interpret their own processes. Briefly, when "Taskik" is mentioned it comes to mind that this term refers to a process taken place based on Islamic Norms. Contrarily, when "*Tawriq*" is mentioned it comes to mind that this term refers to a process taken place based on traditional principles.

It's noted that Taskik (securitization) is more inclusive since the underlying assets (securitized assets) may include:

- All kinds of commodities;
- All kinds of permissible real assets such as real estate and aircrafts;
- The allowed services and usufruct (benefits) such as usufruct arising from lease agreements;

- Debts owed by clients such as debts resulted from *Bai' al-Murabaha, Bai' al-Musawamah, Bai' al-Murabaha, Istisna'a* or a mixture of all of these formulations with the existence of legitimate (according to Shari'ah) restrictions and controls, particularly, over securitizing of "legitimate receivables sale" [*Bai' Dayn (Debt Trading)*].

Through discussing the definitions of securitization, we find that they focus on two main points:

Objectives of securitization; which are represented in disposal of illiquid assets and low-liquidity assets by converting them into tradable securities; and management of certain risks faced by financial institutions.

Underlying securitized assets: whereas debts are the pivot around which the abovementioned definitions turn; such definitions which discuss what is known as "debt-based Securities".

In this regard, securitization process is based on three main elements(26):

- First Element: dividing values (capital) into equal indivisible shares which represent the minimum participation.
- Second Element: documenting return of these values by issuing standard documents: equity (stocks), securities (Sukuk) or bonds proving the ownership of holder of such bonds which represent shares.
- Third Element: providing a mechanism of trading these documents in securities markets.

3.9.2 Elements of Securitization Process

- Existence of Original Relationship: A relationship between an originator of securitization and a debtor/or obligor owed rights to the securitization originator.

(26)

- Desire of a creditor/or originator of securitization to dispose of bonds/debentures or assets in hand which are impossible to be sold and transferred to a third party.

A Creditor tends to dispose of bonds (debentures) in hand when a debtor fails to pay, becomes insolvent or goes bankrupt. Guarantees provided by the debtor may not relieve or fulfill the debts due to creditor, but rather, the creditor represented in a bank, often resorts to write off these debts, in addition to financial appropriations incurred through the bank balance sheet for facing such bad debts. The securitization originator that wants to dispose of the assets which are impossible to be independently sold, transfer such assets to a Special Purpose Vehicle which has to be first created and then this Vehicle (company) and its properties are to be sold.

The creditor or originator may not be fallen under threat of risks of debts and illiquid assets but they (creditor/originator) may need cash liquidity to be able to face a new process of lending or fulfilling financial obligations towards third parties. Cash liquidity may even be needed only for satisfying a desire to increase the capital.

- a transferee (party to which the debt is transferred) is to issue new bonds marketable in the securities markets or to issue documents or value-equal financial certificates which represent equity based on co-property of assets.

The party to which debt is transferred (transferee) is an entity particularly established to receive the original debt bonds by means of buying these bonds from the originator and to subrogate such originator, as a creditor against the original debtor. This entity is represented in the Special Purpose Vehicle.

If this specialized entity is not stand-alone, the originator has to create one specifically for securitizing debts. This entity has to be subsidiary to the originator but treated off-balance-sheet as a separate financial disclosure.

Also, the entity which is specially created for buying assets from the originator is called "Special Purpose Vehicle" which is created only for this purpose, namely, buying assets from the originator.

When an originator sells original debt bonds or assets possessed by it to a Special purpose entity, such entity pays cash. Usually, the sale price is lower than the par value of these debts and assets so as to an opportunity for achieving a profit margin for the entity is available. The Special Purpose Vehicle issues securities (Sukuk) and new bonds called Asset-Backed Securities [ABS] and then, offer these securities (Sukuk) and the new bonds (Asset-Backed Securities) to be sold to new investors.

Getting the new securities/Sukuk backed on collateral (Collateralized Securities/ Mortgage-Backed Securities) or on financial guarantees having future cash flows (Asset-Backed Securities). There are several ways for providing these guarantees/collaterals; firstly: Guarantees accompanied with the Sukuk and original debt bonds whereas these guarantees are transferred by force of law subject to transferring Sukuk and the guaranteed debt. Secondly: guarantees provided by the originator such as giving investors the right to refer to the originator in case that there are written off (bad) bonds/securities or providing Special Purpose Vehicle [SPV] with a collateral if the yields of securities/bonds sold to the originator are not sufficient to fulfill periodic investors' dues. Thirdly: insurance with specialized insurance companies for the purpose of covering cases in which SPV fails to fulfill investors' claims. In this regard, companies have appeared called “Monoline Insurer”.

The Special Purpose Vehicle distributes its activities among different fields such as real estate loans, auto loans and credit cards. Thus, the SPV has a big basis (pool) yielding periodic return which is sufficiently used in paying regular interests charged on the new securities/bonds held by investors.

Collateralized Debt; whereas bonds holder borrows a loan guaranteed by such collateral and then, deposits this loan in an account yielding return which contributes in paying claims due to new investors.

On the other hand; return of securities is based on interest rate which is forbidden according to Shari’ah. Those securities are of varied risks: -some of thereof are of risk-free securities, while other ones are of high risk. For the return of security (*Sakk*), which may vary, it is the outcome of investing such assets. A

financial security (*Sakk*) has the same share of return and risk. For the risk, it may increase and vary because of the risks of Islamic forms.

Existence of Religious Supervision Authority, and Monitoring Compliance**:** In the Islamic Model, the Religious Supervision Authority plays a basic role in securitization process, The Authority examines the issuance and setting the religious standards which control the securitization process and make it religiously accepted. In some cases, it is necessary to have an authority that monitors the compliance of an investment manager to such standards, while the Traditional Model does not stipulate the existence of such authority.

Investment of Excess Liquidity in a Special Purpose Company (SPC): Excess liquidity is invested through bonds and other interest rate – based utilities, while excess liquidity in The Islamic Model is invested as per the religious formulations, not the interest base.

Special Purpose Company (SPC): The original securitized may share in, or own the SPC, while it is preferred in The Islamic Model not to be allowed that the original securitized owns a Controlling interest of the company in order to ensure avoiding conflict of interest.

Temporary Cash Shortfalls and Liquidity Facility: In the Traditional Model, and at the first day of a transaction, the Special purpose company purchases only the full-performance assets, but during the investment period some of such assets may transfer into Arrears, which means the inability to pay circular interests on time. This is the first main obstacle on the securitization transactions, as investors of securitization finance do not want to receive only the circular interests when borrowers are able to pay, or want to do that. Investors want to ensure receiving the interests and the loan fund installments always when due. In this regard, the SPC should have what is called" Liquidity Facility "which most likely takes the form of Revolving Credit Facility provided by a Bank (Third Party), and known as (Credit Enhancement). Such Bank shall be of a high credit classification in order to satisfy and enjoy confidence of securities holders so sufficient cash may be withdrawn for settling differences between the interests already paid by borrowers, and loan fund installments (with Arrears), and between payable interests and loan installments for investors (bond holders), while liquidity facility, if applied, in the Islamic Model is based on a non-usurious

interest process. Liquidity Facility Usually provided as a non-interest loan or interest revenues payments on account till collecting arrears is completed when final accounting and calculation securities holders' real rate of return are accomplished.

General Formulation of Issue Structure**:** Securities are usually issued on the base of a sole formulation as per The Traditional Model, and being under the usurious loan base, while Islamic securities are issued on the base of Islamic Finance formulations.

Tenth: Refunding Invested principal at The End of Term: According to The Traditional Model, the original securitized funds the invested principals in the first value thereof, while in The Islamic Model, the original securitized gives priority to "option to buy". Originally, Invested principal is funded at the market price, unless it is agreed to be funded at the first value.

Issuance Coverage: In securitization, if entire issue or a part of it required for purchasing assets has not been covered, securities shall not be issued, and relevant amounts shall be returned to underwriting. Underwriting traditional bonds, although it has a limit, is not bounded to a Specific project. Cash may be provided by separate usurious loans where direct credit risks arise between bondholders and bond issuers.

The minimum circulation of securities is totally different from the same of bonds, whereas in securitization, a security holder sells its equity of assets to a new security holder, while in bond circulation; it is to deduct the accumulated debt due from the issuer.

Securitized Assets: In securitization, sufficient information about assets and projects representing assets should be provided. In dealing with Traditional bonds, information might be provided to satisfy its holders with regard to availability of cash flows which are sufficient to pay revenues and extinguishment of bonds.

Interpretation of Contractual Relations among Securitization Process Parties: Underwriting Islamic Sukuk by investors leads to accumulated participation, while underwriting Traditional bond does not result in any participation among bonds holders, but rather, it is a parallel creditor due to the non- relation of

holders with the project (the common pot that Sukuk represents). Bond holders may comply when required with a Specific authority that guarantees debtors receivables from bonds issuers.

In The Traditional Model, the original securitized keeps playing the role of the manager including collecting the interests and base amount from the borrowers, and paying base amounts to Special purpose companies. The original securitized receives "management fees" for such service. The original securitized in The Islamic Model performs the same task, but it does not receive "management fees".

3.9.3 Securitization Bases and Prospects

Securitization bases concerns the incentives, benefits, and advantages thereof to be utilized by trading crowd and society as practically transferring quick assets and risky individual loans into securities of higher liquidity and less risk. Securitization could attract a collection of investors looking to utilize opportunities by which debt market has been broadened. Investors pursue high returns and high Specific asset-backed securities of good rating. Securitization made such securities available through providing classified warrant as included among the excellent rating levels (AAA) or (AA). This is because of huge variation existing in loans portfolio, and the insistence of credit statements offices to highly protect investors. Therefore, Merrill Lynch could sell a warrant of mortgage-backed securities owned by bankrupt institutions whereas the warrant was insured by guarantees and warranties till it became classified as excellent level (AAA). Banks, financial institutions, and insurance companies prefer securitization as it allows providing loans from the said institutions balance sheet and having it circulated promptly, so that the aforesaid institutions are not obliged to retain debt allocations which are not expected to be collected. Borrowers also prefer securitization as it provides quick sources for cash. And of course stockbrokers endorse securitization as they receive fees for being brokers in securitization process. These are general bases calling for securitization. Obviously, securitization has good and strong bases to be followed by trading crowd.

Securitization's incentives and benefits as follows:

Securitization incentives**:** Securitization main incentive can be understood through its inception conditions that are related to mortgage. Mortgage is relied on a triplet relation between property owner, buyer, and financier, whereas the property owner sells its property to a buyer in installment to be paid within 15-30 years, and in the same contract, the owner assigns its payable installments to a financier who pays him the buyer debts in less value. The amount paid is considered as a loan taken by the buyer from the financier, and to be paid in installments within the agreed period.

A financier may block huge amounts as Mortgage-backed loans borrowed by thousands of buyers, but a financier needs to continue his business of financing while the collected installments are not sufficient and take a long time to be collected. Therefore, it was proposed for the financier to sell its payable loans in order to gain cash.

As it was difficult to find one buyer of all these loans, many buyers are said to buy the loans through dividing its values into small denominations to be issued as securities (bonds) for public underwriting. Consequently, investors willing to invest its savings safely and gain a fixed return apply for the underwriting; as such loans are Mortgage-backed and earn a fixed return called "interest". Securitization brokers, rating agencies, Credit enhancers (underwriters), and other service providers facilitate securitization process which is confirmed as attracting investors.

Securitization's main object is to directly connect original debts with securities by creating a portfolio of debts and issuing guaranteed securities for such portfolio.

Securitization incentives attracting financial institutions to issue securities are as follows:

1. Recirculation of invested capital without waiting for receivables to be collected on different dates. This is because securitization helps in transferring deferred assets into quick assets.

2. Reduction of finance cost and risk; as securitization enables gathering funding resources by adding new investors and that leads to the

availability of long and medium term funding. Therefore, securitization is considered of a less level of risk due to asset-backed securities. Besides securitization requires the separation of servicing securities with its guarantees from securities owned by securities originator.

3. Activation of stock market through collecting new finance resources, varying issued securities thereof, and activating circulation of securities market. Securities also can help financing huge economic activities which can't be exclusively funded by financing agencies.

4. Enhancement of credit capacity and funding structure of the securities originator whereas securitization requires a separated credit rating of servicing Sukuk away from the company which leads to a high credit rating of the servicing Sukuk.

5. Matching between funding resources and uses of cash, as securitization helps the company to generate sufficient liquidity to pay its short term financial liabilities.

6. For the banks that already have financial rights portfolios of huge amounts represented in granted loans and credit facilities, securitization process is of Special significance due to the following points:

1. Enhancement of capital adequacy ratio according to Pazzel standards.

2. Enhancement of matching between deferred assets and financial liabilities.

3. Gaining sufficient funding for granting new loans.

4. Better varying of credit risks.

5. Reduction of funding cost, and varying its sources.

6. Broadening of stock market activities.

In spite of all the said advantages of securitization, it may lead to the reduction of the total moneyed capital in the banking system, and consequently, the financial system may, nationally and internationally, subject to cracking.

This was the economic crisis took place in U.S.A. 2008.

Therefore, the main incentive of securitization is to generate liquidity for holders of non-actively circulated assets of which due and rating dates are deferred, and creating a new attractive way for investors to invest its cash.

Benefits of securitization**:** Securitization provides benefits for society and trading crowd thereof, most importantly:

A) Disposition of balance sheet restrictions. It is acknowledged in accounting that securitized assets are considered as debts usually included as an item of the balance sheet. When measuring capital adequacy and credit risks, such debts to be precedent and adjusted in value as per the estimated restriction set forth of non-collecting some of thereof. Therefore, securitized assets' value is decreased. In the capital adequacy equation, assets are set as numerator so that adequacy is reduced due to decrement of such asset on a par value of risk ratio. When such assets are securitized, it is to be omitted from the balance sheet and added to the Special Purpose Vehicle (SPV), and to be replaced by the paid price by the company. As a result, asset value and capital adequacy ratio are increased.

   Creditor institution may deduct a Specific proportion debts value from its revenue in order to constitute an allocation of non- collected loans which reduce net profit. By securitization, allocation balance is omitted, added to revenue, and not included in balance sheet.

B) Securitization is an alternative method for funding other than borrowing from other institution, or increase of capital by issuing new shares, with restrictions and obstacles such methods may comprise.

C) Securitization transfers illiquid and blocked assets into liquid assets to be circulated again by an institution, and makes business volume broadened.

D) Securitization decreases credit risks; as institution securitizing some assets thereof is not committed to pay its values for security holders. Therefore, by securitization, the institution assigned credit risks to others, divided, and distributed it to security holders.

E) Merging credit and capital markets results the activation of stock market through circulating securities issued by securitized assets.

It is worth mentioning that incentives and benefits of securitization are applied in The Traditional Securitization of debts and in The Islamic Securitization as well, with consideration of all the differences between the two types.

For the prospects and challenges of securitization, it would be a difficult task to develop a broad market of loans; as most of assets supporting securities are not of similarity, and it is hard to predict cash flows expectations. This construes the investors panic buying of securities organized by Genie Mae. Such securities focus on the attractive commercial mortgage loans; as lenders comply with firm guidelines including the proportion of loans to assets, while it is contrarily performed in the residential mortgage loans, whereas it is developed slowly due to the variable standards of loans among lenders. Some of securitization trading crowd worry about the unexpected risks of Specific assets; as some securities become of less liquidity than loans funding same assets. Also some concerns directed to banks provision of attractive loans that considered, when securitized for new time, not to face any obstacles. This may prevent many borrowers, who can comply with the normal credit terms, from gaining loans, and incorrectly, don't help society or national economy fulfill the needs for cash.

Main challenges of securitization are as follow**:** Lack of awareness of securitization's economic significance.

A. Absence of religious base controlling issuance and management of securities.

B. Weakness of work mechanism in secondary markets (if any).

C. Rareness of circulation, in the secondary market, between banks and few investing institutions resulting extension of clearing and circulation procedures.

D. Ambiguity of securitization regulatory texts.

E. Difficult availability of necessary factors to protect security assets from other owned assets risks.

F. Juristic differences in spite of religious standards.

G. Some securities are considered a type of the religiously forbidden credit operation.

3.9.4 Legislative and Accounting Dimension of Securitization

3.9.4.1 Legislative Dimension

Securitization legislative dimension focuses on interpreting the legal sequence of transferring, as securitization is based on transferring or assignment of securitized assets, meaning the conversion of securitized institution into Special Purpose Company SPC.

Securitization of usufruct and tangibles depends on the real sale of securitized asset to securities holders. While debt securitization is done by one of these methods; -

Transferring assets by renewal, assignment, and novation: such method is also acknowledged as the replacement of original securitized party of assets by Special Purpose Company (SPC).

This method is based on a triplet agreement between debtor, securities originator (original creditor), and Special Purpose Company, and stipulates the termination of financial liability between debtor and original creditor, and establishment of new one between debtor and Special Purpose Company. Real securities, ensuring the execution of the original liability, are not transferred unless it is approved among the three parties to be transferred, and the personal securities are transferred only due to the approval of underwriters. Such method is discriminated from receivable assignment method in two aspects:

- Debtor is not considered a party of the receivable assignment agreement, and to be only noticed of the transfer process in order to cease paying the original debt, while debtor is considered to be a main party in the agreement of renewal.

- Real and personal securities provided by the debtor to the creditor are transferred to the Special Purpose Company by an assignment contract, while such securities are transferred in the renewal only by approval of thereof.

This is the only method by which debts and financial liabilities are transferred; as it comprises the replacement of original debts and financial liabilities by new ones. Also, it is the same mechanism of selling accounts receivables resulted of credit cards allotted for retail stores.

The main difficulty of this method lies in gaining advanced consent of all parties on the original debt, and it is considered as a complicated difficulty especially in case of accumulated debts.

The main legal obstacle of Novation is represented in the priorities and issues arisen about the value gained by the purchaser. Such value is to be determined in order to avoid debt priorities, and failure to pay receivable wages pursuant to Insolvency Act 1986.

The aforesaid method is based on the novation of a creditor by replacement of Special Purpose Company instead of original creditor. As a sequence, a debtor original liability is terminated, and a new liability is established. One flaw of this method is that in Securitization, securitized loan is granted to many borrowers whose consents are required to transfer a debt to a new creditor, which is considered hard to be fulfilled.

Transferring Assets by Assignment**:** Receivables Assignment is one image of transferring liabilities, and is defined as; creditor's assignment of its receivables to other creditors.

Receivables Assignment is different from debt assignment by which a debtor transfers its creditor to a new one, while in a receivable assignment, an original creditor is the transferor, a new debtor is the transferee, a debtor of original creditor is the debt transferee, and a debt amount is the transferred amount.

Assignment in securitization is defined as; securities originator (original creditor) assignment of its receivables, including value, currency, interests, installment,

and guarantees, to a Special Purpose Company for a less value than the debt's in order to have it securitized by public underwriting.

Original creditor (transferor) role is expired once assignment due is completed in a manner not to collect debts or guarantees the payment thereof, unless it is agreed to collect debts as a representative of the Special Purpose Company (transferee) for fees.

This is the method followed in securitizing receivable accounts arisen of motor sale… etc., and by which assets are assigned to creditors, while in respect of Hire-purchase contract, the lessor continues paying installments for the original funder who, in return, transfers the same to the receivables accounts purchaser or pays the same through a series of approved assignments upon securitization agreement. The lessor regains amounts from leasers as a return.

There are two ways of assignment; an assignment by a notice directed to the borrower or the debtor, or an assignment of debt without a notice.

In case of an assignment without a notice, more risks incurred by the debt purchaser including as the most significant the existence of the debt assignor account in books, and the continuous payment to the debt assignor in order to, in return, pay to the debt purchaser. The late said case already exists even when there is an issued notice as debt assignor is still liable to the debt purchaser in case the original debtor fail to pay.

Upon securitization parties' agreement to follow the said method, it shall consider these steps:-

1. Ascertain the non-existence of any related documents to the assets being transferred which may comprises terms restricting transferring thereof.

2. Assets are considered transferable according to the legal regulations applied thereon.

3. Ascertain the stipulation of the debtor approval of transfer. If regulations stipulate debtor's approval, transfer is not affected till the approval of debtor is gained.

4. Due is to be transferred to a transferee with all its guarantees, warranties, liens, and gages, unless otherwise stipulated by warrantors. This is to be considered upon entering securitization agreement.

5. In case of debt instruments or any other guarantees of variable interest rate, a minimum irrevocable interest rate shall be agreed upon in order to ensure payment of interests and expenses for investors.

   Sub-Participation: This method is based on entering an agreement between securities originator (original creditor), and a bank known as the partner bank or the leader. The agreement set forth the bank provision of a loan for the institution in return of debt instruments; as the partner bank repossess its amounts and interests when the institution begins to receive installments and interests from debtors and deliver it to the partner bank respectively.

   Such process is considered as a loan granted by the partner bank and guaranteed by the receivable debts of the institution, besides relating such loan payment to proceeds of debtors without ant connectivity between the partner bank and debtors.

   The institution shall be obliged of payment only upon receiving amounts from debtors, and the partner bank shall undertakes debt securitization as it is an originator as well.

   The partner band is subject to a “Binary Credit Ban**”** as follows:

   a. If securities originator is bankrupted while it still possess debtors' proceeds not yet delivered to the partner bank. Such proceeds become included in the debtors general guarantee without being allocated to the partner bank.

   b. If debtor is under insolvency or bankruptcy, the partner bank becomes affected as collecting its receivables based on debtors' proceeds.

   It is worth mentioning that due assignment is the most applicable in securitization process.

The aforesaid methods are applied only in debt securitization, while usufruct and tangible assets securitization is based on the real sale of securitized assets to securities' holders.

3.9.4.2 True Sale of Assets

True sale is defined as the transfer of possession from an individual to another, other than accounting sale by which debt instruments shall not be actually transferred from owner to purchaser, but only in company books. Should the sale of debt instruments be a true sale, the following terms should be fulfilled:

- Majority of Special purpose company's shares should be owned by a separate individual other than the originator bank.
- The said separate individual prevailing on the Special purpose company's management.
- The said separate individual incurrence of essential risks and advantages arisen from the ownership of debt instruments or any other assets.

Also there are some standards that discriminate between true sale, and guaranteed loan. Guaranteed loan is the loan granted by the originator bank to the Special purpose company to accomplish securitization process. These standards including:

Chapter (4)

LEGAL AND SHARI'AH FRAMEWORK FOR SPECIAL PURPOSE COMPANY IN ISLAMIC FINANCE

4.1 Introduction

This dissertation is appraising issues pertaining to legal compatibility of Special Purpose Company use in contemporary Islamic Finance product structuring (i.e. Sukuk). Sukuk serve a powerful tool for Islamic financial institutions to mobilize funds from the Islamic capital market, and to extend financing through Islamic capital market operations. In Shari'ah values, Sukuk have to represent the ownership of either underlying assets or usufructs or services of the business entity based on asset securitisation concepts as explained in previous chapters, where the return is justified by risk taking coupled with risk mitigation principles. Nevertheless, the present state of Sukuk practices is detached from its ideal values because to some extent a western legal framework is not supportive enough for Sukuk operations in the Islamic capital market to comply with Shari'ah values. As a result, the structure of Sukuk is heavily influenced by conventional bonds practices governed by the western legal framework. Due to that fact, in this research, Sukuk structures are scrutinized to examine legal impediments inherent in Sukuk contract. This research portrays that western legal system is not supportive enough for Sukuk to protect the rights of Sukuk holders in the event of Sukuk defaults. Regulatory and financial implications are suggested as anticipations to any future Sukuk defaults. One of the objectives of this dissertation is to sustain Islamic Finance product development in the Islamic capital market, where Shari'ah and western legal framework can be in a harmony to govern their operations.

4.2 Finance Trust - based Special Purpose Company

The Fund of Funds is lawfully and practically a type of Finance Trust - based agreements and run by Company of Trustees or Board of Trustees; where

Assets of Trustees are managed by an Independent Asset Management Company. Generally speaking, this fund is deemed the current structure and legal establishment which satisfies requirements of the Special purpose company in securitization process.

Programs and Plans developed by the Mutual Fund of Funds are quite separated from each other; due to the fact that there is a must for a separate maintenance account for each program. Moreover, Holders of Investment Units for each program must be proprietors of Undivided Beneficial Interests in Program Assets. Holders of Investment Units have the right to get shares in profits declared by Asset Management Company or Trustees unless the program has guaranteed returns. Further, in case of Initial Investment or Capital Unit Loss; Investors will shoulder the loss.

Pooling Process constitutes a base for the Mutual Fund of Funds and Mortgage Backed Securities [MBS]. The fund of funds buys assets such as bonds and shares. Furthermore, the Fund sells Securities or shares as long as they provide a relative share of Basis or pooling market value. The investors get average or modified returns of pooled assets without any need for buying Shares of single assets.

Managers of Mutual Fund of funds issue Shares to investors in return for Cash Money Sums. Moreover, those managers undertake contractual obligations of buying single shares. However, Holders of shares have a right to claim relative interests of the Investment Fund, operation fees and authorization or commission payments.

Why do investors prefer buying the Fund of Funds shares to buying individual shares? In the light of complete market loans and free of charge transactions and ideal distributions of shares, Investors will no longer tend to buy the Fund of Funds shares because they can do as the case with the fund itself. The physical world is neither perfect nor ideal and the Fund of Funds shares are available due to market deficiencies and disadvantages.

As for Transaction Costs, the Shares trade is costly due to commission or authorizations costs for share brokers or share intermediaries; however commission or authorization costs are lower for those brokers and intermediaries

who make huge trades on the ordinary basis. Therefore, the fund of funds possesses an advantage and a virtue; owing to that transaction costs of the Fund of Funds are lower than Individual Shares Trade.

The indivisibility is where each individual buys a security with a high price for one share. For example, some company trades in 10000 (ten thousand) Dinars for one share. Some investors may need to buy some of this company's shares, but it will impossible for those investors to buy a few numbers of shares such as ten shares. On the other hand, individual can hold shares in the Fund of Funds where he easily holds one hundred shares or so in the company. In return, Fund of Funds supplies a share of the first company's value to that individual.

Costs of obtaining Information: In the light of the complete market conditions, all investors hold the right to access the same information of lending process which is flagrantly violated in the physical world. It is worth mentioning that Information gaining is a costly issue, however the Fund of Funds applies the same information policy in behalf of all investors in a manner that saves macro-economies.

The Fund of Funds holds most of the Special Purpose Company's desired characteristics for securitization process as following[1]:

1. Fund of Funds allow issuance of securities.
2. **T**he Fund of Funds are structured in Master Trust contracts in a way that provides flexibility prerequisite for issuing units in multiple programs, keeps Cash money pooled in programs and consequently rights of investors in various programs are distinct from each other. For example, Funds of Funds are structured in a type of Master Trust Contracts in accordance with Master Trust Contracts Law of 1882 in India.
3. Mutual Fund of Funds' income must be exempted from Taxes in accordance with the applied laws in most of countries; for example in accordance with provision ten (23d), Income Tax Law of 1961s in India (Cox, Samuel H., 2000).

In brief, Funds of funds are in use because they indicate much more efficiency and they can serve as a vehicle to overcome some negative effects of market deficiencies.

4.3 Finance Trust -Based Agreement Law

Oftentimes the Finance Trust-Based Agreement based company is the institution which is mostly the commercial bank. This company is established to facilitate crediting process of agencies and deposits. This entity is naturally propertied by three types of structures which are as following: an independent company or a bank or a law firm. Further, each one of these three structures exerts the Trustee's role for various types of deposits and real estate's Management. The Finance Trust -Based Agreement based companies aren't required to practice all their incumbent powers. Moreover, the Finance Trust -Based Agreement based company in certain place of jurisdiction which doesn't practice its duties as a Finance Trust -Based Agreement based company; it has no relation with another place of jurisdiction. Therefore, it can be stressed that the term of a Finance Trust -Based Agreement based company mustn't be narrowly interpreted.

This Trust term refers to capacity of establishment administration which is based upon finance Trust -Based Agreement to practice Trustee's roles. Moreover, The Trustee is an individual who holds financial assets on behalf of another individual. These assets are usually in a type of deposits. It is worth mentioning that this is a legal vehicle which specifies beneficiaries of assets and domain of money expenditure.

The trustee manages investments, keeps records, manages assets, prepares court's accounts, pays bills according to the Finance Trust – based agreements, prepares the charity gifts and finally manages inheritance or other distributions of income and the like.

In Common Law Systems, the Finance Trust -Based Agreement is a type of relationship whereby properties including real estates, tangible and intangible estates are run by an individual or some individuals or by organizations for the good of another body. This type of contracts is established by the in charge of legal settlement or organization; namely donors or testators who confide some or all properties to a selected personality. The selected personality, who is the trustee, holds a legal claim of the deposited property, however that personality must keep these property for the good of an individual or individuals or

organizations; namely the beneficiary who is usually defined by the testator. In other words, the trustee shoulders the credit duty for the beneficiary who is beneficiary of the deposited property. The Finance Trust -Based Agreement is subject to Deposit document conditions which are usually written and sometimes take the type of contracts. Moreover, This Finance Trust -Based Agreement is subject to Local law and the Trustee abides by managing this contract in a manner that is compliant with deposit document conditions and the governing law.

4.3.1 Finance Trust and Islamic Law

Idea of finance trust based agreement in common law is familiar to Muslims; because endowment System in Islam Sharia and idea of this type of contracts are alike in many sides; where properties of some individual are given to a third party; to be kept for the good of other people. Muslim may use the Finance Trust -Based Agreement to achieve many aims; owing to flexibility of this type of contracts which permit to abide by Islamic Sharia Rules and keep other peoples' properties.

In principle, it seems clear that Master Trust Contracts (Trust-Based Agreement) can be used to transfer properties to a third party and as a mechanism to guarantee either abidance by Islamic Sharia principles or contradiction with these principles.

In principle, there are different pathways to have a role in Finance Trust -Based Agreement Process; to achieve the main aim. However, it is very important to notice that these pathways work in a parallel way and of which are the following ones:

- The Custodian or the Defender: The trustee can appoint a scholar of legitimate sciences; as a Custodian Finance Trust -Based Agreement or deposit. It is evident that the general idea of custodian role invests some positive or negative powers of Finance Trust -Based Agreement in someone other than the Trustee. Practically speaking, the trustee's selection for a scholar of legitimate sciences is based upon a premise that powers of scholars are limited to tasks of the agent.

- The scholar is like the trustee: If role of assistant is vital, it will be necessary to appoint the scholar as one of trustees. This matter will lead to conformity between daily activities of the agreement with the Sharia rules. However, this agreement is practically run by an external or unknown judicial power. Therefore, this issue won't be suitable for application.
- The investment consultant: Providing a scholar for the trustees to be one of them or for purposes of consultation in issues relating to their investment decisions or to their freedom of action; is considered one of the less formal solutions or alternatives. Moreover, appointment of a Shari supervision committee is one of very important issues in Islamic Banking world. This committee is composed of Islamic science scholars who are experts in Islamic Banking Services and Financial tools. It is worth mentioning that advice of this committee is very vital especially in relation to investment decisions and selecting the financial instruments; for the sake of guaranteeing compliance with the Islamic sharia rules.
- Type of Finance Trust – based Agreement: Narrowly speaking, the Finance Trust – based Agreement in designed in conformity with the Islamic Sharia. It may be said that it takes a type of fixed interests for various relatives of testators who are defined on the agreement.

One of the most important considerations on this contract is that this contract is liable to be revocable in principle. It is evidently significant that we shouldn't ignore Finance Trust – based Agreement is a revocable agreement. The deliberate thinking becomes a priority when contemplating interests of beneficiaries from such agreement; due to the fact that such interests may come out of compulsory inheritance laws for the guardian of underage children in cases of death.

In brief, there are various methods which can be flexibly used in Finance Trust – Based Agreement; for confirming the suitable consultation the trustees followed and for asserting the complete supervision over suitable principles of Islamic Sharia laws.

4.3.2 Notices on Dictates of Islamic Law

The key to know conformity of any investment with the Islamic sharia laws is that this investment must be free of prohibited transactions legislator indicates based upon Quran and *Sunnah*[1]. One of the most prominent examples of Haram is usury which is prohibited in Quran. Further, Usury is widespread in the western financial organizations through charging interests on loans. Interest idea isn't fair from the Islamic Sharia prospective. On the other hands, there are many economic reasons which stress the idea that abiding by paying an interest for any type of commercial activity which is dubious itself, is economically unfair. For example, merchant or businessman is forced into paying an interest irrespective of profitability or unprofitability of the business itself. Consequently, the rigid system of usury leads to bankruptcy, inflation and tastelessness of project organization. There is a condition to make investment halal or legitimate which is there are no fixed interests. Instead, the investment must have an opportunity for achieving interests and facing loss risks.

4.3.3 Examples on Dictates of Islamic Law:

A. Lease Contracts**:** Although Islamic financing foundations call these types of contracts lease agreements, the most effective type of the lease contracts the Islamic Sharia permits is Lease agreement then purchasing. The commodities are delivered on prompt and lessee pays in installments. Then property will be transferred to lessee on the final payment agreed upon.

B. There is a type of Futures Contracts called Commodity Futures which are contracts for future purchase or sale of goods at a set price and date in the future.

C. Finance trust – based agreements Unit: These investments fall into investment category Islamic Banks prefer; where investors invest its Capital in one of Finance Trust – based agreements Units with other individuals without taking any type of guarantees of fixed interests on its Cash Capital. Despite the fact that value of each unit may rise, it may go down at any time too. Non - fixed interests for Capital is deemed an anxiety point for investors,

[1] Authenticated source of prophet Muhammad (peace be upon him)

however this makes interests of such investment legitimate (halal) and as a result conformable with Sharia.

D. Equity Shares: direct investment in assets and shares is in conformity with the Islamic Sharia; because interests of investment in shares, returns of shares and value increase of each share are in conformity with the Islamic Sharia principles. By nature, share interests aren't guaranteed and are based upon discretion of company board. Moreover, these interests may fluctuate in value up and down. Consequently, any share interests will be halal in principle, due to the fact that investor while making investments won't wait for fixed or predetermined interests and will jeopardize its equity shares.

E. *Mudarabah* (Profit-sharing) is a type of financing businesses and is like common types in Cash money financing project. On this type of contract, equity or Cash capital is given to some business in return for an interest quota which is to be agreed on by partners and generated by business. Once again, investors jeopardize their equities by receiving some of the company's profits rather than a fixed regular payment. Consequently, this profit is legitimate (Halal); because investors don't have a share in this business management.

F. Joint Venture Means (Partnership) is unlike *Mudarabah* wherein investors have no share in business management. On this type of contracts, all investors provide Capital money of some business and divide profits according to their investment principles as the case with Capital Financing venture. In reality, Non - fixed returns for investors and Money loss Risk make investment profits legitimate (Halal).

The company whose contracts are based upon trust or Trustee Company is like Special Purpose company despite the fact that Trustee's role is assumed by some company who has an authority to issue Pass – Through Certificated for investors as the case with individuals. Further, pass – through terminology

means that company receives money from money owner and transfers it to investors.

One of the most important characteristic of Trust is that it has an authority to take receivables from originator and keep them according to its capacity as a trustee. The Finance Trust based agreement management must make sure that company can assume trustee's role and keep separate trenches of relevant receivables for various transactions. Moreover, Trustee's company isn't responsible for goodness of Assets performance. Asset management by Trust or Special Purpose Company can be partly held by originator or any service provider based upon an administrative agreement featuring various tasks which originator must shoulder in its capacity as a manager or in charge official.

As for the practical framework of Trust, securities the Trust issues won't constitute a binding deb such as Path through certificates. Moreover, Path through certificate refers to interests of receivables or pool of assets which are transferred to securities. The Path through certificate represents a declaration or a statement of interests in pools of assets which are transferrable in case of beneficiary change. Finance Trust based agreement management will confess to changing beneficiaries by enhancing Path through certificates.

There is no transfer of interests in finance trust based agreements; as well as securities will be continuously held on such agreement even if beneficiaries are changed and will be presented in a type of classes. The Path through certificates won't be regarded from transferrable receivables; due to the fact there is no transfer of interests from trustee to Path through certificate holder. The trustee continuously holds property of beneficiaries since emergence of finance trust based agreements and possesses no authority either to sell or transfer such property. Moreover, this contract isn't revocable. Owing to the fact that there is in definition of any interests in Path through certificate issuance phase, there won't be any retransfer process on changing certificate holder.

There is a must for an announcement of finance trust based agreement which is regarded as an integral part for all pools of receivables in each securitization process. Further, each announcement must include a promotion brochure; to exactly describe all available programs as well as inclusive privileges of unit holders affiliating to each program.

4.4 Finance Trust Based in Special Purpose Company Securitization

4.4.1 Master Trust

A master trust is a type of Special Purpose Company particularly suited to handle revolving credit card balances, and has the flexibility to handle different securities at different times. In a typical master trust transaction, an originator of credit card receivables transfers a pool of those receivables to the trust, and then the trust issues securities backed by these receivables. Often there will be many tranche based securities issued by the trust all based on one set of receivables. After this transaction, the originator typically continues to service the receivables, in this case the credit cards.

There are various specific risks involved with master trusts. One is that the timing of cash flows promised to investors may be different from the timing of payments on the receivables. For example, credit card–backed securities can have maturities of up to 10 years, but credit card–backed receivables usually pay off much more quickly. To solve this issue, these securities typically have a revolving period, an accumulation period, and an amortization period. All three of these periods are based on historical experience of the receivables. During the revolving period, principal payments received on the credit card balances are used to purchase additional receivables. During the accumulation period, these payments are accumulated in a separate account. During the amortization period, new payments are passed through to the investors.

A second risk is that the total investor interests and the seller's interest are limited to receivables generated by the credit cards, but the seller (originator) owns the accounts. This can cause issues with how the seller controls the terms and conditions of the accounts. To solve this, language is typically written into the securitization to protect the investors and potential receivables.

A third risk is that payments on the receivables can shrink the pool balance and under-collateralize the total investor interest. To prevent this, often there is a required minimum seller's interest, and in the case of a decrease, an early amortization event would occur.

4.4.2 Issuance Trust

In 2000, Citibank introduced a new structure for credit card–backed securities, called an issuance trust, which does not have limitations (like master trusts sometimes do) that require each issued series of securities to have both a senior and subordinate tranche. There are other benefits to issuance trusts: they provide more flexibility in issuing senior/subordinate securities; they can increase demand, because Superannuation Funds are eligible to invest in investment-grade securities issued by them; and they can significantly reduce the cost of issuing securities. As a result, issuance trusts are now the dominant structure used by major issuers of credit card–backed securities.

4.4.3 Grantor Trust

Grantor trusts are typically used in automobile-backed securities. Grantor trusts are very similar to the pass-through trusts used in the earlier days of securitization. An originator pools together loans and sells them to a grantor trust, which issues classes of securities backed by these loans. The principal and interest received on the loans, after expenses are taken into account, are passed through to the holders of the securities on a pro-rata basis.

4.4.4 Owner trust

In an owner trust, there is more flexibility in allocating principal and interest received to different classes of issued securities. In an owner trust, both interest and principal due to subordinate securities can be used to pay senior securities. Due to this, owner trusts can tailor maturity, risk, and return profiles of issued securities to investor needs. Typically, any income remaining after expenses is kept in a reserve account up to a specified level, and all additional income is returned to the seller.

It is observable that there are different types of Finance trust based agreements; however all of them aren't Islamic sharia rules compliant; because they are based upon interests (usury) which are prohibited in Islam Sharia. This problem can be avoided through one of methods appropriate for Islam.

4.5 Islamic Jurisprudence of Special Purpose Company

4.5.1 Securitization Process Parties

Before embarking on the jurisprudent interpretation of relationships amongst securitization process, researcher finds it suitable to explain procedures of securitization process; because this process is conducted in relation to specific steps and numerous stages. These points are conducted through three phases as following:

a. Securitization issuing period
b. Securitization portfolio servicing
c. Repayment of Sukuk Holders
d. Securitization issuing period

First step: Originator must designate assets needed to be securitized through pooling all its various assets in one investment pool called investment portfolio and transferring them to Special Purpose Company which is an independent entity established by originator according to decision of Money market Authority in conformity with special conditions and procedures.

Second step: Securitization and selling Assets. The Special Purpose Company re-categorizes assets and divides them into parts or units appropriate for needs and desires of investors as well as transferring these assets to Sukuk and selling them to investors.

4.5.2 Mechanism of Islamic Sukuk issuance

The Islamic Sukuk issuance process is deemed a window wherefrom issuers or their agents look at investors. Consequently, this process must be of high degree quality. Further, Sukuk issuance process includes preliminary steps called issuance organization or ordering and can be summarized in the following steps:

First: preparing proposal or an organizational structure representing the investment mechanism by Sukuk, studying legal, organizational and procedural problems and feasible studies as well as grouping all these points in issuance brochure. This may synchronize with drawing the system or the regulations and agreements that define rights and duties the relevant different authorities (Abu-

Ghuddah, 2005). Further, there is much importance in selecting such authorities; to assure underwriters. This step is supposed to be taken by body issuing Sukuk; namely by financing investor or by beneficiary of financing.

In most cases, the body issuing Sukuk depends on experienced individuals to take control of organization process for a commission; in addition to a legal authority to make sure that all procedures are Islamic Sharia laws and regulations compliant.

Second: representation of Sukuk holders or investors through finding independent personality; to represent them in searching process for relationships with different bodies.

Third: Offering Sukuk for underwriting, to pool money prerequisite for financing assets represented by Sukuk (Alshayji, 2005).

Fourth: Sukuk marketing is conducted either by directly offering them to the public or by selling Sukuk as a one package to the first investor which may be a bank or a host of banks; to market and sell Sukuk to the public.

Fifth: Undertaking to cover underwriting: Undertaking process may not take place with full issuance of securities. So there will be a must for existence of a body which abides by covering underwriting process for this unwritten part and selling it to other investors**.**

After that, an underwriting process starts which constitutes the real contract stage between project proprietor and investors, after these preparatory steps for issuing Sukuk and then the post underwriting preparations come.

4.5.2.1 Underwriting process

Underwriting is a binding contract for all parties whereby underwriter abides by having a capital quota in the company in a type of shares which underwriter uses in underwriting process. In other words, underwriting is defined to be a lawful act whereby individual abides by having a share in the joint stock company and providing a quota of its capital (Antaki, 1964). The law experts differ over the underwriting process nature where some experts think underwriting is deemed to be a lawful act with a single will, while others believe underwriting process is a complete contract between underwriter and company represented by originators

(Al-Akili, 2007). Underwriting contract includes offering and acceptance: offering is considered to be the statement originators issue to all people inviting them to participate in company establishment with them; while acceptance is meant to be underwriter's signature to the underwriting document.

The aforementioned perspective is a lawful one; while contemporary jurisprudence experts divide into two groups in this regard as following:

1. First group adopts *Hanafi* School of law (*Madhhab*) emphasizing that offer is what one of parties states at the very beginning; while acceptance is what another party states expressing its satisfaction with the offer. Consequently, issuance prospectus is deemed the offer for people, while underwriting in Capital money is deemed the acceptance.

2. The second group holds that underwriting in cash money is the offer while the issuing entity's approval is the acceptance based upon scholars' opinion which emphasizes that offer is all what the proprietor states whether it comes first or second, while acceptance is what receiver of property (assignee) states despite being firstly issued. This is a widely accepted opinion in Islamic jurisprudence compound's decision on its fourth round (fifth decision).

   Sukuk underwriting is carried out through public underwriting whereby shares are offered for underwriting to the public; wherein any person will have then the right to underwrite with any number of shares as long as this is within permissible limits. On the other hand in the private underwriting, originators in partnership with or without other investors cover underwriting process with shares.

   Each issuance process has an underwriting beginning date and an underwriting closure date. Further, underwriting price is fixed for all units and on underwriting process, there may be a minimum limit for individual or organizations' underwriting which sometimes permits them to underwrite.

4.5.2.2 Post Underwriting Stage

Total underwriting after underwriting expiry date is assessed; to estimate its level in comparison with capital money offered for underwriting. Moreover,

there will be no a problem at all in the event that underwriting money is equivalent to the capital money, however in case that underwriting money is bigger than capital money offered for underwriting, the issuance entity must conduct pro rata unit distributions and return surplus cash money to investors. Issuer could also increase issuance cash money in a manner that the paid cash money will be defined at underwriting level as long as it doesn't exceed maximum permissible level.

In case of issuance money deficiency; i.e., underwriting money is less than offered capital money; the issuance entity will have one of the following options:

A. Reduction of the issuance capital money to money limit the public covered; in a manner which spares issuance entity the difficulty of searching for coverage undertaker and what follows in terms of additional costs.

B. Extension of the underwriting period; in order that we could attract more investors.

C. Resorting to underwriting coverage undertaker who guarantees covering uncovered units by the public.

D. Participation of the issuance entity in underwriting process; in as much as issuance prospectus states that the issuance entity has the right to participate in project capital money.

E. Cancellation of company incorporation and returning money to shareholders in the event that there is no 50% coverage of capital money offered for underwriting process.

Second stage: Securities (Sukuk) portfolio: after Sukuk selling for investors, the Special Purpose Company (SPC) manages this portfolio on behalf of the investors during issuance period by pooling receivables & periodic revenues of assets as well as distributing them amongst investors and finally providing all prerequisite area services.

Third stage: Sukuk extinguishment stage: This stage is carried out through paying the nominal value of Sukuk on dates the issuance prospectus sets according to the following procedures:

a. Beginning company holds the Sukuk principal. As mentioned before, securitization is conducted through transferring some assets of the company to Special Purpose Company; in exchange for issuance of securities which are to be offered for public underwriting.

b. Sorting and pooling process of principal components in one package wherein return rates and receivables maturity are alike.

c. Assessment of Sukuk principal; to identify compatibility of assets book value with Sukuk value by one of the appraisal bureaus.

d. Assessment by one of rating agencies; to identify the credit eligibility of borrowers in event of debts and level of returns in case of circulating assets and leases and extent of partners' efficiency as well as regular payment of lessees.

e. Procedures of the credit enhancement agreement by guarantors whether they are governmental institutions or insurance companies.

f. Agreement with Special Purpose Company on how to transfer assets according to securitization methods as well as defining cash money which Special Purpose Company must pay for these assets.

g. Special Purpose Company's payment of due cash money to the beginning organization either through borrowing from one of the financial organizations with interests or from Sukuk returns.

h. Special Purpose Company's security issuance representing Cash principal with the nominal value plus issuance bonus and offering them to general writing.

i. Selecting the entity which will serve securities.

j. Special Purpose Company's receiving of underwriting process outcome in securities from the offering underwriter as well as repayment of loan taken by the financial institution or repayment of the beginning organizations' receivables.

k. The selected entity must collect returns and due installments for principal creditors and deliver them to Custodian to be distributed to security holders and to repay security value piecemeal.

l. If investors from security holders would like to sell these securities in aftermarket, they must sell these securities with their original price or with more or less prices in comparison with their prices in financial markets.

m. In case of security maturity, process will be null and void.

n. In case that those investors abiding by paying the securitized principal are at arrears with or freeze paying their installments or any returns or interests, the guaranteeing entity will abide by paying for investors [21].

4.5.3 Securitization Process Parties

In this section, researcher tries to draw a general framework for interpreting different securitization process relationships from Islamic perspective; without going into jurisprudent details or specific legal evidence. It is remarkable that Special Purpose Company is a basic pillar of securitization process; because it satisfies condition of the original securitization originator financial disclosure separation from entity issuing Sukuk according to necessities of improving the credit eligibility for issued Sukuk.

Consequently, interpersonal relationships of securitization process parties can be followed and be then interpreted as following:

a. Relationship between original securitization originator and Special purpose Company can be interpreted as a real forward sale relationship till pooling cash money through Sukuk whether the total asset is completely or partly sold.
b. In event of securitizing a part of the asset propertied by the original issuer and its retention of a bigger part of it, it will be given a priority of rebuying on securitization process period expires according to the right of pre-emption.
c. Relationship between Special Purpose Company and entity in charge of pooling securitization portfolio is an agency relationship.

d. Relationship between Special Purpose Company and trustee is a lease based relationship.
e. Relationship between Special Purpose Company and investors is a restrictive speculation or partnership or agency.
f. Relationship between Special Purpose Company and promoter is a sale relationship with a commission or charges or agency.
g. Relationship between Special Purpose Company and coverer is a legally permitted sale with discount relationship.
h. Relationship between Special Purpose Company and guarantor is donation relationship with possibility of paying expenses in return for that.
i. Relationship between Special Purpose Company and accountant is a leasing or partnership relationship.

4.6 *Shari'ah* Guidelines for Special Purpose Company

Before stating the Sharia controls of Special Purpose Company, it will be convenient to shed light upon the structural controls of Securitization process; due to fact that this process is vital for Special Purpose Company. Further, the Islamic Investment Securities are issued based upon religious contract with Islamic Finance formulations. This contract results in provisions and legal effects of this formulation. Offer process is conducted for Underwriter by Issuance Prospectus including all Religious contract pillars and conditions upon which Investment Securities are issued. Therefore, Underwriters' selling for these Securities, is deemed an acceptance.

The Islamic Securities Issuance is subject to General religious controls applicable to all securitization process and private religious controls based upon the Islamic formulation of Securitization Process. These controls are as following

First Control: Security represents a co -property on project where securities are issued for its establishment or financing. Property of security holder is a co-property not an individual property. This property persists along project work period and results in all rights and claims legally permissible for proprietor such as selling, donation, mortgage, inheritance and other legally permissible claims

with putting into consideration that securities represent assets of real and cash projects and their debts.

Second Control: Securitization contract is based upon that Contracting conditions are defined on Issuance Prospectus. Offer is expressed by Underwriting in these securities; while acceptance is expressed by the issuing entity's approval. However, if stated approval of issuing entity is deemed an offer on Issuing Prospectus, Underwriting will be then an acceptance.

Third Control: Securities must be marketable after elapse of period designated for underwriting on the ground that this is permissible on part of partners with regarding the following controls:

A. If Pooled Money after writing is still cash as the case when beginning underwriting process and even when finishing underwriting process; circulation of these securities will be like an exchange process of cash for cash. These securities will be subject to exchange council laws which are exchange of two alternatives before transfer, unavailability of alternative and conformity provided that one of two cashes is sold for its same type of cash; namely the paid nominal value will be the base money wherein securities are sold without paying much or less sum of money.

B. In the event that Assets are changed into debts as the case with Murabahah (Cost Plus) wherein price becomes a debt with purchasers. Therefore, debt laws will be applied to Securities Circulation. Further, Jurisprudence experts agree on non- permissibility of securitizing the future fixed debt, either through Advance Selling of Cash for Cash of same or different type.

C. If Money Capital becomes mixed assets which are in types of cash money, debts, Real Estate and usufruct; it will be permissible to circulate securities based upon agreed upon prices; provided that majority of these securities are Real Estate and Usufruct. In other words, Real Estate and Usufruct must be much more than Cash money and Debts.

D. Circulation must be based upon conditions of supply and demand and must be subject to contractors' will.

Fourth Control: following conditions should be put into consideration on underwriting prospectus:

1. Prospectus must include definition of investment field and Islamic Financing Formulation such as *Ijarah* (Leasing), *Mudarabah* (Profit-sharing), *Musharakah* (Partnership), *Murabaha* (Cost plus), Salam and *Muzarah* (Farm-letting).

2. Security formulation must satisfy all pillars and conditions of issuance process as well as it mustn't include conditions contrary to its legal provisions.

3. Prospectus must imply abiding by Islamic Shari'ah laws and principles and establishing a legal supervision authority for approving and supervising issuance mechanism all over the time.

4. Prospectus must state that each security holder must have a share in profits and losses bases upon money value of its securities.

5. Prospectus must state contracting conditions and sufficient data of participants in issuance process: religious features, rights and obligations. There are many examples for those participants in issuance process such as issuance deputy, payment deputy and the like base upon appointment and dismissal conditions.

6. It isn't permissible for Issuance Prospectus or issued Securities to include a text which may cut Company's returns. If so, condition will be void, contract will be valid and profits will be distributed based upon Cash Capitals as long as distribution proportions aren't agreed on.

7. There is no Religious impermissibility if Issuance Prospectus states that a specific proportion will be deduced at end of each money turnover; either from Securities quota in returns as long as there is a periodic transfer of securities to Cash money or through security quotas in distributed yield and depositing it in a set aside bank account for facing Capital Loss Risks on the ground that this condition acceptability will be based upon satisfaction of all parties.

8. It isn't permissible for Issuance Prospectus to include a text explicitly or implicitly states that security issuer guarantees security holder face value of security except for transgression and default cases. However, there is no impermissibility in taking a pledge from other people, namely a third party with a distinct personality and a financial disclosure; to donate a non – refundable sum of money to loser's neighbors in a certain project. Further, this must be an independent obligation on part of donor, namely payment of this obligation doesn't represent an integral condition in contract validity and effect of its provisions amongst its parties. Therefore, security holders don't have a right to claim for voidance of contract and default on their security payments; because donor comes back on its pledge to pay its donation on pretext that this obligation is a consideration on contract.

In brief, it will be possible to say that one of Shari'ah controls perquisite for general security issuance process is that Shari'ah law compliant securitized assets can be securitized without giving a chance for religiously prohibited transactions such as Usury and Uncertainty. For example, it isn't permissible to securitize Usurious Loans based debt; because they fall in usurious transactions class and consequently same Shari'ah laws are applicable to them. There are many example for such transactions most important of which when selling of Assets which are to be securitized based upon indebtedness by originator to Special Purpose Company in cash for avoidance of On Credit selling; Steps and where there is a necessity for securitization Structure must be legally accepted; namely satisfying all pillars and conditions of selling and buying process either in issuance stage of securities or in circulating of securities in aftermarket as well as necessity of property element availability in order for selling and buying process to be valid and justifies the benefit of returns.

4.6.1 Shari'ah Conditions for Special Purpose Company

There are general controls and conditions for Special Purpose Company. In other words, general conditions are conditions necessary to be available in every contract, while private conditions are conditions perquisite to be available in some types of companies. Jurisprudence experts' interpretations for conditions of company incorporation are numerous despite being integrated in giving sound vision for conditions of companies' incorporation in

Islamic Jurisprudence. Hanafi School of law divides conditions according to type of company; so conditions at *Hanafi* School of Law are four as following:

- First: conditions related to all types of companies.
- Second: conditions related to *Sharikat* Al-Mal.
- Third: Conditions related to Sharikat *Mufawadah.*
- Fourth: conditions relating to Sharikat *Al-inan*.

As for *Maliki* School of law, conditions relate to contract parties, contract formulation and Cash Money; while *Shafi'i* school of law asserts that conditions relate to *Sharikat Al-inan* pillars and *Hanbali* School of law divide conditions in company into three sections which are as following:

1. True conditions.
2. Spoilt conditions.
3. Contract validity based conditions.

It seems from the first glance that Jurisprudence experts' directions are numerous and integrated at the same time. Further, it is remarkable that the general conditions of company incorporation validity divide into two sections as following:

A. Agreed on section
B. Controversial section

Agreed on conditions section is legal capacity of contract parties for authorization and working by proxy. This entails that contract parties must be free, adult and rational. Further, if each one of contract parties represents itself on the contract, it must be legally competent.

Hanafi School of law opinionates that object of contract must be ready to be deputized; in order to qualify each contract partner to be free with other partners' claims. Therefore, it isn't permissible to incorporate the company for religiously accepted objects such as crops and wooding because such things are permissible and authorization won't be given for permissible objects. Company implies meaning of authorization, so it won't be incorporated for permissible objects.

Although *Hanafi* and *Hanbali* Schools of law agree on that participation in permissible objects are religiously accepted, Shafi'i School of law contradicts their opinions; because it asserts that Sharikat Al-abdan is not religiously accepted either in acquisitions of permissible object or wherever else; because it isn't based upon Capital and there are much more uncertainties; so Shafi'i assert that it isn't legally accepted company.

Capital of company mustn't be from unknown resources; because it must be returned on liquidation while *Hanafi* School of law doesn't consider that. Capital of company must be available once company starts selling and purchasing; because it won't be permissible for company to do transactions without sufficient Capital or through taking debts; because company is established for achieving returns and profits and this won't be attained without availability of sufficient sum of money.

If profits are unknown, this will lead to spoiling of company because this is the basic target behind company incorporation. Therefore, uncertainty of profits quantity leads not only to spoiling of contract; but also to termination of Selling or Leasing (Ijarah) contract. Further, *Jahalah* (unknown element in contract) is regarded when it leads to dispute; but when *Jahalah* is of a simple type, it won't be regarded. It is possible that there is an equity part of the whole such as half, quarter or third. However, it isn't permissible to designate a value for this part such as five dinars due to the fact that yields won't be more than sum of money defined for each party; so one of company incorporation elements will be missing. Moreover contract necessitates sharing in profits and allotment cuts profits from contract parties. Consequently, sharing won't be necessary as long as each party's profit quota is defined.

Controversial conditions:

1. Shafi'i School of law necessitate expressing permission formula; for example when partners say " we enter into agreement; however other jurisprudence experts opinionate that there is no necessity for such expressing phrase but is suffices to imply its intent either through saying or action.

2. Shafi'i necessitate that capital of company must have an equivalent, namely capital of company must have equivalent objects such as wheat or different

types of grains; while Value based Capital is Capital which is assessed based upon values such as different types of clothes and animals. However, other jurisprudence experts assert that this isn't necessary. Hanafi and Hanbali schools of law assert that there is no necessity for existence of equivalents for Capital of company but it is permissible for Capital of City to be tradable and marketable in markets.

3. Shafi'i school of laws necessitates mixing cash money of contract parties while other schools of law contradict with Shafi'i school of law.

4. Maliki and Shafi'i school of laws necessitate that returns division must be based upon each partner's quota in Capital of Company. On the contrary, Hanafi and Hanbali schools of laws deny their opinion confirming that returns division doesn't necessitate to be based upon each partner's quota in capital of company; but it is permissible to be based upon a prior agreement amongst partners on contract.

5. Shafi'i school of law necessitates that Assets must be of the same type for contract validity. For example, all assets must be gold objects. However, majority of Jurisprudence experts flatly contradicts this standing confirming that this isn't a necessary condition for contract validity.

These conditions are necessary at all Muslim Jurisprudence experts; however they aren't necessary in Objective Law be based upon contract parties' mutual satisfaction. Based upon the aforesaid, there are a host of controls necessary to be taken into consideration by Special Purpose Company:

a. First Control: Complete compliance by Sharia laws of contract based securities. If there is an agreement that all Islamic Securities are issued based upon one of highly considered contracts in Islamic Sharia and that each contract of aforesaid contracts has respective provisions, consequently Special Purpose Company must abide by provisions which govern contracts belonging to securities.

For example, one of Mudarabah provisions is that Mudarabah can't guarantee Money Capital unless there is a transgression or a default. By the way, this provision must be in use when issuing Mudarabah securities. Further, it won't be

sound to breach this provision on securities level on the ground that this provision can't be breached upon Contract level.

This point is applicable to Leasing Securities; so there is a must for not causing damage to the lessee during leasing contract validity. Moreover, it is religiously prohibited that issuers issue leasing securities which may cause explicit or implicit damage to lessee; for example securities give ample liberty for underwriters to cancel Leasing contracts (Ijarah Contracts) prior to their property for leased Estate which becomes a property for underwriters then.

This control steers Islamic securities away from committing Sharia contraventions which may spoil the process at large. It is possible to voice that there is no impressibility in issuing different types of Securities as long as there is compliance with Sharia laws governing Securitization process.

b. Second Control: regard of Sharia intentions in Money and business

Islamic Sharia has five highly regarded intentions in Money and business which are promotion, Money keeping, clarity, justice and evidence of money resources. Promotion is meant to be money turnover at people's hands and also refers to that many hands trade in Money Capital and there is no impermissibility in that capital returns for those hands in terms of trade returns and currency interests paid to them from money of capitalists. Money keeping term is used to refer to money protection against waste, extravagance and excessiveness as well as necessity of being at Islamic Nation's hands. Clarity term is used to refer to Money clarity and being away from damage and liability as much as possible. Consequently, Allah legitimates recording, testimony and mortgage in borrowing. Justice term is used to refer to money taking without prejudice to any one either through earning or taking as damages or donation or bequeathing. Further, it is observable that justice compliance implies protecting public interest and money prerequisite for all society classes to sustain their lives, such as money necessary for food supplies. Finally, evidence of money resources establishes undisputable property of money.

Based upon aforesaid control, Special Purpose Company must put into its consideration that how much these intentions are achieved in Securities issued

by it. It is out of Sharia laws to issue securities which couldn't wholly or partially achieve these intentions.

It's not far from any one to realize that Salam, Musharakah (Partnership), Mudarabah (Profit-sharing) and Istisna'a (Contracting) Contracts are more effective in achieving five intentions of Leasing and Murabaha (Pre-agreed Profit) Contracts; in a manner which gives more priority for these contracts to expand. This issue endorses Banks and Islamic financial organizations' inclination towards expansion in promotion campaign for Murabaha Contracts, Installment Sales System and Future Sales; in a way which urges much more people to believe that Islamic Financial systems don't oftentimes differ from traditional financial systems which are based upon borrowing and lending processes.

c. Third Control: Putting consequences of Contract provisions intro considerations

If regarding Sharia intentions in Money and business is a vital matter, this control won't come into effect without giving much care and consideration for consequences of Islamic securities in terms of its capacity to achieve social justice, sustainable development, complete easiness and its effectiveness in eliminating poverty, destituteness of fragile classes in Islamic contemporary societies.

Compliance with this Sharia Control exceeds dealing with contracts as religiously accepted or not accepted contracts to measure to what extent these contracts achieve religious intentions in case of application in contemporary realities. In other words, in case of establishing that investment method inability to achieve sharia intentions in reality; so there will be a must to bypass these methods and pathways and adopt methods able to achieve purified sharia intentions.

It is very well known that the Islamic Economy seeks to achieve human dignity through empowering human to satisfy its basic needs through legislating series of laws and procedures which can extend hands of assistance to achieve this purpose. However, this human dimension in Islamic economy is far fetching unless there is a thorough scrutiny in consequences of investment and

development in a manner which could help reinforce these investment methods and pathways which could bridge gap between society members then achieve solidarity and complete cooperation amongst them.

In sum, Special Purpose Company must be Shari'ah law compliant; to achieve much more money promotion and circulation space in society.

4.7 Suggested Model for Special Purpose Company

Based upon what has been mentioned before, researcher extends the suggested model for Special Purpose Company in Securitization Process. The Model will be as follows:

Definitions: in application of this model's provisions, following phrases and words are equivalent to meanings next to each one of them unless text entails otherwise.

Investment Trustee: any company authorized to invest in money for other people's interest and is financially and administratively independent from financer and investment manager.

Securities: they are documents with equal nominal values and represent equity quotas in property of Real Estate, usufruct or services or even a mixture of all these objects or in Assets of specific project or in an investment activity or in finance. Further, they don't represent a debt owed by security issuers to security holders.

Governmental Securities: they are securities wherein the financed entity is one of authorities, public institutions or one of state owned companies.

Non-governmental securities: there are securities wherein the financed entity isn't one of authorities, public institutions or one of state owned companies.

Securitization Process: it is a process of issuing documents with equal values representing equity quotas in property of Real Estate, usufruct or services or even a mixture of all these objects.

Islamic Shari'ah Laws: they are those laws formulated by brilliant jurisprudence experts in the light of Sharia reference from Quran and Purified Sunna and other resources which the contemporary Fiqh Academies or any specialized Sharia

compliant Authority conclude without complying with any specific jurisprudence *Madhhab* (school of law).

Issuance Entity: it is the financier or Special Purpose Company.

Returns: they are sums of money which are to be distributed on Security holders as investment profits.

Special Purpose Company: it is a company established for possessing Assets of securities on behalf of securities holders as well as issuing securities against their value and representing securities holders.

Financed personality: it is a legal personality whom this model qualifies to obtain a fund through issuing securities by itself or through Special purpose Company establishment.

Fiqh Academies: The International Islamic Fiqh Academy, Accounting and Auditing Organization for Islamic Financial Institutions, Islamic financial services Board and other Islamic Fiqh Academies.

Fatwa Authority and *Shari'ah* Supervision: this authority is comprised of a host of Sharia Fiqh experts and economy experts who incessantly check how much securitization process conditions are compliant with Islamic Sharia Laws.

Underwriter/ Investor/ Security holder: any normal or legal personality who can underwrite or possess securities.

Security Assets: Real Estate, usufruct, services or a mixture of these objects which are to be securitized.

Securities issuance methods**:** It isn't permissible to obtain financing through securities issuance from entities other than following ones:

I. Public authorities and state owned companies.
II. Joint stock companies.
III. Any legal personality for which Money Market Authority issues an approval.

Any of state owned money isn't permissible to fall in Assets of governmental Securities.

4.7.1 Issuance Entity

It is permissible for financed body to perform securitization process and to establish Special Purpose Company for performing Securitization process. In the event that financed body performs securitization process; it must transfer property of Securitized Assets to investment Trustee. At this case Investment Trustee appoints Investment manager for taking charge of securitized assets. It is permissible for Money Market Authority to dispose Investment Manager and replace it with someone else; as long as its actions cause damage for public interest or at least for security holders. Further, it is permissible for investment manager or financed body to contest in authority's decision before competent court. It is not permissible to issue governmental securities except by Special Purpose Company which must be completely owned by state.

4.7.2 Special Purpose Company Incorporation

Financed Body or Investment Trustee may individually or collectively incorporate a company or more than a company whose incorporation purposes are limited to securitization process. Further, Special Purpose Company acquires the legal entity as of date of registration on the commercial register and it will have a financial disclosure and an administrative structure independent from the entity which established it.

4.7.3 Purposes of Special Purpose Company

In addition to aforesaid purposes, purposes of Special Purpose Company will be as following:

a. Property of securitized assets on behalf of security holders.
b. Protection of security holders' rights.
c. Management of securitized Assets and investment of non- invested assets.
d. Obtainment of income based upon returns and leases.
e. Distributing net returns and interests of securities to their holders.
f. Issuing a periodic publication for informing security holders of all developments to their property.
g. Liquidating all security assets at the end of securities maturity and distribution of liquidation outcome to security holders based upon policies and conditions of underwriting prospectus for security issuance.

4.7.4 Legal Framework; headquarters and Capital of Special Purpose Company

Special Purpose Company adopts the legal framework of Limited Reliability Company. Further, it could take headquarters of entity which established it as its own headquarters.

It won't be necessary that Capital of Special Purpose Company is commensurate with the total sum of money for issued securities or with value of securitized assets. Moreover, Capital of Special Purpose Company can be equivalent to incorporation expenditures.

4.7.5 Special Purpose Company Management

The financed body must invest Special Purpose Company Management to one of competent entities which are financially and administratively independent from financed bodies by banks or companies which can manage money for other people's interests. As for Governmental securities, the financed body must invest Special Purpose Company Management in General Investment Authority which can then invest management of this company to one of aforesaid bodies and simultaneously can decide at any time to replace these bodies with new ones.

4.7.6 Independence of Special Purpose Company

In the event that underwriting is conducted in securities issued by Special Purpose Company, it isn't permissible for the financed body to dissolve or liquidate Special Purpose Company or even to change its board of directors without prior consent of Money Market Authority. Further, it is permissible for Money Market Authority to dismiss and replace management of Special Purpose Company issuing non – governmental securities with new management; as long as its actions cause damage for public interest or even security holders' interests. The management of special purpose company then has the right to contest in Authority's decision before the competent court. Limited Liability Company's laws available on commercial company laws; are applicable to Special Purpose Company as long as these laws don't work against its nature or

purposes or even against provisions of this model. Money Market Authority is concerned with supervision and inspection over Special Purpose Company; where Authority draws prerequisite standards for this purpose.

4.7.7 Investor

It is permissible for individuals or legal entities such banks, companies, public organizations as well as public & private organizations to underwrite in and hold securities.

It is permissible to issue securities whose underwriting concession is limited to individuals or legal entities.

4.7.8 Identity and Types of Securities

Securities represent equity quota in property of Real Estate assets or usufruct or services under disposal of issuing entity or even assets or usufruct or services necessary to be supplied. Securities per se don't represent a debt owed by issuing entity for security holders. Further, they are issued in the name of their proprietors or holders with various value classes; for purpose of establishing property of security holders for what these securities represent such as assets, usufruct and issued services against their liabilities.

Different types of securities must be issued based upon Islamic Sharia laws such as leased assets property or usufruct property or Salam or Murabaha or Musharakah or Real Estate Property and services. The executive regulations determine provisions of each security type. Moreover, Underwriting Prospectus indicates the detailed provisions of contract upon which securities are issued.

4.7.9 Conditions of Security issuance

There are certain conditions for issuing securities as following:

1. If the financed body is a company, Underwriting process Capital should be fully paid and it is necessary for general secretariat of company to issue a relevant decision of security issuance.
2. if the financed body is a public authority or organization, it will be necessary for authority or organization board of directors to issue a decision for security issuance.

3. Money Market Authority must take a decision for approving security issuance.5
4. Security issuance permission must be given by Fatwa Authority and Sharia Supervision.
5. Any other conditions drawn by Money Market Authority.
6. There is a must for Sharia Supervision Authority to follow up model workflow steps.

4.7.10 Guarantees of Securities

In case that Underwriting includes conditions with effect that securities will be guaranteed with personal or real guarantees, or in case that there is a must in securitization process to transfer property of a right, it will be necessary to take legally accepted procedures to submit guarantee and transfer property based upon Money Market Authority Laws.

In the event of submitting a guarantee on the part of the financed body or investment manager or Special Purpose Company manager, guarantee must be limited to compensating damages ensuing from breaching this model provisions or its executive regulations or Fatwa Authority and Sharia Supervision's decisions or misusing invested authorities or committing default or transgression or gross negligence or breaching security issuance conditions.

Chapter (5)

SPECIAL PURPOSE COMPANY (SPC) IN SUKUK STRUCTURING

5.1 Introduction

There has been recently quite a lot of talk about *Sukuk*[1] and their role in contemporary Islamic finance and Islamic investment market. In fact, those financial instruments have made a significantly tremendous and steady growth, making it necessary, without any doubt, to broach the subject from a *Shari'ah* perspective. This exercise must not only scrutinize matters related to issuance of *Sukuk*, but also address the correction of its track by examining its current reality, applicability, and inspecting issuers Term Sheets.

With this background in mind, the researcher opted for addressing one important part of the process of *Sukuk* issuance, known as "*Taskeek*[2]" both in theory and practice, hence the title of this research as "The Role of Special Purpose Companies (SPC's) in the Structuring of *Sukuk*[3]", which is made up of the following three sections:

1. Defining Securitisation and *Taskeek*.

2. A descriptive study of the Special Purpose Companies (SPC's).

3. *Shari'ah* guidelines of SPC's in theory and practice.

Definition of Securitisation and *Taskeek*[4]*:* Given the fact that securitisation and *Taskeek*[5] are among the main reasons for establishing Special Purpose

[1] Although *Sukuk* is a plural in Arabic, it will be treated in this dissertation like the English word 'sheep', which is used for both the singular and the plural.
[2] Sometimes referred to in this dissertation as "*Sukukization"*, both terms mean the same from an Islamic perspective.
[3] After finishing with this dissertation, I found an unpublished MA thesis titled "SPV Role in *Taskeek*: A jurisprudence approach" Faculty of *Shari'ah*, Yarmouk University, Jordan 1432 AH), the present study is more comprehensive as it addresses application in Sukuk. The other study addresses accounting details, not a priority for the current research.
[4] In absolute terms, securitisation is used for traditional debts heedless of the Shari'ah guidelines. *Taskeek* is meant to observe those guidelines as will be defined later.
[5] Securitisation and *Taskeek* will be defined in relation to SPVs.

Companies (SPC's), the researcher will begin by providing short definitions of each term with the specific purpose of highlighting some aspects of SPC's.[6]

Securitisation (Securitization)[7]: Having reviewed a number of legal, financial and banking definitions of the term, the researcher can conclude that securitisation (securitization[8]) boils down to the pooling of assets, including, for example, mortgage backed debts of their various types, then selling such debts to an SPC, which is formed especially for the maintenance and operation of such assets. Afterwards, the said SPC would issue bonds collateralised by those assets and offer them for public subscription.

Accordingly, securitization can be defined as the process of converting collateralised or otherwise mortgage backed debts from illiquid assets to liquid cash assets to be usually for funding new banking processes.

Conceptualisation of Securitisation: The concept of securitisation can be explained by reviewing, in a nutshell, the steps pursued in implementing it. These are as follows:

1. A financial institution with mortgage backed or collateralised debts sells such assets[9] or a part thereof at a price lower than the value of those debts to an SPC formed specially for the purchasing of those assets, which the said institution wishes to securitise.
2. The liability of those assets, along with their collaterals, is then moved from the seller to the SPC. The idea is to make the SPC's obligations secure even if the seller goes bankrupt and to keep it immune from any liabilities or claims instituted against the seller.
3. A credit rating agency, such as Standards and Poor's (S&P) or Moody's, then rate the assets being securitized. The rating is decisive in building investors' appeal to the bonds that will be issued by the securitization exercise.

[6] Though some *Sukuk* issuance is based on the *Taskeek* of current assets (thereby subject to the following definition) some other ones are not based on current assets as the *Sukuk* are based on new assets.

[7] I will define securitisation here using the traditional sense of the word as it is important to do so for the conceptualisation of the subject issues.

[8] Both terms securitization and Sukukization are used in an exchangeable matter throughout this dissertation.

[9] In the context of securitisation definition, the word "assets" means debts.

4. The SPC (it is the "issuer" at this stage) issues bonds that carry the value of the securitised debts in order to get liquidity by selling them to investors. It is very important, here, that those bonds are compatible with the interest payable on the securitised debts on their maturity dates.
5. The SPC pays out the value of the securitised assets to the seller through the proceeds of the sold bonds.

Definition of *Taskeek:* According to existing AAOIFI *Shari'ah* standards; *Taskeek* is defined as “the division of in-kind assets, utilities or both into equal parts then issuing *Sukuk* with their values” (AAOIFI, 2010). The purpose is to convert assets and contracts, such as consumption, lease and other types of contracts, into tradable securities. This process of issuing *Sukuk* is called *Taskeek*. Examples include the division of in-kind ownership of leased properties or utilities, assets of standing enterprises, capitals of *Mudarabah* or *Musharakah* and other such *Sukuk* into tradable units of equal values. In this way, the *Sakk* owner owns the financial share in the property or the capital of the enterprise as represented by the value of the *Sakk*.

5.2 A Descriptive Approach to SPC's

Several terms are used to refer to the Special Purpose Vehicle / Company. It is sometimes called Special Purpose Vehicle (SPC), but in American English, is more known as Special Purpose Entity (SPE).

Jordan’s Financial Financing *Sukuk* Law has defined SPC as: “A company established to finance the acquisition of assets for which Islamic *Sukuk* can be issued.” The Malaysian Securities Commission defined it as “Any entity that issues financial securities backed by assets subject to all of the standards stipulated in these Guidelines.”

According to Standards and Poor’s, an SPC is “a bankrupt-remote entity (whether it be a commission, a firm, a limited partnership, a credit agency, a

limited liability company, etc.) to the effect that it can fulfil the standards of the special purpose under consideration."

Therefore, despite the fact that SPC's are often used for securitisation or *Taskeek*, they can also be formed for other purposes such as structured financing contracts, derivative contracts and other financial contracts and instruments.

5.2.1 SPC's Legal Character

The use of the word "vehicle" in this context might seem to be funny at first glance, for what should "Companies" have to do with such a complicated area of study. The fact, however, is that it does reflect lots of reality of the legal character of such an entity. It is indeed a vehicle, or a legal container, so to speak, that is established to achieve a number of goals and functions. Such purposes can include "keeping asset ownerships independent from their original owner". Little significance is placed on the nature of that vehicle, so long as it does serve the aspired goals, which once accomplished, would mean the end of termination of the vehicle.

Accordingly, quite a lot of countries do not enact a special law or SPC's and may even go beyond that by providing for its establishment under such terms as Trust or Limited Liability Company, etc. What matters most, in all cases, is its legal character, which must meet some conditions, mainly:

a. Must be a limited liability entity
b. Must not exercise a general commercial activity except maintenance and management if assets as prescribed by its Memorandum of Incorporation.
c. Measures should be taken to keep it bankruptcy-remote. Such measures include:
    - Prevent it from borrowing or getting loans
    - Prevent it from merging with another company or entity and prevent it from acquiring or be acquired by another entity.
d. Its name, identity, accounting books and legal ownership must stand on its feet independently from its originating company.

e. Its Memorandum of Association must mention the reason why it was created, its authorities and dissolution mechanism. The key element in an SVP, therefore, is that the Memorandum of Association should clearly mention its special purpose and that its life will be destined to end once the purpose is attained.

Now, having reviewed some relevant experience and laws worldwide, I can say that an SPC can have any of the following legal characters:

1. A special purpose entity in countries where special relevant laws are enacted.

2. A limited liability company (often registered in tax exempt regions).

3. A trust or an offshore trust.

4. A mutual fund.

5.2.2 Trust[10]: Definition and Parties

"A trust is a legal relationship[11] in which one party (trustee) holds title to property of another party for investment by defining the beneficiary/beneficiaries" It is also defined as "a legal arrangement whereby the monies or properties of the owner (trustor) are assigned to another person (the trustee) to manage them for the benefit of one or more beneficiaries".

A trust, therefore, is legal entity established with an aim to protect and manage assets. Such assets are given by the trustor to the Trust in accordance with an agreement that defines, among other things, the beneficiary the trust owner and the period of trust.

The main principle underpinning a Trust is the segregation between the official owner or legal holder of assets, whose title is assigned to the Trust, and the one that benefits from those trusts in addition to the beneficiaries of the trust (*cestui que trust*) as defined in the Trust's instrument. Another prominent feature of a

[10] It is quite relevant to cast some introductory remarks on Trusts because an SPV takes the form of a trust in our assumption here.

[11] The Financial Trust Law of Bahrain No. 23 (2006) is the only one in the Arab world that regulates trusts. Other laws in Muslim countries include Labuan Trust Act (Malaysia 1996) and the 1998 Guidelines on Shari'ah Compliant Trust in Labuan.

trust is that is limited and has an redemption period. There are four parties to a Trust:

1. Settlor: It is a natural or legal person that creates the trust, thereby assigning the legal property of the trust subject assets to another party, which undertakes to manage, maintain, and in some cases to invest them.

2. Beneficiary: The beneficiary of the trust is a person/persons identified by the trustor in the trust's instrument as those who will benefit from the trust.

3. Trustee: It is a person or a firm that holds the legal title of the trusted property. Its role is to carry out the tasks and duties assigned thereto by the trust instrument in relation to those assets. Trustees are trusted to make decisions in the beneficiary's best interests.

4. Trust Protector: This party is not required in all trusts, but when existent, he is appointed under the trust instrument to direct, restrain and hold accountable the trustee for the latter's administration of the trust as defined in the trust instrument.

The Trust Instrument[12] is the key element in the whole process. It creates the divisions between the various parties to the trust and defines their respective rights and obligations. Following is a list of main issues defined by the trust instrument:

f. The trust's goal.
g. The beneficiary/beneficiaries.
h. Trust subject assets
i. Trustee's powers, duties and responsibilities towards the trust's assets and beneficiaries.
j. Rights of the beneficiaries and their shares in the benefited trust subject assets.
k. The trust protector and his powers.
l. Term of trust and redemption.
m. Disposal of trust assets after redemption or liquidation.

[12] Some of those points are compulsory while others are optional and vary from one jurisdiction to another.

5.3 SPC's as Trusts in Modern *Sukuk* Issuances

Putting in mind the above highlights about trusts, an SPC can be a trust entity if created to preserve the assets of *Sukuk*, provided the following terms are met:

1. The trustor (or settlor) must be the finance seeking party and the issuer of *Sukuk*.

2. Beneficiaries: Sukuk Holders.

3. Trustee: A legally licensed entity that holds the trust.

Accordingly, the *Sukuk* issuer removes the subject trust assets from its legal property and accounting books and transfers them to the trust. Sukuk Holders are, then, identified as beneficiaries, and the trust is governed by the terms stipulated in the Trust Instrument, which regulates such matters as the method of administering and investing assets, distributing revenues among Sukuk Holders, amortisation method and the fate of assets after the issuance or amortisation, etc.

5.3.1 Functions and Purposes of SPC's

SPC's can be created for several purposes, including securitisation (securitisation) or *Taskeek* of assets[13]. The following are some common purposes:

1. Guarantee the rights of investors (*Sukuk* or deed holders)

   A main purpose of creating SPC and transferring the subject *Taskeek* or securitisation assets, financial liability and accounting books to the property of an SPC is to guarantee the rights of investors (*Sukuk* or deed holders.) This purpose is pursued by protecting those assets in case of the trustor's bankruptcy.

   If the court declares the trustor bankrupt, liquidates him or decides to appoint an official receiver, the creditors cannot any more have claims to the subject

[13] From the traditional securitisation perspective, assets refer to debts. In *Taskeek*, they mean real estate, utilities and/or services in addition to affiliated money and debts.

Taskeek assets nor can they request such assets to be cashed as they are now removed from the legal properties and accounting books of the trustor. This underlines the importance of fully removing the subjects assets form the originator and vest them with the given SPC[14].

2. Administer the *Taskeek* or securitised assets in line with the best interests of investors (*Sukuk* or deed holders)

Through *Taskeek* or securitisation, an SPC represents the Sukuk Holders, its being an independent legal and financial person that has the right to own and dispose of assets. The SPC can manage the *Taskeek* subject assets in a way that lies in the best interest of Sukuk Holders. This is of a particular significance when the management and investment of the subject *Sukuk* assets are contradictory with the trustor interests. In effect, therefore, the existence of an SPC is a must to undertake that role.

3. Comply with *Shari'ah* guidelines in respect of *Sukuk* structuring
   In the field of *Sukuk* structuring and other financial contracts created by Islamic banks, SPC's can ensure compliance with some Shari'ah guidelines in accordance with the rulings made by the Shari'ah Committee that authorises the issuance. A review of relevant applications show the following main Shari'ah issues for which SPC's were created in the context of *Sukuk* structures and structured financial products:[15]

   A. Offer a guarantee for the capital of Sukuk holders or investors: The Shari'ah law as confirmed by several Islamic jurisprudence councils (Fiqh Councils)[16], prohibits the trustor

[14] See Jordan Islamic Finance *Sukuk* Law (10-D), Guidelines on the Offering Asset-Money Terms website, Backed Securities, Securities Commission, Malaysia, http://moneyterms.co.uk/spvspe/

[15] Mentioning those forms does not necessarily mean that the researcher uphold to the creation of SPVs as a solution of the dilemma as will be discussed in the ensuing discussions.

[16] For example: the decision of the Islamic Jurisprudence Council No. 178 (4/19) stating that "The *Sukuk* manager is a custodian who does not guarantee the value of the *Sakk* except within the limits of infringement, negligence or violation of the conditions of Mudarabah, Musharakah or Wakalah in investment". It also rules that the *Sukuk* may not be amortised at nominal value but at market value or any other value agreed upon at amortisation." Paragraph 5/1/8/7 of the Investment *Sukuk* Standard (17th Standard) issued by the Shari'ah Council of the Accounting and Auditing Commission for Islamic Financial Institutions provides that "The memorandum must not include any provision binding the issuer of the *Sakk* to guarantee the owner the nominal value of the *Sakk* in other cases than infringement or negligence, neither can it guarantee a

or *Sukuk* asset management to hold liabilities for guaranteeing the capital of Sukuk holders. Therefore, some establishers of *Sukuk* and structured financed contracts, as a leeway, refrain from offering direct guarantees from the originator or the issuance manager and tend, instead, to establish an SPC that can offer such a guarantee.

B. Promise (Undertaking) to repurchase the *Securitized assets* or financing it. Some Shari'ah jurisprudents and other Shari'ah legal councils were critical of a sort of hire-purchase transactions related to *Taskeek*. In that given instance, the originator sells an asset or many assets from Sukuk holders at a *Sukuk* price then it re-rents the same asset(s) with a promise of ownership. Alternatively, it rents the asset(s) from them by giving a promise to re-purchase the asset(s), which was sold to them and then leased for the whole term of the *Sakk* at the nominal price of the *Sakk*.

The critical view on such transactions originates from the assumption that it is a form of real-estate commercial sales and that it attempts to guarantee the capital of Sukuk holders of the leased property.[17] So, to sort out this issue and align the business with the Shari'ah law, some *Sukuk* establishers incorporated in the structuring the establishment of an SPC whose main aim is to purchase the asset from the originator then sell it through the Sukuk holders (of their representatives). Afterwards, the originator rents the asset from the Sukuk holders with an ownership promise (or alternatively rents it and makes a promise to repurchase the asset at nominal value). In this way, the seller of the asset and the one who makes a binding promise to repurchase it at nominal price are two different persons.

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specific amount of profit." This is affirmed by the Shari'ah Council of the Accounting Commission in Bahrain in its statement in 1429H "Neither the speculator nor the partner or agent of investment may pledge to buy the assets from certificate holders or their representatives at nominal value upon the expiry of *Sukuk* and their amortisation."

[17] The research has detailed this issue in Chapter Four of this dissertation where he explained the Shari'ah position towards such transactions.

C. Sorting out the issue of funding an Islamic bank's investment project by a usurious loan

The Islamic *Shari'ah* prohibits the use of usurious loans in financing an investment deal even if a Shari'ah compliant loan is not accessible in a given country. Moreover, a usurious loan can be more appealing given the fact that it is less costly than the permissible one.

The researcher came across an investment deal of an Islamic bank in a European country. It was almost impossible to get there a *Shari'ah* compliant loan. Therefore, the said bank established an SPC owned by other party than the Islamic bank (an orphan company). The latter company obtained a usurious loan from a traditional bank in that country with the guarantee of the Islamic Bank, or an entity affiliated with it. Afterwards, the SPC executed a Shari'ah compliant contract for the investment deal of the Islamic bank for the amount of the loan that was procured from the traditional bank with the same terms of repayment. By doing this, the Islamic bank believes that it is no longer liable from the Shari'ah law perspective in funding the subject deal by a usurious loan through the SPC.[18]

4. Financing Purposes

Some companies resort to the securitisation or *Taskeek* of some of their assets and transfer them to an SPC, the process seen as an alternative for other sources of funding like borrowing (or seeking financing) from other banks or financial institutions or increasing the capital by issuing new shares. While the latter two alternatives have their own constraints and problems, securitisation and *Taskeek* are effective in establishing accessibility to capital makers. Those two methods can be helpful in increasing funding while lessening credit risks by transferring some of the originator's assets to an SPC then by securitising them into tradable financial securities.

5. Credit Management Purposes

[18] More details will be brought in the upcoming sections.

Securitisation and the transfer of the to-be-securitised assets to an SPC helps in reducing credit risks. In other words, the originator will no longer be liable before Sukuk holders. By the securitisation of those debts, liability has been transferred to third parties as divided by Sukuk holders. Some companies, furthermore, tends to identify their higher risk assets then transfer the title to those assets to an SPC.

6. Accounting Purposes

Several accounting considerations may prompt companies to establish SPC's. Here are the most common ones:

a. Relief from the balance sheet constrains

According to the accounting standards, securitised assets (debts) appear as one item on the balance sheet. However, when calculating the adequacy of capital[19] and measure credit risks, these debts are adjusted in value depending on the expected risk of failure to collect some of them. Such risk debts are deduced from the overall value. Since assets are placed above the fraction line (numerator) in the capital adequacy calculation formula, such adequacy will be decreased and will be affected negatively by a reduction the assets in view of the debt collection risk issue.

If, however, the debts are securitised, they will be crossed out form the balance sheet simply because the title thereto is now vested with an SPC. The debts are replaced by the amount paid to SPC thus increasing the assets of the company, which will in effect increase its capital adequacy.

[19] Adequacy of capital as defined by the Glossary of the Islamic Institute for Research and Training of the Islamic Development Bank is: "a term that explains the relationship between a bank's capital sources and the risks besetting the assets or other transactions of the bank. The adequacy of capital is an instrument used to measure the solvency of the bank that is its ability to fulfil its liabilities and face up any losses that may be incurred in the future. This is further explained by the Capital Adequacy Bylaws issued in Oman (BM 14*7/78) on 10/2/1982. The bylaws state that the "Bank shall have a net value that can guarantee the bank's ability to continue operation as an on-going business and meet immediate demands of depositors and creditors under unfavourable economic and financial conditions".

b. Improve capital structuring: Securitisation allows banks, financial institutions and other such entities to offer loans and transfer them swiftly; in their respective balance sheets. This will relieve them from retaining doubtful debts, given the fact that any entity that is owed by third parties must deduce from its revenues a specific percentage that is equal to the value of debts to create a doubtful debt allocation, thus reducing net profit. Through securitisation, that allocation vanishes from the balance sheet as it is transferred to the revenue item.

7. Legal Purposes

SPC's can be created to address such legal problems as when the law in a given country prevents banks from owning real estates, shares or cars. In such a condition, the bank can establish an SPC to own such assets and sell them to its clients on a Murabaha basis or otherwise lease such assets to them on a hire-purchase basis.

8. Tax Purposes

   Some tax havens like Cayman, Bahamas, Falkland Islands and Virgin Islands affiliated to the United Kingdom are tax free regions. This has tempted some wealth people and companies to strip out some of their assets and vest them with SPC's there, a legally acceptable way to reduce taxes or get rid of them.

5.4 SPC's *Shari'ah* Guidelines: Theory vs. Practice

This Section concludes our previous review of SPC's by citing Shari'ah guidelines on SPC's. Following then is an applied study of *Sukuk* issuance with specific reference to the role of SPC's in the structuring of *Sukuk*. I will also discuss some of those guidelines and their applications on such issuance.

1. Shari'ah Guidelines on SPC's

   Further to our discussion above, SPC's, as indicated by its name, can take several forms and can have different goals depending on why they have been established in the first place. It follows, therefore, that they cannot be all subject to one Shari'ah provision or guideline,

which will differ from one SPC to another. Nevertheless, the Shari'ah provides some general guidelines on whether an SPC is permissible or not. Those include the following:

First Guideline: If an act or a commitment is deemed non-permissible for a natural or legal person in the context of a contractual relationship, the judgement will not change if such an act or commitment arises from an SPC created by the person prohibited to pursue such an act or commitment or by the one who coordinates with that person. Three cases can be highlighted in respect of the application of this first guideline:

i. Offer a capital guarantee for Sukuk holders or Share holders

The originator (or the one who coordinates with him as a legal advisor or the issuance manager) may not establish an SPC for the purpose of guaranteeing issuance (or investment) irrespective of the legal registration of the name of the owner of that SPC.

The researcher finds that it is forbidden for the *Sukuk* issuer or the SPC (created under his instructions) to offer a guarantee for the *Sakk* value (the capital) or a specified amount of profits. This prohibition applies whether the offering is a commitment, an undertaking or a binding promise. It is also forbidden for the originator to take commitment, Undertaking, undertake or make a binding promise to purchase the *Sukuk* asset (or what the *Sukuk* represent) at the nominal price of the *Sakk* upon the amortisation of *Sukuk* or theory termination before amortisation is due for any emergency circumstances.

There is a consensus that what is possessed by the *Mud'arib* is deemed as custody in its hand and the only guarantee that can be given in this case is a guarantee against infringement or negligence[20]. The majority of scholars of the four schools of jurisprudence, i.e. the *Hanafi*, the Maliki and S*hafi'i'* and *Hanbali* agree that it is prohibited to require a Mud'arib

[20] Scholars include Imam ibn Abdilbir in *Alistizkar* (21/124) and Sheikhulislam ibn Taymiyyah in *Majmoo' Al-Fatawa (30/82).*

guarantee other than infringement or negligence use. Deeming such a requirement as null and void, they explained that to guarantee the capital on behalf of the Mud'arib turns the contract from *Mudarabah* (speculation) into a loan, as it turns the Mud'arib from an agent into a guaranteed borrower. This means the subject speculation has been turned into a loan that brought about a profit. In such circumstances, the guideline applies even if the name of the contract is Speculation following the rule, which says: a contract is defined by purposes and implications rather than by phrases and structures.

Some scholars went even further by asserting that no two scholars would disagree that the requirement of guaranteeing the *Mud'arib* is null and void. Among them is Imam *Ibn Qad'amah* who said: "Once the *Mud'arib* is required to guarantee the capital or a share of the subject transaction, the requirement is turned out to be null and void. This is not a subject of controversy, as far as I know".

The same prohibition would apply regardless of whether the act has been made by the originator or the SPC that it established to offer the guarantee. If we do not submit to this rule, it means that every forbidden act can be turned permissible by simply creating an SPC, which is not in line with the Shari'ah law.

ii. *Undertaking to repurchase Taskeek or financing subject assets* I do not believe it is permissible by the Shari'ah law to establish an SPC with the purpose of making a Undertaking to purchase the *Sukuk* assets from investors or purchase the assets from the originator then sell them from the Sukuk holders on cash to eventually have the originator re-purchase them from the Sukuk holders on credit or lease the assets from them on a hire-purchase basis.[21]

iii. *Obtain a usurious loan then re-producing it in the form of a project funding*

It is forbidden to establish an SPC (even if it is not legally owned by the Islamic bank, i.e. an orphan company for example) for the purpose of getting a usurious loan that the SPC would then give

[21] It will be detailed in the upcoming sections.

> to the Islamic bank as an investment funding project. This is a trick that is strictly forbidden by the Islamic Shari'ah. It is a harm that is even more heightened by the perpetuator establishing an SPC to bypass the clear Shari'ah rules.
>
> *Sheikhul Islam Ibn-Taymiyyah* was amazed that usury would be used again: “Usury is one of the most hateful acts mentioned in the Quran. God ordained that those who adopt it are to be fought. He cursed the People of the Book because they used it just as He cursed the receiver and the payer of usury, the one who records it and the two witnesses to the transaction. Punishment to usury is perhaps severer than any other punishment. Given that, how come that a man would consider it as *halal*, sometimes with the absence of necessity, by drafting a ridiculous and deceitful contract? It is more deplorable that a man would invoke the traditions of a given prophet, or Prophet Muhammad even God Himself condemning usury then permits it by such ridiculous tampering and bypassing actions whose face covers do not represent the genuine intents of the contract parties!”

Imam Ibn Hajar says “That who has when executing a contract the intent of usury is certainly committing usury. His sin cannot be forgiven by simply selling what was obtained through it. ….Everything that is meant to prohibit what God made lawful or otherwise legalise what God forbade is a sin. Bypassing the forbidden act is a sin regardless of whether the act is made for itself or for another thing under any given pretext.”

Second Guideline: The SPC must not be used for purposes implying fraud or deception. An example is when a company tries to conceal its lost assets or transfer such assets to an SPC or to make fictitious sales or purchases with SPC's created for the originator to achieve unreal profits. The intent is to deceive organisational entities, investors, potential investors, credit rating agencies and the like.

In real world, a factual prominent example relates to the bankruptcy of the Enron Corporation, known as the Enron scandal. The company collapsed because of misuse of SPC's in addition to the use of legal and accounting loopholes in relevant legislation. The aftermath saw changes in some relevant laws and acts in the United States. Some studies say that the laws of SPC's after Enron's scandal are not as they were before.

Since such SPC's are meant to deceive people, they are forbidden as stipulated by the Quran and *Sunnah*:

"Do not consume one another's wealth unjustly"[22]

On the authority of *Qais bin Said bin Obadah*, Messenger Muhammad Prayers be upon Him said "Deception is in hellfire."[23]

Third Guideline**:** SPC's cannot be used to disguise monies acquired from illegal sources (dirty money) such as through looting, stealing, usurpation or embezzlement. Furthermore, it is forbidden to extend any help, logistics, consultation or any other such services to SPC's whose money comes from illicit sources, since Shari'ah prohibits cooperation in sins and aggression "cooperate in righteousness and piety, but do not cooperate in sin and aggression"[24].

5.5 Case Study: The impact of SPC on *Taskeek* Structuring

I here examine one *Sukuk* issuance of a real life case form the perspective of the position of an SPC in its structuring and its impact on the Shari'ah judgment on it.[25]

- Issuance in figures:
  a. Total size of issuance is US$1,000,000,000.
  b. Term of issuance is five years commencing the closing date of 21/7/2007 and expiring at 16/7/2012.

[22] Surat Al-Baqarah (verse: 188)
[23] Documented by: Al-Bukhari in *Sahih* Al-Bukhari as a suspended hadith in the Najash (deceitful outbidding) section of the Sales Book.
[24] Surat Al-Maedah (verse: 100)
[25] For the sake of relevance, I will not address some other aspects and guidelines related to Sukuk issuance since they are not related directly to the SPC based structure of issuance.

c. The issuance is made up of 20 instalments. Each gets mature every 3 months; that is on 16th day of January, April, July and October.
d. Sukuk holders should receive on the disbursement day the following amount:
   - A part of the original capital (US$ 1 billion) in addition to;
   - Average Interest Rate + the agreed profit margin of 2.25%.

5.5.1 Sukuk Issuance Structure: Explanation

I. Main contractual parties:

1. Sukuk holders: Those are the public investors who will pay for purchasing the *Sukuk*.
2. The financed real estate company (the issuer): It is a shareholding[26] company, which in addition of being the issuer; it plays several roles that will be discussed in the ensuing sections on structuring. It is important to mention; the Sukuk Issuance is mainly structured to finance this company.
3. SPC (1): It is a limited shareholding company established in Cayman Islands with the capital of US$250. Its purpose is to represent the Sukuk holders.
4. SPC (2) (Dubai SPC): A limited liability company incorporated in Dubai with a capital less than the one authorised for such companies (UAE Dirhams 500,000). It is owned by two partners whom are not related to the issuer.

II. Description of Sukuk Structuring Steps: Having read the issuance memorandum, I found the following:

1. SPC (1) issues *Sukuk* then sells them to Public investors (Sukuk holders).
2. SPC (1) receives the cash proceeds of subscription in *Sukuk* from those investors.

[26] The real name is kept anonymous for the purpose of confidentiality.

3. SPC (1) pays the monetary proceeds of subscription (US$ one billion) to SPC (2) as a price for the purchase of the real estate assets.
4. SPC (2) receives the amount from SPC (1) in return for sale proceeds of real estate assets.
5. SPC (3) purchase specific real estate assets from the issuer (the real estate company) and makes the payment in cash.
6. SPC (2) delivers the real estate sold to SPC (1).
7. In its capacity as an agent of the Sukuk holders, SPC (1) leases the real estates that are owned by Sukuk holders form the issuer (real estate Company).
8. In its capacity as an agent of Sukuk holders SPC (1), the issuer (real estate Company) appoints a servicing agent for the management of leased assets. This entails on the issuer (real estate company) a number of responsibilities on behalf of the Sukuk holders. Those responsibilities include: basic maintenance of leased properties and paying for that maintenance, structural reforms, taxes, zakat and insurance.
9. SPC (2) makes an undertaking, legal binding, unconditional and irrevocable promise to purchase the real estates leased from the Sukuk holders once they make the offer and at the execution price. The agreement provided that the execution price is US$1 billion in addition to any other financial dues that have not been paid in the periodical disbursements (i.e. when making a re-purchase using the basic amount with an undertaking to make up any delayed payment out of the profits generated).
10. The issuer (real estate Company) makes a binding, unconditional and irrevocable promise to purchase the real estate leased from SPC (1) under the same conditions made by SPC (2) for Sukuk holders.
11. The issuer (real estate Company) in its capacity as a third party offers an unconditional and irrevocable guarantee to Sukuk holders that SPC (2) fulfils its promise to by the assets from Sukuk holders.

In this way, Sukuk holders, as represented by SPC (1), have purchased real estate assets in cash (US$1 billion) from the issuer but through SPC (2). Then, they leased these assets from the issuer with a promise by the issuer to repurchase those assets at their nominal value (US$1 billion.)

Let us take a closer look at the above example to highlight the role of SPC's in that structuring:

SPC (1): It plays the simple role of Sukuk holders and custodian of *Sukuk* assets just like any other SPC specialised in *Sukuk* issuance.

SPC (2): served as an intermediary between the issuer and Sukuk holders. It is the one that sold the assets from Sukuk holders. The renter was the issuer. Then the guarantee for repurchasing the assets in advance was made by the issuer, which was not in the structure of the direct seller of assets from the Sukuk holder, i.e. it is a third party independent from the seller.

5.5.2 *Shari'ah* Position Towards Issuance

It appears to the researcher that such issuance is non-Shari'ah compliant[27]. It is a form of *I'nah* (بيع العِينة) sale[28] already prohibited by the majority of predecessors and successors of Islamic jurisprudents. It is, in particular, forbidden by the *Hanafi*, the *Maliki* and the *Hanbali*.

Argument (1):

As discussed earlier, scholars have mentioned some conditions whereby a sale is construed as a forbidden sale of I'nah (بيع العِينة). One main condition stipulates that the sold object does not change to account for the decrease in the price

In our subject lease *Sukuk*, the second contract is separated from the first one by a long period of time, something like five or ten years. This term is long enough for the sold object, not to mention the market, to be changed. That the first and second selling transactions are separated by a long term alien contract means that the *Sukuk* can no longer be deemed as sale of *I'nah* (بيع العِينة) in this sense.

[27]Cited jurisprudents' opinion is not meant to be conclusive on the issue of "renting a real estate by a person who has sold it by a rent-to-own contract". Rather, the aim is to shed some highlights on them to explain the impact of SPCs in sorting out this problem.

[28] Jurisprudents mentioned several forms of *I'nah (*). The general form that is referred to is usually about a person selling a commodity at a deferred price then the same person purchasing the commodity from the first buyer in cash before the lapse of the term at a lower price. The above mentioned form, however, is the opposite of *I'nah (*), which is to sell a commodity at a given price, then buy it back from the purchaser at a deferred price higher than the original price. Both transactions are treated equally because in effect they are not different.

Sukuk holders are, also, bearing the risks of *Sukuk* assets during the leasing term (in their capacity as landlords). If the leased object is destroyed, the lease contract is terminated and accordingly, the issuer cannot guarantee to the Sukuk holders the capital. This shows the difference between this kind of sale and sale of *I'nah* (بيع العِينة).

Answer (1):

The following issues must be raised in answering the above argument:

a. *I'nah* (عينة) sale itself is not prohibited by nature but is so prohibited because it is meant to bypass the anti-usury guidelines. Therefore, if something in the contract is found for which the object is prohibited, then the contract becomes prohibited. This is still valid even if it is argued that those conditions are no longer existent because this form of "*Ijarah Sukuk*" is obviously made to bypass usury rendering the transaction a *haram*.
b. Jurisprudents mentioned conditions that show absence of tricks (Shari'ah ruses) including the change of the object to the effect that it significantly reduces its value, undermining the purpose for which the object was made, i.e. to access the forbidden increase. This does not apply to the present form of *Sukuk*.
c. As for the condition that a long period of time (5 or 10 years for example) should elapse between the two contracts, it is not significant here. It does not serve the usury trick in this form of "*Ijarah* Sukuk". The reason is that the second consideration is predefined and the increase (the lease fees) is predefined as well with a full Undertaking and guarantee by the issuer to continue with the lease then to purchase the object at current conditions and at the predefined price.

In this context, it is appropriate to cite a valuable quotation by *Ibn Al-Qayyem*. He says: “Among those forbidden tricks (Shari'ah ruses) is to bypass the issue or permissibility of the sale though it is a trick per se to bypass usury. The majority of scholars have forbidden it. Trick makers have used such tricks (Shari'ah ruses) as: the buyer affects to the commodity something whereby it is decreased or flawed, so it can be sold to its original buyer at a price less of what he sold it. Another trick is to sell a divisible commodity. He then; holds a part and sells a

part thereof. Still another one is that the seller adds to the commodity a knife, a handkerchief, an iron ring or the like, sells it to the buyer then the buyer sells the commodity without the addition at a less price. Another one is that the buyer gives it as a gift to his son, wife or another person he trusts. Then the gift receiver sells it to the ultimate buyer and gives the money to the endower. He may also sell it to him without any changes or without resorting to the endowment trick but by adding to its price an iron ring, a handkerchief, a knife or the like". He, then, adds "No doubt the transaction per se is easier to be handled than in this twisted way and less corruptive. If the legislator prohibited the subject transaction as a source of damage, that damage cannot be removed by this ruse. It will rather inflict a graver damage that is deception, fraud and an act of mocking the provisions of Allah Almighty."

d. Those Sukuk holders bear the risks of the assets during the term of the *Sakk* certificate to the effect that they lose their capital if the assets are destroyed; is not accurate in several structures of this type of *Sukuk*. Several issuance Term Sheets of those *Sukuk* provide that the issuer shall undertake to or shall make a binding promise to purchase the *Sukuk* asset at its nominal value upon the expiry of the *Sukuk* term (Sukuk redemption) or when an emergent situation takes place such as the destruction of the assets. This is in fact a guarantee of the capital of the Sukuk holders before or after the *Sukuk* term expires.

Argument (2):

Another argument is that it is plausible to say that lease *Sukuk* are a form of sale of *I'nah* (بيع العِينة) in the existence of a dual relationship between the issuer and Sukuk holders. Duality means that the Sukuk holders have bought the assets from the issuer (real estate company) then the issuer (real estate company) leased those assets from the Sukuk holders and made a binding promise to repurchase those assets from them at nominal value. The matter is different here, however. The structuring has involved a third alien party (SPC 3) which bought the assets from the issuer (real estate Company) then sold it out from the Sukuk holders. The lessee from the Sukuk holders is the issuer (real estate company), which is not the person that sold the assets from them.

In addition, the one that Undertakes to buy from the Sukuk holders is the third party (SPC 2). The issuer (real estate Company) is just a guarantor to buy, making him an alien third party. Accordingly, the condition of that form of asset prohibited by jurisprudents is not existent here.

Answer (2):

The Sale of I'nah was prohibited because it was meant to lead to usury. Non Shari'ah compliant transaction cannot turn into *halal* (permissible) just because of the entry of an alien third party.

Ibn Al-Qayyem says: “Sale of I'nah (بيع العِينة) has a fifth form, the ugliest and most forbidden one of all. The two usurers intend to involve themselves in usury. They go to someone who has an asset. Then that someone buys it from the needy then sells it to the usurer at a current price and he receives the price. Then he sells it to the usurer at a deferred price, which is their subject agreement, and returns the asset to the man by giving him some profit. This is a tripartite relation because it involves three entities. If it is between the two then it is a dual relation. In the former case, they have entered into the transaction a person whom they claim can relive them of the sin of committing usury that is forbidden by God. He is similar to the forbidden *"mohallel*" (a cosmetic second husband illegally used to tamper with irrevocable divorces). But, God knows everything they hide. He knows what deceives the eyes and what hearts conceal.”

5.6 Chapter’s Conclusion

The following is a list of conclusions that can be withdrawn out of the previous sections on the role of SPC in Sukuk Structuring and the aforementioned case study:

1. An SPC is a mere legal vehicle that is established to achieve a number of goals and functions (including maintaining the ownership of assets separately from the original owner) regardless of the legal form of this vehicle as long as it achieves the objectives. The SPC expires with the aim of accomplishing the goal(s) for which it was established.

2. Having reviewed relevant experience around the world and a number of laws internationally, I found that an SPC can take one of the following forms:
    a. A special purpose entity in countries that provide in their local laws special law provisions for their establishments.
    b. A limited liability company (often established in tax-exempted regions).
    c. A trust or an offshore trust.
    d. A mutual fund.

3. SPC's have in common certain characteristics regardless of their different legal forms. An SPC mainly:
    a. is limited liability entities
    b. Does not exercise any other commercial activity than the maintenance and management of assets in accordance with its memorandum of association.
    c. is bankrupt-remote, a goal achieved by:
        i. Refraining from borrowing or getting credit.
        ii. Maintaining independence from the entity that runs it (originator).
        iii. Being not authorised to merge with other companies or entities and being unable to acquire or to be acquired by another company.
    d. Its memorandum of association mentions the object for which it is established along with its powers and method of liquidation.

4. A trust is a legal entity that is established to preserve and manage assets. Its ownership is transferred from the trustor to the Trust in accordance with an agreement that defines the beneficiary/beneficiaries, the trustee, the term of trust and other relevant and significant provisions.
5. An important principle underlying the concept of trust is the separation between the official or legal owner of the assets (which will become in the name of the trust) and the owner of the utility of those assets, who are the beneficiaries, defined in the articles of incorporation of the trust or the trust instrument.

5.6.1 *Shari'ah* Guidelines for SPC's

1. If the disposal or obligation from an entity (person) is not permissible (whether a natural or legal) in some contractual relationship, then judgement (Shari'ah position) does not change if such an act is made by an SPC established by the one prohibited entity or by the one who coordinates with that entity (person).

2. SPC's may not be used for goals that imply deception and fraud, as in the case, for example, of a company that tries through SPC's to hide its losses either by fictitiously selling or transferring such assets to an SPC or by conducting cosmetic selling and purchasing transactions with SPC's that it established to achieve fictitious gains.

3. SPC's may not be established to conceal dirty money gained from illicit resources such as loots, thefts, usurpation or embezzlement. It is also prohibited to extend logistics, help or advice to such endeavours following the *Qura'nic* ordinance “Cooperate in righteousness and piety, but do not cooperate in sin and aggression”.

Chapter (6)
CONCLUSIONS, RECOMMNEDATIONS, AND FUTURE OUTLOOK

6.1 Conclusions

Following are the most important conclusions, recommendations and suggestions that can be drawn from this dissertation:

1. The term Special Purpose Company (SPC) is the global term that is often used synonymously with Special Purpose Vehicle (SPV), and Special Purpose Entity (SPE).

2. The Special Purpose Company is a legal structure that has been established under the instruction of a sponsoring company, referred to as a sponsor, an originator, a seller or sometimes a manager. In addition to the sponsor, various groups and third parties may engage in the special purpose company depending on the purpose of the sponsor behind establishing the special purpose company.

3. The key attribute or feature that identifies the special purpose company is its remoteness from bankruptcy. This sort of companies is generally organized in order to keep it away from any potential bankruptcy of the sponsoring company. If the sponsoring company was involved in a case of bankruptcy, creditors will not be able to seize the assets of the special purpose company. Moreover, special purpose companies were established as a limited purpose entity, and are designed to reduce the risk of insolvency by the special purpose company itself.

4. Remoteness from bankruptcy can be achieved through several techniques, including the limitation of the purpose of the Special Purpose Company, as well as the limitation of debts and assets, besides other commitments. Such remoteness can also be achieved by ensuring, through the management process of the company that decisions will be taken against bankruptcy by the SPC itself rather than by the sponsoring

company or any of its subsidiaries. Moreover, when the assets are transferred from the balance sheet of the sponsoring company to the special purpose company, this transfer should be organized as a real sales transaction of legal purposes. By meeting the requirements of the real asset sale, the assets become more remote from the risk of bankruptcy by the sponsor.

5. Special purpose companies are used for several commercial purposes. They are used to transfer away the credit risks, to source funding, to facilitate customer service and retention, as well as to manage balance sheet, among others.

6. Based on the legal structure and accounting system, both assets and liabilities of the special purpose company may be required to be united or merged in the balance sheet of the sponsoring company, or any other involved entities, regardless of how remote the company might be from bankruptcy. Otherwise, the company will be an off-balance sheet entity.

7. The most important benefit of special purpose company is in the field of securitization. Securitization is a process of collecting and classifying cash-flow assets and converting the same into securities and instruments, and then selling them to investors, who become partners in ownership of these assets. Such securities are called Asset-Backed Securities, which carry the same strength of those assets. Often special purpose companies are used for securitization process in order to isolate the assets of the selling company and transfer them to a bankruptcy remote establishment.

8. Islamic securitization (Sukukization) is similar to traditional securitization in terms of procedures. Both mobilize resources and then divide them into equal parts known as securities that prove the ownership for their holders.

9. The ownership and control of the special purpose company depends on the jurisdiction of its incorporation. In order to recognize the proper framework for assets by the sponsoring company and the required distance from the bankruptcy, the special purpose company need to meet specific legal

requirements, accounting laws, tax laws, and pertinent regulatory requirements.

10. A special purpose company is usually a single-purpose entity that cannot participate in any activity other than acquiring and keeping of the assets of the sponsoring company and then issuing securities and instruments.

11. The special purpose company has multiple forms. Each of these forms has different important in the process for securitization. The SPC can take the form of a company, a mutual fund, trust contract, or other formats.

12. Let’s consider the following example in order to understand the reasons why a company may not directly issue bonds, but rather establish a SPC to issue asset-backed securities: Assume that a company wanted to borrow funds. That company can issue bonds. The yield on these bonds is calculated according to the company's credit worthiness or evaluation of their status, which determines borrowing costs for the company. Assume the creditworthiness of a company was low. That means the cost of borrowing will be high. That company can also issue asset-backed bonds if that company has access to such assets with value exceeding the required amount to be borrowed. The cost of borrowing will not be changed. When the company becomes subject to bankruptcy, creditors will demand their legal rights, including that collateral of the bonds. Accordingly, the company seeks other vehicles in order to reduce the cost of borrowing. That is, the establishment of a special purpose company, and then the transfer of the asset, to be used as collateral, to that company. In this case, if the parent company was subject to bankruptcy, the Sukuk holders will not lose their legal rights on that asset, as it has become under the ownership of another establishment. Additionally, the special purpose company can issue asset-backed securities with creditworthiness higher than that of the owner company; this leads to the reduction of borrowing costs.

13. The documentation of the relationships between the securitization parties will be based on the nominate contracts under Islamic jurisprudence. Each relationship among these parties has a different arrangement based on the different contracts concluded with them.

14. The special purpose companies should observe the Islamic judicial intents and spirit for funds. That implies the importance of issuing Sukuk that meets such intents.

15. Jurists take the following steps in order for them to know the legal ruling behind a new contract:
    a. Check the concerned transaction against the known legal transactions, and conduct a comparison between them in order to know the truths about such a transaction.
    b. Apply one of the general rulings on that contract, where no specific ruling is identified.
    c. Resort to practical fundamentals in case jurists were not able to get a result through the above two methods.

6.1.1 Observational Evidence from Interviews

Having understood how *SPC* is embedded in a Sukuk structure, let us examine the view of different market participants on the function of SPC combined with Promise Undertaking (PU). The question asked to bankers, Lawyers, regulator and rating bodies was the same: “What is the function of SPC in PU based Sukuk structure?” We then followed up with another question: “Is SPC/PU a guarantee structure?” For Shariah scholars we asked the question in a slightly different manner: “Does SPC in Equity Based Sukuk (EBS) secure the principal?” Tables in Appendix A shows the keyword from the answers of participants to the question of whether SPC/PU structure is a guarantee.

We then classified the answers into 5 main categories according to the most frequently repeated keywords. The results are shown in Table 6.1.1.1:

Code	Class	Count	%
1	Recourse to issuer	7	21%
2	An obligation to pay	6	18%
3	Reliability	2	6%
4	Guarantee (direct or indirect)	12	36%

5	Others	6	18%
	Total	33	**100%**

Table 6.1.1.1: Frequency Count on Function of PU

Out of 32 participants that answered this question, fifteen people (36%) said that SPC/PU is a form of guarantee of the principal (either direct or indirect). This is the highest Class of all the answers. Note that we included an answer in Class 4 (Guarantee) only if they explicitly mentioned that it is a guarantee. If they just mentioned that it creates recourse or creates an obligation to pay, we have provided a separate Class for that. "Others" include stand-alone answers that are not repeated by other participants. Only three feedbacks were in this Class. The keywords that were included in "others" were:

i. Protect investor capital and profit
ii. Undertake (SPC) of investment
iii. Legally, not a guarantee, but bankers will say, "This is what we use to get back principal".

Take note that although the key words in Appendix A could be easily interpreted as a guarantee, we did not lump them under the guarantee Class. We created a separate Class for them altogether. The purpose of this technique is to ensure that those who say PU is a guarantee surely meant it; it is not our own interpretation of what they said. Following Class 4 (guarantee), other categories that were frequently quoted as the function of PU are Class 1 (recourse - 21%), Class 2 (An obligation to pay – 18%) and Class 5 (others – 18%). Since we have participants from different groups, Table 22 shows the keyword count according to the group of participants.

If we refer to the different groups of participants, it seems that the scholars (75%) and the regulators (67%) are the groups that have the highest percentage of participants who say PU functions as a guarantee. Among bankers, the largest single bloc view PU as a mechanism to provide recourse to the obligor (31%), and the same view prevail among the rating bodies; 50% (2) of the rating bodies interviewed consider PU an instrument that provides investor's recourse to the obligor. Lastly, the lawyers cite two main functions of the PU: recourse (40%) and

guarantee (40%). Let us now analyze the reasons cited by the scholars and regulators for viewing the PU as a guarantee since these are the groups with the highest percentage that characterized it in this way. We interviewed nine scholars, but only nine answered this question. Their answers are displayed in Table 6.1.1.2 as below.

Scholar 1	It does work to sort of guarantee capital because it does not leave the capital to be subjected to the normal market forces, unless you have (SPC) to buy at market prices at the time of purchase
Scholar 2	1. If there is a guarantee to purchase the asset in *Musharakah* *Murabaha* at nominal price or pre-determined price, it will become a guaranteed debt, not *Musharakah* anymore. 2. If SPC/PU is at (PV), it contradicts with the concept of the valuation of the asset. Regardless of the value of the asset, you give me your money and at maturity I will redeem back the asset with principal & profit.
Scholar 3	If the SPC/*PU* is at pre-determined value, it will be a guaranteed *Sukuk*, and it is prohibited. If the *PU* is at MV or value to be agreed in future, it's OK
Scholar 4	It does not directly guarantee the principal, but the element of buying the asset at (PV) allows the investor to get back his capital regardless of the performance of the venture. So if we look into the effect (end result) of the PU, it allows the investor to get back his principal
Scholar 5	Yes, because it's stated clearly in AAOIFI Standard (AAOIFI, 2010), p. 206: Partners are trustees for each other and cannot be made liable for loss of capital. PU is an indirect guarantee because you use the proceeds from the sale to pay off the outstanding balance. Similarly ZCB is also an

	indirect guarantee, because it's issued at discount, but at maturity the investor gets the full face value amount.
Scholar 6	In most cases, the undertaking is from one party. I do not argue or debate so much on this; the risk is when it comes from both sides because when both parties give *PU*, it becomes a contract and hence binding religiously. Anybody who gives a promise, it makes it binding on him religiously. For example, when I give you *PU* to buy a particular item, you have the option to provide it or not. You definitely look at your own benefit.
Scholar 7	From a *Shari'ah* standpoint, some scholars have allowed the application of PU at (PV) for *Shirkah al-milk* that provides capital and profit guarantee. In banking all are *Shirkah al-Naqd*.
Scholar 8,9	Initially when scholars allowed SPC/PU, it was viewed as an exit mechanism and not a guarantee. If a third party can promise to purchase, it can become the obligor. Later, some scholars realized that to give a (PU) at face value is, in substance, like a guarantee. If the price of the undertaking was at the face value of $100 and the market price of the asset falls to $50 then it is almost like guaranteeing the $100, i.e. the face value.

Table 6.1.1.2. Scholars' Answers to the Query: Is SPC/PU structure is a Guarantee?

Out of the nine scholars, only two did not specifically mention that SPC/PU is a guarantee (Scholar 4 and Scholar 6). Scholar 4 said the effect of PU allows the investor to get back his principal but did not specifically characterize this as a guarantee. Therefore, we let this answer remain in Class 5 (others). Scholar 6, on the other hand, viewed PU as a unilateral instrument, and thus, did not say

whether it was a guarantee or not. For all other scholars, they specifically mentioned that PU is a guarantee (either direct or indirect). Out of the six scholars that viewed PU as a guarantee, three scholars gave clear reasons for their view. These are summarized in Table **6.1.1.3**

Scholar	Legitimacy of SPC/PU as guarantee
1	Capital is not subject to market forces
2	Contradicts with the concept of *Shari'ah* asset valuation (non interest based). Regardless of the asset value, you get your money back.
5	Indirect guarantee because it uses the proceeds of the asset sale to pay the outstanding balance.

Table 6.1.1.3. **Reasons Given by Scholars Who Say SPC/PU Is a Guarantee.**

Two other scholars (7 and 8) highlighted the reasons why some scholars allow the PU in EBS. These include allowing PU (although it has the effect of a guarantee) in *Shirkah al-milk* and scholars who (in the past) allowed PU as they viewed it as an exit mechanism; however, they later realized that PU at (PV) is a guarantee in substance because, regardless of the market price of the asset, the investor will get his money back.

Readers should note that this is an issue about which scholars differ. The fairest method to technique this issue is to examine why certain scholars view PU as a guarantee while others do not. On the one hand, scholars who do not view PU as a guarantee cite the reason that PU is only unilateral and is not a literal guarantee. On the other hand, scholars who view PU as a guarantee say that although PU is not literally a guarantee, in substance it does provide the effect of a guarantee, as the investors are protected from losses.

We included four regulators in our interviews, but only three answered this question. From the three participants, two were interviewed face-to-face while one more regulator's input was obtained from the available online resources. Their answers are displayed in Table **6.1.1.4** The regulators that were interviewed said that the PU at (PV) is a guarantee because it makes the EBS more debenture-like, i.e. it gives the investors the Reliability of debt. The first regulator highlighted a clear distinction between the role of PU at (PV) and PU at market value. If the PU is at (PV), it gives the investors the Reliability of debt;

whereas, if the PU is at market value, it does not change the nature of the instrument; the EBS would still remain as an equity-like instrument; only, in this case the PU would play the genuine role of an exit mechanism. If not (i.e. if the PU is at (PV)), it doesn't function merely as exit mechanism; it plays the role of guarantee.

Regulator 1: Interview	In general, the PU is used as an exit mechanism; however, that would not in itself require the fixing of the term (price) of the PU. If the PU is at (PV), in effect it is to guarantee the return of capital subject only to the counterparties' credit-worthiness,
Regulator 2: Online resources	Asset-based *Sukuk* may have underlying assets, but essentially they require some form of guarantee or contractual stipulation such as a "(PU)" from the issuer.
Regulator 3: Interview	(PU) is a guarantee. It gives the investors the Reliability of a debt instrument.

Table 6.1.1.4. **Regulator's answers regarding the SPC/ PU structural form of Sukuk.**

In sum, the top two functions of PU from the interview results are a guarantee (36%) and recourse to the obligor (21%). The scholars (75%) and the regulators (67%) had the highest percentage of participants who viewed PU as a guarantee. Rating bodies (50%) and bankers (31%) had the highest percentage of participants who viewed PU as recourse. The most common reason cited by the scholars who said that PU functions as a guarantee is that the capital of the investors is not subject to market forces because, regardless of the value of the asset/venture, the investors will get their original value back if the PU is priced at (PV).

6.1.2 Shari'ah Issues and Objectives of SPC/PU in Equity Based Sukuk (EBS)

In this section, we will provide concluding remarks on *Shari'ah* concerns of SPC/PU at PV in EBS. We will utilize a review of the relevant AAOIFI

standard as well as the interview results with the *Shari'ah* scholars. Before going into the *Shari'ah* analysis, let us recap the application of PU in SPC based EBS. In reference to the way the PU is priced, the PU then becomes an instrument to create an element of indebtedness in the equity-based *Sukuk*. What does this mean? By utilizing SPC/PU, the *Sukuk*-holders can be assured that they can claim not damages (i.e. actual damages suffered if any), but the amount of the principal plus any accrued but unpaid profit, from the other partner/agent (i.e. the obligor). Equity-based instruments (*Musharakah, Murabaha* and *Wakalah*) fall under the Class of trust-based contracts (*Naqd al-amanah*). AAOIFI *Shari'ah* Standard No. 5 (guarantee) clearly indicates that a guarantee is allowed in contracts of exchange (e.g., sales) but not in trust (fiduciary) contracts. Refer to Table 6.1.2.1.

2/2/1 It is not permissible to stipulate in trust (fiduciary) contracts, e.g. agency contracts (*Wakalah*) or contracts of deposits, that a individual guarantee or pledge of security be produced, because such a stipulation is against the nature of trust (fiduciary) contracts, unless such a stipulation is intended to cover cases of misconduct, negligence or breach of contract. The prohibition against seeking a guarantee in trust contracts is more stringent in *Musharakah* and *Mudarabah* contracts, since it is not permitted to require from a manager in the Mudarabah or the *Musharakah* contract or an investment agent or one of the partners in these contracts to guarantee the capital or to promise a guaranteed profit. Moreover, it is not permissible for these contracts to be marketed or operated as a guaranteed investment (AAOIFI, 2010).

Table 6.1.2.1. AAOIFI *Shari'ah* Standard on Guarantee in Trust Contracts

It is clear from the above that a guarantee in SPC equity-based (or fiduciary) instruments is not permissible in *Shari'ah* because it contradicts the nature of the instruments. However, the fundamental question is: is SPC/PU a guarantee form in any Sukuk Structure? The observational evidence from our interview shows that this was the main function cited by the participants. In our opinion, when PU is priced at principal plus any unpaid profit, and it is unconditional, it may play a role of guarantee in substance because PU creates the element of indebtedness in these

trust-based contracts. In other words, an unconditional PU at (PV) takes away the profit-and-loss sharing nature of equity-based instruments. Furthermore, if we recall the IDB 2006 case, the *Shari'ah* Board[1] clearly stated that the PU functions as a guarantee of principal and profit.

Nevertheless, a conditional PU, though at (PV) (like in Saudi Holland Bank), does not take away the nature of profit-and-loss sharing in the equity-based instruments. In other words, the payment to investors is still subject to project performance. Thus, it is not a guarantee because it does not create an element of indebtedness to one partner in the venture. This is our preliminary view, and it is subject to future in-depth thesis on the nature of conditional PUs from a *Shari'ah* standpoint.

We also asked the *Shari'ah* scholars in our interviews why a guarantee in equity-based instruments is not allowed. Four scholars provided answers to this question, which are shown in Table **6.1.2.2**.

Scholar 1	In general because there is this basic fairness principle under Islamic law. We have this maxim "*Al-ghunm bil-ghurm*" and "*Al-kharaj bildhaman*", meaning that if you don't take any liability then is not fair for you to actually charge an additional amount. This would be comparable with the prohibition of *riba*. If you give a loan, you are not taking risk on the capital, in a sense, because the borrower has to legally pay the full amount to the lender. This legal obligation means you are not taking any liability on the capital and so you are only entitled to get your principal amount. Since you do not take any liability on your capital, it is not fair for you to impose on the user of the capital to pay [something] additional. So in *Musharakah*, the moment the partner guarantees the capital, then by implication, it has turned into a loan contract. I give you $50,000 and you guarantee to pay $50,000; in substance it is actually a loan contract.

[1] The members of the Board at the time of issuance were Sh. Hussain Hamid Hassan, Sh. Saleh al-husayn, Sh. Abdul Sattar Abu Ghuddah, Sh. Mohammad Ali Taskhiri, Sh. Mohamed Mokhtar Sellami, Mohamed Hashim Bin Yahya. (IDB 2006 Offering Circular, 2009)

Scholar 3	In investment you must take risk. If you give guarantee, it will be treated as a loan. You put an amount, and it's guaranteed, and you will get additional money on this. We must apply the rule "*Al-kharaj bildhaman*. You have to take risk. It's prohibited in *Shari'ah* for the issuer or arranger to give this guarantee.
Scholar 4	In *Naqd al-ishtirak*, the partners are considered as trustees to each other. The same principle applies for *Wakalah*. A trustee will not be responsible for losses except due to negligence. Thus, guarantee in a trust contract contradicts with the trustee principle.
Scholar 6	Based on the requirement of a partnership (*Sharikah)* contract, the law of *Al-ghunm bil-ghurm* applies. Therefore, when one of the parties promises to buy the portion in the case, he is in fact, protecting his fellow counterparty from any potential loss (*Al-ghunm*). This is simply prohibited and unacceptable.

Table 6.1.2.2. *Shari'ah* Justification for Prohibition of Guarantee in Equity-Based Instruments

The common *Shari'ah* reasoning cited by three scholars in Table 6.1.2.4 is based on the legal maxims, "*Al-kharaj bildhaman*" and "*Al-ghunm bil-ghurm*". The first scholar provided a clear explanation of these legal maxims. She mentioned that in a loan contract there is a legal obligation on the borrower to pay back the principal. In other words, the inability of the borrower to pay back the loan (*qard*) does not affect his/ her obligation. Only if the creditor pardons the debt will the obligation be annulled. This legal obligation means that the lender does not take any liability on his principal. Thus if we have a guarantee in equity-based contracts, it means that one partner is not taking liability on his capital. The equity-based contract now becomes like a loan. Thus the partner that enjoyed the guarantee can only get back his principal and not any additional amount because any additional amount will be *riba*.

Scholar 3 noted that a guarantee in an investment contract takes away the risk; thus it will be treated like a loan. This violates with the principal of "*Al-kharaj bildhaman*". Scholar 6 discussed the application of *PU* in light of the legal maxim "*Al-ghunm bil-ghurm*". He said, "When one of the parties promises to buy

the portion in the case, he is, in fact, protecting his fellow counterparty from any potential loss *(Al-ghunm)*. This is simply prohibited and unacceptable."

If we refer to *AAOIFI Standards*, it discusses the effect of having guarantee in a *Wakalah* contract. Refer to Table 6.1.2.4 below:

2/2/2 ….a guarantee given by a party acting as an agent in respect of an investments turns the transaction into an interest-based loan, since the capital of the investment is guaranteed in addition to the proceeds of the investment (i.e. as though the investment agent had taken a loan and repaid it with an additional sum which is tantamount to riba)

Table 6.1.2.3. The Effect of a Guarantee in an Investment Contract (Hassan, 1978)

If we diagnose the PU, it establishes the legal obligation of the buying partner to pay back the principal and profit. Regardless of whether the partner has the money to buy back or not, PU acts as a mechanism to establish this legal obligation. As a result, it behaves very similar to a *qard*. Recall the evidence from the interview conducted on the function of PU. 18% of the participants said that the PU's function is to secure the obligation to pay. This obligation to pay means the *Sukuk*-holders are not taking any liability on the capital. This may render the transaction similar to a loan transaction, which entitles the *Sukuk*-holders to get back their capital only and nothing more. The way PU is currently priced it includes not only the principal but also additional profit. This additional profit may be considered *riba* if we apply the maxim of "*Al-ghunm bil-ghurm*" (Shehateh, Hussain H., 1978).

Furthermore, we can also relate PU to what Scholar 6 said: by way of the promise, the undertaker is protecting the counterparty (i.e. partner) from any potential loss. We can relate this to the function of PU as recourse. Once the PU is at (PV), the *Sukuk*-holders will not be exposed to any fluctuation of the market value of the asset. Regardless of the market value of the asset, the obligor has promised to buy the asset at a predetermined price. This contradicts with the principle of asset valuation (as highlighted by Scholar 2 in Appendix A). Scholar

8 gave a simple example to illustrate this point in Appendix A. He said, “If the price of the undertaking was at the face value of $100 and the market price of the asset falls to $50, then it is almost like guaranteeing the $100, i.e., the face value.” PU provides recourse to the obligor and takes away the asset risk from the *Sukuk*-holders. 21% of the participants agreed that PU provides recourse to the obligor. This recourse means the liability is on the obligor, not the asset.

In conclusion, if we analyze PU as a stand-alone component in equity-based *Sukuk*, it fulfills the *Shari’ah* requirement. However, when we look at the binding effect of PU at PV, it may be viewed as playing the role of a guarantee because it provides the investors with recourse to the issuer, regardless of the performance of the business venture. Furthermore, it creates an obligation for the issuer (obligor) to pay not only the principal but also the accrued but unpaid profit. If we compare EBS to lease-based *Sukuk* (LBS), for example, LBS requires the obligor to have a tangible asset before he can obtain funding. The requirement to have a tangible asset in order to issue the *Sukuk* is taken away in equity-based *Sukuk*, thus making it a very “asset-light” structure (Haneef, R., 2009). That’s why we observe the increased popularity of EBS. It provides an easy unsecured funding avenue for issuers. Nonetheless, in these asset-light structures, the anchor was profit-and-loss sharing. However, with the application of an unconditional PU at (PV), this anchor (loss sharing) may have gone astray. We should always keep in mind that this unconditional obligation to pay will be subject to court interpretation of the undertakings (Shabnam M., 2011). Thus actual testing of default cases may bring new evidence that may change such analysis.

6.2 Recommendations

This dissertation has provided clear evidence from case studies on how SPC and Sukuk are structured and influenced by the AAOIFI equity-based Sukuk pronouncement and guidelines. The researcher has studied 15 cases. In the sample of the cases that used SPC, Ten cases used SPC along with Promise Undertaking (PU). The remaining five cases only used SPC.

With regards to the main trigger events for SPC, all samples had maturity and default as the trigger events. With regards to price, the PU is priced not only

at principal but also to include expected profit (not realized profit) that has not yet been paid.

Besides the case studies, we also conducted interviews with different market players (bankers, lawyers, rating bodies, regulators and Shari'ah scholars). The main question covered in the analysis is about the function of SPC when linked to PU. The top two functions of SPC/PU structure identified from the interview are guarantee and recourse to the obligor. The scholars and the regulators had the highest percentage of respondents who viewed PU as a guarantee. Nonetheless, we should highlight that there are other Shari'ah scholars in the market who have different views on this subject. However, due to the time constraint we were not able to get their views through formal interviews. Thus readers should be mindful that there are other segments in the market with a different view and which have obtained Shari'ah approval from their respective scholars.

To recap, in Islamic Development 2005 Sukuk, the scholars clearly stated that SPC/PU functions as a guarantee of capital and return. Nonetheless, in the deal, which was considered a Sukuk Mudarabah, it was allowed because the obligor (IDB) and the issuer (SPV) were viewed as independent parties. The most common reason cited by the scholars who said SPC/PU functions as a guarantee is that the capital of the investors is not subject to market forces: regardless of the value of the asset/venture, the investors will get their original value back if the PU is priced at par. This unconditional obligation on one partner to pay means that the investor is not taking any liability on his capital. This alters the equity-based Sukuk, making it loan like. These scholars are of the view that the partner who enjoys the guarantee can only get back his principal without any additional amount because any addition will be "*riba*".

Notwithstanding the above, with Sukuk default cases kicking in, we will be able to empirically examine how extensive or strong is the effect of purchase undertaking in SPC Sukuk Structure. This may provide new evidence that can be used to conduct further Shari'ah analysis. Also, a more rigorous Shari'ah Objective analysis can be conducted to analyse different types of PU that have been applied in SPC based Sukuk, namely: conditional PU priced at par, as in PLSC case; non-default-related PU priced at par, as in Tamweel Asset Backed Sukuk; and unconditional PU priced at par used in convertible and exchangeable Sukuk, for example. These different types of PU have different functions and

effects. A thorough applied Shari'ah analysis would produce a good Shari'ah parameter that can be used by scholars in the application of SPC/PU in Sukuk.

In addition, the independence of SPC (as issuer) and obligor is another area that can benefit from applied Shari'ah objective analysis. IDB 2005, Bin Ladin Group Sukuk, Nakheel Sukuk, PLSC and Dar al-Arkaan would be good case study candidates for more dissertations on related topics. Finally, another area that needs further clarification is the application of SPC with PU in Sharikah al-milk and Sharikah al-Naqd. This is still an area in which scholars differ in their views. Not only applied Shari'ah objectives analysis discuss the issue of SPC/PU, but also the damages that the investors are entitled to, would provide clarity to the Islamic Capital market.

It is recommended for future researchers to go deeper in the calibration of the existing pricing models of SPC equity-based Sukuk brought forward by researchers by contemporary researchers, which is the normal critical issue for quantitative methods of Islamic financial engineering due to the fact of shortage of data, especially for asset backed Sukuk.

Among the challenges facing the Islamic banking and Finance industry; is the social impact of bankruptcies and Sukuk defaults result in structural impairment of the economy. Although the framework of the study is that of an Islamic banking system with limited data, it can also be implemented by conventional intermediaries. These are applied to the cases of infrastructural SPC based project financing Sukuk.

There must be a regulatory body that assumes a supervisory role over special purpose companies and their systems. This body must monitor the relationship of the SPC and securitization. Otherwise, securitization market will be out of control, and the funds of especially little investors will be subject to fraud; smaller companies and brokers will enter the market and the nation's wealth would be at stake.

It should be recognized that the special purpose company will not be able to grow or achieve its goals, like other companies in the market, except with good

scientific and economic awareness in addition to sufficient technical knowledge of the modern Islamic financial and economic transactions. Further, it requires good management of the company's assets that are converted to securities. It is an industry that requires specialized technical, financial and administrative equipment.

All terms and conditions related to contracts and Sukuk issuers must be observed.

6.3 Future Outlook

It is crystal clear that the time is ripe for a more solidified cooperation among Shari'ah scholars, practitioners, and researchers, which is fervently required to be very innovative in its approach towards equity-based Sukuk development. Sukuk issuing countries must mutually understand that the modern trend in Islamic capital markets is a general move towards the standardization and harmonization of best and practical practices and Shari'ah standards based on unified parameters of Maqasid al-Shari'ah, which had initially led to the establishment of certain regional bodies and intensive ongoing conferences, workshops, and international discussions between Malaysia and GCC countries (i.e. Bahrain, Dubai, Qatar, and Saudi Arabia). AAOIFI as a respected and professional source of Shari'ah governance especially to the GCC countries; under which Shari'ah scholars from over 53 countries operate to spearhead a modern approach towards the globalization of Equity-based Sukuk issuances based on Shari'ah based products. This can be achieved through practical steps to integrate the different exchanges of the OIC member countries and move a step forward towards innovating new Shari'ah compliant structures to be able to compete at the global level and attract more investors (Alsayyed, 2011).

Every special purpose company must have a legal monitoring commission with binding decisions. Such a commission must enjoy absolute authority. It can inspect whatever books, records, accounts, contracts, transactions or dealings.
The need for a mechanism; whereby security holders become able to practice their right to monitoring and protecting their interests.

It is important to pursue the development of systems and laws pertinent to the work of the special purpose companies. This should be done in a way that can improve the delivery of their mission, and allow them to cope with the new transactions developments as well as the market and community requirements, in addition to the protection of all related parties, while enabling them to compete in the market.

It is of a serious need to conduct seminars, workshops and conferences on Sukuk and Islamic securitization, as well as the special purpose company among legal scholars. Besides, special focus should be given to the participation of legal scholars and jurists in order to control the legal commitments.

Legal scholars, specialists, as well as research centers and Islamic economists should offer more research and studies in order to develop securitization projects and special purpose companies; a special focus must be given to diversification and review of related terms in order to achieve the optimum application and the correct formulas for securitization and the special purpose companies, through specialized workshops and presentation of research and in-depth studies.

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APPENDIX A

Interview and Data Collection Tables

Table 1
List of Equity-Based S*ukuk* from 2001-2004

Year	Date	Obligor	Domicile	Type of Ṣukūk Issued	Amount USD$	Term Sheet Available	PU available at Par
2001	15/6/2001	Majlis Ugama Islam Singapura	Singapore	*Muḍāraba h*	33	No	No
2002	26/2/2002	Cagamas Bhd	Malaysia	*Muḍāraba h*	13.15	Yes, but bayʿ al-dayn	No
2002	23/4/2002	Cagamas Bhd	Malaysia	*Muḍāraba h*	131.57	Yes	No
2002	15/6/2002	Sitara Group of Industries	Pakistan	*Muḍāraba h*	5.93	No	Unknown
2002	22/8/2002	Cagamas Bhd	Malaysia	*Muḍāraba h*	15.78	Yes, but *bayʿ al-dayn*	No
2002	6/11/2002	PT Indosat Tbk	Indonesia	*Muḍāraba h*	19.4	No	Unknown
2003	27/3/2003	Cagamas Bhd	Malaysia	*Muḍāraba h*	31.57	Ye s	No
2003	28/5/2003	PT Berlian Laju Tanker	Indonesia	*Muḍāraba h*	6.89	No	Unknown
2003	10/7/2003	Bank Bukopin	Indonesia	*Muḍāraba h*	5.2	No	Unknown
2003	15/7/2003	Bank Syariah Mandiri	Indonesia	*Muḍāraba h*	22.97	No	Unknown
2003	20/7/2003	Islamic Development Bank	Saudi Arabia	*Muḍāraba h*	500	No	Yes
2003	26/9/2003	Ciliandra Perkasa	Indonesia	*Muḍāraba h*	6.89	No	Unknown
2004	15/2/2004	HANCO Rent a Car -Caravan I	Saudi Arabia	*Muḍāraba h*	25.12	Ye s	No
2004	26/3/2004	PTPN VII	Indonesia	*Muḍāraba h*	8.71	No	Unknown

Table 2
List of Equity-Based *Ṣukūk* in 2005

Year	Date	Obligor	Domicile	Type of Ṣukūk Issued	Amount USD$	Term Sheet Available	PU available at Par
	28/2/2005	PG Municipal Assets Bhd	Malaysia	*Muḍārabah*	21.05	Ye s	No
	4/4/2005	Time Engineering (Musyaraka h One)	Malaysia	*Mushāraka h*	658.02	Yes, but bayʿ al-dayn	No
	19/5/2005	Gold *Sukūk* (Dubai Metals & Commoditie s Centre)	UAE	*Mushāraka h*	200	Ye s	Yes
	11/6/2005	Islamic Developmen t Bank	Saudi Arabia	*Mushāraka h Istithmār)*	500	Yes	Yes
	1/8/2005	IJN Capital Sdn Bhd	Malaysia	*Mushāraka h*	26.31	Yes	No
	1/8/2005	IJN Capital Sdn Bhd	Malaysia	*Mushāraka h*	28.68	Yes	No
	8/8/2005	Cagamas Berhad	Malaysia	*Mushāraka h*	539.47	Yes, but involved *bayʿ al-dayn*	No
	24/8/2005	Sanctuary Building *Sukūk*	GB	*Mushāraka h*	261	No	Unknown
	3/10/2005	The Investment Dar Company K.S.C	Bahrain	*Mushāraka h*	100	No	Unknown
	23/12/2005	Vastalux Sdn Bhd	Malaysia	*Mushāraka h*	26.31	Yes	No

Table 3
List of Equity-Based *Ṣukūk* in 2006

Year	Date	Obligor	Domicile	Type of Ṣukūk Issued	Amount USD$	Term Sheet Available	PU available at Par
2006	4/1/2006	Dubai Ports Authority and DPI Terminal (PCFC)	UAE	*Mushārakah*	3500	Yes	2006
	14/3/2006	Rantau Abang Capital Berhad	Malaysia	*Mushārakah*	2029	Yes	
	15/3/2006	Rantau Abang Capital Berhad	Malaysia	*Mushārakah*	789.47	Yes	
	21/3/2006	IJN Capital Sdn Bhd	Malaysia	*Mushārakah*	55	No	
	17/5/2006	Bukhatir Group	UAE	*Ṣukūk al-Wakālah bil-istithmar*	50	Yes	
	2/6/2006	Aabar Petroleum Investment Co.	Cayman	*Muḍārabah*	460	Yes	
	15/6/2006	East Cameron Gas Company	USA	*Mushārakah*	167	No (ABS)	
	11/7/2006	Saudi Basic Industries Corp (SABIC)	KSA	*Mushārakah*	800	Yes	
	14/8/2006	Rantau Abang	Malaysia	*Mushārakah*	394.73	Yes	

		Capital Berhad					
	17/9/2006	Investment Dar	Cayman Island	*Mushārakah*	150	Yes	
	18/9/2006	Qatar Real Estate Investment Company (QREIC)	Qatar	*Mushārakah*	270	Unknown	
	20/9/2006	A'Ayan Leasing & Investment Co.	Bahrain	*Mushārakah*	100	Yes	
	29/9/2006	Khazanah Nasional Bhd	Malaysia	*Mushārakah*	750	Yes	
	3/10/2006	Mukah Power Generation Sdn Bhd	Malaysia	*muḍārabah*	175	No	
	3/10/2006	Sarawak Power Generation	Malaysia	*Mushārakah*	56.57	No	
	6/10/2006	Sharjah Islamic Bank (SIB)	UAE	*Mushārakah*	225	Unknown	
	8/10/2006	Projek Lebuhraya Utara Selatan Berhad (PLUS)	Malaysia	*Mushārakah*	184.21	Yes	
2006	18/12/2006	PLUS	Malaysia	*Mushārakah*	52.63	Yes	2006
	20/12/2006	PLUS	Malaysia	*Mushārakah*	15.78	Yes	
	20/12/2006	PLUS	Malaysia	*Mushārakah*	52.63	Yes	
	20/12/2006	PLUS	Malaysia	*Mushārakah*	52.63	Yes	
	20/12/2006	PLUS	Malaysia	*Mushārakah*	52.63	Yes	
	20/12/2006	PLUS	Malaysia	*Mushārakah*	52.63	Yes	

	21/12/2006	Am Islamic Bank Berhad	Malaysia	*Mushārakah*	105.26	Yes, but restricted PU	
	26/12/2006	Serawak Power Generation	Malaysia	*Mushārakah*	56.58	Yes	
	27/12/2006	Lagoon City *Ṣukūk*	Kuwait	*Mushārakah*	200	Yes	
	27/12/2006	Mukah Power Generation	Malaysia	*Muḍārabah*	250	No (Muḍarabah + Istiṣnaʿ)	

Table 4
Sampling Frame for Years 2001- 2006

Year	Date	Obligor	Domicile	Type of Ṣukūk Issued	Amount USD$	Term Sheet Available	PU available at Par
	2003 2004 2005 2006	20/7/2003	Islamic Development Bank (IDB)	KSA	*Mushārakah*	500	Yes
		15/2/2004	HANCO Rent a Car (Caravan I LLC)	KSA	*Mushārakah*	25.12	No (ABS)
		28/2/2005	PG Municipal Asset Bhd	Malaysia	*Mushārakah*	21.05	No
		19/5/2005	Gold *Ṣukūk* (DMCC)	UAE	*Mushārakah*	200	Yes

		11/6/2005	Islamic Development Bank (IDB)	KSA	*Mushārakah*	500	Yes
		1/8/2005	IJN Capital SdnBhd	Malaysia	*Mushārakah*	26.31	No
		1/8/2005	IJN Capital SdnBhd	Malaysia	*Mushārakah*	28.68	No
		23/12/2005	Vastalux Sdn Bhd	Malaysia	*Mushārakah*	26.31	Yes
		4/1/2006	Dubai Ports Authority (PCFC)	UAE	*Mushārakah*	3500	Yes
		14/3/2006	Rantau Abang Capital Berhad	Malaysia	*Mushārakah*	2029	Yes
		15/3/2006	Rantau Abang Capital Berhad	Malaysia	*Mushārakah*	789.47	Yes
		21/3/2006	IJN Capital Sdn Bhd	Malaysia	*Mushārakah*	55	No
		17/5/2006	Bukhatir Group	UAE	wakālah	50	Yes
		2/6/2006	Ābār Petroleum Investment Co.	Cayman	*muḍārabah*	460	Yes
		15/6/2006	East Cameron Gas Company	USA	*Mushārakah*	167	No (ABS)
		11/7/2006	Saudi Basic Industries Corp.	KSA	*Mushārakah*	800	Yes
		14/8/2006	Rantau Abang Capital Berhad	Malaysia	*Mushārakah*	394.73	Yes
		17/9/2006	Investment Dar	Cayman	*Mushārakah*	150	Yes
		20/9/2006	A'Ayan Leasing & Investment Co.	Bahrain	*Mushārakah*	100	Yes
		29/9/2006	Khazanah Nasional	Malaysia	*Mushārakah*	750	Yes

			Bhd				
		3/10/2006	Mukah Power Generation Sdn Bhd	Malaysia	*muḍārabah*	175	No
		3/10/2006	Sarawak Power Generation	Malaysia	*Mushārakah*	56.57	No
	8/10/2006	Projek Lebuhraya Utara Selatan	Malaysia	*Mushārakah*	184.21	Yes	8/10/2006
	9/10/2006	National Industries Company for Building Material	Cayman	*Mushārakah*	100	Yes	9/10/2006
	9/10/2006	Projek Lebuhraya Utara-Selatan	Malaysia	*Mushārakah*	177.63	Yes	9/10/2006
	11/10/2006	Projek Lebuhraya Utara-Selatan	Malaysia	*Mushārakah*	1184.21	Yes	11/10/2006
	7/12/2006	Abu Dhabi Islamic Bank	UAE	*Mushārakah*	800	Yes	7/12/2006
	8/12/2006	Khazanah Nasional Bhd	Malaysia	*Mushārakah*	564.9	Ye s	8/12/2006
	18/12/2006	Projek Lebuhraya Utara Selatan	Malaysia	*Mushārakah*	52.63	Yes	18/12/2006
	20/12/2006	Projek Lebuhraya Utara Selatan	Malaysia	*Mushārakah*	15.78	Yes	20/12/2006
	20/12/2006	Projek Lebuhraya Utara Selatan	Malaysia	*Mushārakah*	52.63	Yes	20/12/2006
	20/12/2006	Projek Lebuhraya Utara Selatan	Malaysia	*Mushārakah*	52.63	Yes	20/12/2006
	20/12/2006	Projek	Malaysia	*Mushāraka*	52.63	Yes	20/12/200

		Lebuhraya Utara Selatan		*h*			6
	21/12/2006	Am Islamic Bank Berhad	Malaysia	*Mushāraka h*	105.26	Yes, but restricted	21/12/2006
	26/12/2006	Sarawak Power Generatio n	Malaysia	*Mushāraka h*	56.58	Yes	26/12/2006
	27/12/2006	Al-Ahlia Gulf Holding (Lagoon City	Kuwait	*Mushāraka h*	200	Yes	27/12/2006
	27/12/2006	Mukah Power Generation Sdn Bhd	Malaysia	*muḍāraba h*	250	No ((Muḍarab ah + Istiṣnaʿ	27/12/2006

Table 5
Sampling Frame for Post-AAOIFI Structures

Year	Date	Obligor	Domicile	Type of Ṣukūk Issued	Amoun t USD$	Term Sheet Availabl e	PU available at Par
22/1/2008	Sistem Lingkaran Lebuhraya Kajang	Malaysi a	*muḍāraba h*	229.9	No		22/1/2008
24/1/2008	Tamweel PJSC	UAE	*Mushāraka h*	300	Yes	Yes	24/1/2008
30/1/2008	Gamuda Berhad	Malaysi a	*Mushāraka h*	73.5 8	Yes	Yes	30/1/2008
30/1/2008	Pace (Pakistan) Limited	Pakistan	*Mushāraka h*	31.8 7	No	Unknow n	30/1/2008
5/3/2008	Khazanah Nasional Berhad	Malaysi a	*Mushāraka h*	550	Yes	Yes	5/3/2008
7/3/2008	Wesport Malaysia	Malaysi a	*Mushāraka h*	77.5 3	Yes	Yes	7/3/2008
7/3/2008	Wesport Malaysia	Malaysi a	*Mushāraka h*	31.6 4	Yes	Yes	7/3/2008
7/3/2008	Wesport Malaysia	Malaysi a	*Mushāraka h*	31.6 4	Yes	Yes	7/3/2008
16/3/2008	Tajeer	KSA	*Mushāraka*	66.84	No	Unknow n	16/3/2008
26/3/2008	WCT	Malaysi	*mushāraka*	31.54	Ye s	Yes	26/3/2008

	Engineering Berhad	a	*h*				
26/3/2008	WCT Engineering Berhad	Malaysia	*mushāraka h*	31.54	Yes	Yes	26/3/2008
26/3/2008	WCT Engineering Berhad	Malaysia	*mushāraka h*	31.54	Yes	Yes	26/3/2008
27/3/2008	Salam International Investment	Qatar	*mushāraka h*	137.5	Yes	Yes	27/3/2008
14/4/2008	Lingkaran Trans Kota Holdings Berhad	Malaysia	*Mushāraka h*	95.02	Yes	Yes	14/4/2008
14/4/2008	Lingkaran Trans Kota Holdings Berhad	Malaysia	*Mushāraka h*	362.68	Yes	Yes	14/4/2008
15/4/2008	Muhibbah Engineering (M) Bhd (WCT)	Malaysia	*muḍāraba h*	126.18	Yes	Yes	15/4/2008
2/5/2008	Hong Leong Industries	Malaysia	*Mushāraka h*	15.84	Yes	Yes	2/5/2008
2/5/2008	Hong Leong Industries	Malaysia	*Mushāraka h*	15.84	Yes	Yes	2/5/2008
7/5/2008	Gulf Holding Company (Villamar)	Bahrain	*Mushāraka h*	190	Yes	No	7/5/2008
11/5/2008	Mohammed H. Al Mana Group	Qatar	*muḍāraba h*	163.4	Yes	Yes	11/5/2008
15/5/2008	Tanjung Langsat Port Sdn Bhd	Malaysia	*mushāraka h*	1.53	Yes	Yes	15/5/2008
15/5/2008	Tanjung Langsat Port Sdn Bhd	Malaysia	*mushāraka h*	9.17	Yes	Yes	15/5/2008
15/5/2008	Tanjung Langsat Port Sdn Bhd	Malaysia	*mushāraka h*	13.78	Yes	Yes	15/5/2008
15/5/2008	Tanjung Langsat Port Sdn Bhd	Malaysia	*mushāraka h*	13.78	Yes	Yes	15/5/2008
15/5/2008	Tanjung Langsat Port Sdn Bhd	Malaysia	*mushāraka h*	12.25	Yes	Yes	15/5/2008

26/5/2008	Saudi Basic Industries Corporation	KSA	*mushāraka h*	1333. 2	Yes	Yes	26/5/2008
27/5/2008	Matang Highway Sdn Bhd	Malaysi a	*mushāraka h*	4.64	Yes	Yes	27/5/2008
27/5/2008	Matang Highway Sdn Bhd	Malaysi a	*mushāraka h*	8.18	Yes	Yes	27/5/2008
27/5/2008	Matang Highway Sdn Bhd	Malaysi a	*mushāraka h*	10.8 2	Yes	Yes	27/5/2008
28/5/2008	Bumiputera Commerce Holding Berhad	Malaysi a	*mushāraka h*	4.64	Yes	Yes	28/5/2008
28/5/2008	Eden Developers Ltd	Pakistan	*Mushāraka h*	3	No	Unknow n	28/5/2008
3/6/2008	Toyota Motor Corporatio n	Malaysi a	*Mushāraka h*	30.8	Yes	Yes	3/6/2008
5/6/2008	Mayora Indah Tbk, PT	Indonesi a	*muḍāraba h*	21.7	No	Unknow n	5/6/2008
26/6/2008	PLUS Expressway Bhd	Malaysi a	*Mushāraka h*	322.8	Yes	Yes	26/6/2008
10/7/2008	Bank Muamalat	Indonesi a	*muḍāraba h*	34.2	No	Unknow n	10/7/2008
20/8/2008	Islamic Development Bank	Malaysi a	*muḍāraba h*	89.87	Yes	Yes	20/8/2008
28/8/2008	Sitara Group of Industries (SGI)	Pakistan	*mushāraka h*	18.2	No	Unknow n	28/8/2008
28/8/2008	Sorouh Real Estate Company	UAE	*muḍāraba h*	68.31	Yes	Yes, but limit ed	28/8/2008
28/8/2008	Sorouh Real Estate Company	UAE	*muḍāraba h*	751.4 9	Yes	Yes, but limit ed	28/8/2008
28/8/2008	Sorouh Real Estate Company	UAE	*muḍāraba h*	273.2 7	Yes	Yes, but limit ed	28/8/2008
17/9/2008	Binladin	KSA	*muḍāraba*	267	No	No	17/9/2008

	Group, Saudi Arabia		*h*				
31/10/2008	Projek Lintasan Shah Alam (PLSA)	Malaysia	*muḍāraba h*	27.9	Yes	No	31/10/2008
31/10/2008	Projek Lintasan Shah Alam (PLSA)	Malaysia	*muḍāraba h*	13.9	Yes	No	31/10/2008
31/10/2008	Projek Lintasan Shah Alam (PLSA)	Malaysia	*muḍāraba h*	8.4	Yes	No	31/10/2008
31/10/2008	Projek Lintasan Shah Alam (PLSA)	Malaysia	*muḍāraba h*	8.4	Yes	No	31/10/2008
31/10/2008	Projek Lintasan Shah Alam (PLSA)	Malaysia	*muḍārabah*	5.6	Yes	No	31/10/2008
21/11/2008	Tanjung Langsat Port Sdn Bhd	Malaysia	*Mushāraka h*	5.52	Yes	Yes	21/11/2008

Table 6
Pre-AAOIFI *Ṣukūk* Deals and Utilization of *al-Waʿd al-Mulzim*

	Before AAOIFI Pronouncement (2008)	Obligor	Used *Waʿd*?
1	IDB *Sukūk Al-Istithmār* issued in IDB 2003 July 2003.	Yes. PU only	IDB *Sukūk Al-Istithmār* issued in IDB 2003 July 2003.
2	Caravan 1 (Hanco) *Sukūk Al-Istithmār* issued in February 2004	Hanco	Caravan 1 (Hanco) *Sukūk Al-Istithmār* issued in February 2004
3	Pasir Gudang Municipal *Sukūk Muḍāraba* issued in February 2005	PG Municipal	Pasir Gudang Municipal *Sukūk Muḍāraba* issued in

			February 2005
4	Gold *Sukūk* DMCC *Sukūk Mushāraka* issued in May 2005	Gold *Sukūk* DMCC Yes. PU only	Gold *Sukūk* DMCC *Sukūk Mushāraka* issued in May 2005
5	IDB *Sukūk Al-Istithmār* issued in June 2005	IDB 2005	IDB *Sukūk Al-Istithmār* issued in June 2005
6	PCFC *Sukūk Mushārakah* issued in January 2006	PCFC	PCFC *Sukūk Mushārakah* issued in January 2006
7	Rantau Abang *Sukūk Mushārakah* issued in March 2006	Rantau Abang	Rantau Abang *Sukūk Mushārakah* issued in March 2006
8	East Cameron Gas *Sukūk* issued in June 2006	East Cameron	East Cameron Gas *Sukūk* issued in June 2006
9	Abu Dhabi Islamic Bank *Sukūk Mushārakah* issued in December 2006	ADIB	Abu Dhabi Islamic Bank *Sukūk Mushārakah* issued in December 2006
10	KL Sentral *Sukūk Mushārakah* issued in April 2007	KL Sentral	KL Sentral *Sukūk Mushārakah* issued in April 2007
11	DP World *Sukūk Muḍārabah*issued in July 2007	DP World	DP World *Sukūk Muḍārabah*issued in July 2007

Table 7
Trigger and Price for IDB, Gold *Sukūk* DMCCDeals

Type of *Waʿd*	PU by Obligor (IDB)	PU by obligor (DMCC)	PU by obligor (IDB)
PU Trigger event			
Periodic distribution		√	
Maturity (Scheduled dissolution)	√		√
Dissolution Event	√		√
Conversion into equity			
Tax Event			
Optional			

Dissolution			
Change of Control			
Price of PU	Principal + Unpaid Profit	Principal + Unpaid Profit (LIBOR+0.6%)	Principal + Unpaid Profit
SU Trigger Event			
Tax Event			
Look Back Period			
Maturity (Scheduled Dissolution)			
Dissolution			

Table 8
Trigger and Price for PCFC, Rantau Abang and ADIB *Sukūk*

	PCFC	Rantau Abang	ADIB
Issuer	PCFC Development (SPV)	Rantau Abang Capital Bhd (SPV)	ADIB *Sukūk* Co Ltd (SPV)
Obligor	PCFC	Khazanah	ADIB
	Type of *Waʿd*	PU by obligor (PCFC) and	PU by Obligor (Khazanah)
PU Trigger Event			
Periodic			

distribution			
Maturity (Scheduled dissolution)	√	√**	√
Dissolution Event			
Conversion into equity	√		
Tax Event		√	
Optional Dissolution			√
Change of Control			
Price of PU	Principal + accrued return (7.125% if convert, 10.125% if not)	CP: Cost + YTM MTN: Cost + YTM-Periodic Distribution	Principal + Unpaid Profit (LIBOR+0.4%)
SU Trigger Event			
Tax Event			
Look Back Period	√	y**	
Maturity (Scheduled Dissolution)			
Dissolution		y**	

Note: ** Matched PU and SU trigger

Table 9
Trigger and Price for KL Sentral and DP World *Ṣukūk*

	KL Sentral	DP World
Issuer	KL Sentral Bhd	DP World *Ṣukūk* Ltd (SPV)
Obligor	KL Sentral Bhd	DP World Ltd
Type of *Waʿd*	PU by obligor (KL Sentral)	PU by obligor (DP World) and
		SU by issuer (tax event)
PU Trigger Event		
Periodic Distribution		

Maturity (Scheduled Dissolution)	√	√
Dissolution Event	√	√
Conversion into equity		
Tax Event		
Optional Dissolution	√	
Change of Control		√
Price of PU		
SU Trigger Event		
Tax Event		
Look Back Period		
Maturity (Scheduled Dissolution)		
Dissolution		

Table 10
View on Function of Purchase Undertaking

Category	Respondent	Brief View	Division
Bankers		Recourse	1
		Credit (recourse)	1
		Comfort because if	3

		obligor bankrupt, PU has no value	
		Recourse (how far can deal with asset)	1
		Guarantee because it gives recourse	4
		Crystallize obligation to pay	2
		Obligation to buy	2
		Legal instrument for recourse	1
		Protect investor capital and profit	5
		Comfort – because it restricts risk to credit risk	3
		Creates obligation to pay	2
		Sense of guarantee because obligor is obliged to buy back	4
		Undertake nominal value of investment	5
Rating Bodies		Mechanism to pay principal by creating payment obligation	2
		Shift focus from asset to entity (recourse)	1
		Shift credit assessment to obligor not asset (recourse)	1
		Form of guarantee because PU gives recourse to obligor	4
Regulators		Guarantees the return of capital	4
		contractual stipulation	5
		Guarantee - comfort of debt instrument	4
Scholars		sort of capital guarantee coz capital is not subject to normal market forces	4
		guarantee	4
		guarantee	4
		allows investor to get back capital	5

		indirect guarantee because you use the proceeds from the sale to pay off the outstanding balance	4
		capital and profit guarantee	5
		in substance like a guarantee	4
			4

Table 11
Function of PU according to Respondent Group

Code	Keyword	Bankers		Legal Counsel		Rating Bodies		Regulators		Scholars	
		Count	%	Count	%	Count	%	Count	%	Count	%
1	Recourse	4	31%	0	0%	2	50	0	0	0	0
2	Crystallize Obligation to pay	3	23%	2	40%	1	25	0		0	0
3	Comfort	2	15%	0	0%	0	0	0	0	0	0
4	Guarantee (direct or indirect)	2	15%	2	40%	1	25	2	0	6	75%
5	Others	2	15%	1	20%	0	0	1	67%	2	25%
		13		5		4		3	33%	7	

APPENDIX B

AAOIFI *SUKUK* RONOUNCEMENT

الحمد ، رب العالمين والصلاة والسلام على رسوله الكريم وعلى آله وأصحابه أجمعين..
أما بعد،
فإن المجلس الشرعي بهيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية (AAOIFI) نظراً لاتساع تطبيق الصكوك عالمياً والإقبال العام عليها ومايثار حولها من ملاحظات وتساؤلات، بحث موضوع إصدار الصكوك في ثلاثة اجتماعات:
(أولاً) بالمدينة المنورة بتاريخ 12 جمادى الآخرة 1428 هـ الموافق 27 يونيو 2007
(وثانياً) بمكة المكرمة بتاريخ 26 شعبان 1428 ه الموافق 8 سبتمبر 2007
(وثالثاً) بمملكة البحرين بتاريخ 7 و 8 صفر 1429 ه الموافق 13 و 14 فبراير 2008 ،

بعد ما اجتمعت اللجنة المنبثقة منه بتاريخ 6 محرم 1429 ه الموافق 15 يناير 2008 بمملكة البحرين بحضور عدد كبير من ممثلي مختلف البنوك والمؤسسات المالية الإسلامية وقدمت تقريرها إلى المجلس الشرعي.
وبعد النظر فيما دار في هذه الاجتماعات، والأوراق والبحوث التي قدمت فيها، فإن المجلس الشرعي_ إذ يؤكد على ما ورد بشأن الصكوك في المعايير الشرعية _ يوصي المؤسسات المالية الإسلامية وهيئات الرقابة الشرعية أن تلتزم عند إصدار الصكوك بما يأتي:

أولاً: يجب أن تمثل الصكوك القابلة للتداول ملكية حملة الصكوك بجميع حقوقها والتزاماتها، في موجودات حقيقية من شأنها أن تتملك وتباع شرعاً وقانوناً، سواء أكانت أعياناً أم منافع أم خدمات وفقاً لما جاء في المعيار الشرعي رقم (17) بشأن صكوك الاستثمار، بند (2) وبند 5-1-2 ويجب على مدير الصكوك إثبات نقل ملكية الموجودات في سجلاته وألا يبقيها في موجوداته.

ثانياً: لايجوز أن تمثل الصكوك القابلة للتداول الإيرادات أو الديون ، إلا إذا باعت جهة تجارية أو مالية جميع موجوداتها، أو محفظة لها ذمة مالية قائمة لديها ودخلت الديون تابعة للأعيان والمنافع غير مقصودة في الأصل وفق الضوابط المذكورة في المعيار الشرعي رقم (21) بشأن الأوراق المالية.

ثالثاً: لا يجوز لمدير الصكوك، سواء أكان مضارباً أم شريكاً أم وكيلاً بالاستثمار أن يلتزم بأن يقدم إلى حملة الصكوك قرضاً عند نقص الربح الفعلي عن الربح المتوقع، ويجوز أن يكون احتياطي لتغطية حالة النقص بقدر الإمكان، بشرط أن يكون ذلك منصوصاً عليه في نشرة الاكتتاب. ولا مانع من توزيع الربح المتوقع تحت الحساب وفقاً للمعيار الشرعي رقم (13) بشأن المضاربة، بند 8/8 أو الحصول على تمويل مشروع على حساب حملة الصكوك

رابعاً: لا يجوز للمضارب أو الشريك أو وكيل الاستثمار أن يتعهد بشراء الأصول من حملة الصكوك أو ممن يمثلهم بقيمتها الاسمية عند إطفاء الصكوك في نهاية مدتها ويجوز أن يكون التعهد بالشراء على أساس صافي قيمة الأصول أو القيمة السوقية أو القيمة العادلة أو بثمن يتفق عليه عند الشراء، وفقاً لما جاء في المعيار الشرعي رقم (12) بشأن الشركة (المشاركة) والشركات الحديثة 3-1-6-2 وفي المعيار الشرعي رقم (5) بشأن الضمانات، بند 2-2-1 و بند 2/2/2 علماً بأن مدير الصكوك ضامن لرأس المال بالقيمة الاسمية في حالات التعدي أو التقصير ومخالفة الشروط، سواء كان مضارباً أم شريكاً أم وكيلاً بالاستثمار. أما إذا كانت موجودات صكوك المشاركة أو المضاربة أو الوكالة بالاستثمار تقتصر على أصول مؤجرة إجارة منتهية بالتمليك، فيجوز لمدير الصكوك التعهد بشراء تلك الأصول _عند إطفاء الصكوك_ بباقي أقساط الأجرة لجميع الأصول، بإعتبارها تمثل صافي قيمتها.

خامساً: يجوز للمستأجر في التعهد في صكوك الإجارة شراء الأصول المؤجرة عند إطفاء الصكوك بقيمتها الاسمية على ألا يكون شريكاً أو مضارباً أو وكيلاً بالاستثمار.

سادساً: يتعين على الهيئات الشرعية أن لا تكتفي بإصدار فتوى لجواز هيكلة الصكوك، بل يجب أن تدقق العقود والوثائق ذات الصلة وتراقب طريقة تطبيقها، وتتأكد من أن العملية تلتزم في جميع مراحلها بالمتطلبات والضوابط الشرعية وفقاً للمعايير الشرعية، وأن يتم استثمار حصيلة الصكوك وماتتحول تلك الحصيلة إليه من موجودات بإحدى صيغ الاستثمار الشرعية وفقاً للمعيار الشرعي رقم (17) بشأن صكوك الاستثمار، بند 5-8-1-5 هذا ويوصي المجلس الشرعي المؤسسات المالية الإسلامية أن تقلل في عملياتها من المداينات، وتكثر من المشاركة الحقيقية المبنية على قسمة الأرباح والخسائر ، وذلك لتحقيق مقاصد الشريعة

وآخر دعوانا أن الحمد ، رب العالمين.

المصدر هيئة المحاسبة والمراجعة للمؤسسات المالية الاسلامية

ENGLISH

The Shari'ah Board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), in view of the increased use of sukuk worldwide, the public interest in them, and the observations and questions raised about them, studied the subject of the issuance of sukuk in three sessions; first, in al-Madinah al-Munawwarah, on 12 Jumada al-Akhirah 1428 AH (27 June 2007), second, in Makkah al-Mukarramah, on 26 Sh'aban 1428 AH (8 September 2007), and third, in the Kingdom of Bahrain on 7 and 8 Safar 1429AH (13 and 14 February 2008).

Following the meeting of the working group, appointed by the Board, which met in Bahrain, on 6 Muharram 1429AH (15 January 2007), which was also attended by a significant number of representatives from various Islamic banks and financial institutions, the working group presented its report to the Shari'ah Board.

After taking into consideration the deliberations in these meetings and reviewing the papers and studies presented therein, the Shari'ah Board - while re-affirming the rules provided in the AAOIFI Shari'ah Standards concerning Sukuk - advises Islamic financial institutions and Shari'ah Supervisory Boards to adhere to the following matters when issuing sukuk:

First: Sukuk, to be tradable, must be owned by the sukuk holders, with all the rights and obligations of ownership, in real assets, whether tangible, usufructs or services, capable of being owned and sold legally, as well as in accordance with the rules of

the Shari'ah, in accordance with Articles (2) and (5/1/2) of the AAOIFI Shari'ah Standard (17) on Investment Sukuk. The Manager issuing the sukuk must certify the transfer of ownership of such assets in its (sukuk) books, and must not keep them as his own assets.

Second: Sukuk, to be tradable, must not represent receivables or debts, except in the case of a trading or financial entity selling all its assets, or a portfolio with a standing financial obligation, in which some debts, incidental to physical assets or usufruct, were included unintentionally, in accordance with the guidelines mentioned in AAOIFI Shari'ah Standard (21) on Financial Papers.

Third: It is not permissible for the Manager of sukuk, whether the manager acts as the Mud'arib (investment manager), or Shari'k (partner), or wakil (agent) for investment, to undertake to offer loans to sukuk holders, when actual earnings fall short of expected earnings. It is permissible, however, to establish a reserve account for the purpose of covering such shortfalls to the extent possible, provided the same is mentioned in the prospectus. It is not objectionable to distribute expected earnings, on account, in accordance with Article (8/8)3 of the AAOIFI Shari'ah Standard (13) on Mudaraba, or to obtain project financing on account of the sukuk holders.

Fourth: It is not permissible for the Mud'arib (investment manager), Shari'k (partner), or wakil (agent) to undertake {now} to re-purchase the assets from sukuk holders or from one who holds them, for its nominal value, when the sukuk are extinguished, at the end of its maturity. It is, however, permissible to undertake the purchase on the basis of the net value of assets, its market value, fair value or a price to be agreed, at the time of their actual purchase, in accordance with Article (3/1/6/2) of AAOIFI Shari'ah Standard (12) on Sharikah (Musharakah) and Modern Corporations, and Articles (2/2/1) and (2/2/2) of the AAOIFI Shari'ah Standard (5) on Guarantees. It is known that a sukuk manager is a guarantor of the capital, at its nominal value, in case of his negligent acts or omissions or his non-compliance with the investor's conditions, whether the manager is a Mud'arib (investment manager), Shari'k (partner) or wakil (agent) for investments.

In case the assets of sukuk of al-mushÉrakah, mudarabah, or wakÉlah for investment are of lesser value than the leased assets of 'Lease to Own' contracts (Ijarah MuntahÉ Bitamleek), then it is permissible for the sukuk manager to undertake to purchase those assets - at the time the sukuk are extinguished - for the remaining rental value of the remaining assets; since it actually represents its net value.

Fifth: It is permissible for a lessee in a sukuk al-ijÉrah to undertake to purchase the leased assets when the sukuk are extinguished for its nominal value, provided he {lessee} is not also a partner, Mudarib or investment agent.

Sixth: Shari'ah Supervisory Boards should not limit their role to the issuance of fatwa on the permissibility of the structure of sukuk. All relevant contracts and documents related to the actual transaction must be carefully reviewed {by them}, and then they should oversee the actual means of implementation, and then make sure that the operation complies, at every stage, with Shari'ah guidelines and requirements, as specified in the Shari'ah Standards. The investment of sukuk proceeds and the conversion of the proceeds into assets, using one of the Shari'ah-compliant methods of investments, must conform to Article (5/1/8/5) of the AAOIFI Shari'ah Standard (17).

Furthermore, the Shari'ah Board advises Islamic financial institutions to decrease their involvements in debt-related operations and to increase true partnerships based on profit and loss sharing, in order to achieve the objectives of the Shari'ah.

In the end, all praise is due to Allah, Lord of all the Worlds!

DRAFT RESOLUTION TO THE DISTINGUISHED ACADEMY ON SECURITIZATION

[It was] decided as follows:

First: Securitization is a financial instrument to convert debts of the same type with their attendant interest into tradable paper securities through a Special Purpose Vehicle (SPV). Securitization by this definition falls within the prohibited debt securities about which Resolution No. 60 (6/11)[1] was issued. It makes no difference to the ruling if the transfer of debts to the SPV occurs by the transfer of a right (*ÍawÉlah*) or by debt renewal or sub-participation.

Secondly: *TaÎkÊk,* which is mentioned in Resolution No. 13 (3/15), is the SharÊÑah-compliant alternative to securitization. It is done by the issuance of *ÎukËk*, which are based on *muÌÉrabah* for a project, or a particular investment activity, or on the basis of a *mushÉrakah* contract. The owners of the *ÎukËk* in this project do not receive interest or a fixed profit; rather, they will get a percentage of the profit generated from this project, according to the parameters mentioned in the Council's Resolution No. 30 (4/5) issued on *qirÉÌ* (*muÌÉrabah*) bonds. Another alternative is *ÎukËk* based on an *ijÉrah* contract or some other permissible contract which can be the basis for a *ÎukËk* project with its special regulations for issuance and trade.

[1] Cf: *Majallat Majmaʿ al-Fiqh al-Islāmī* (1989), issue no. 6. vol. 2, p.1273; issue no. 7, vol. 1, p. 73.