Jordanian Islamic Finance Sukuk Law
A Critical Study

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ABSTRACT
This research paper critically examines the Jordanian Islamic finance Sukuk Law number 30 of the year 2012 which was issued on 16 of September 2012. Examination of the Jordanian Islamic finance sukuk Law involved critical examination to the primary provisions of the Law for the purpose of unveiling the strengths and weaknesses of the Law within the Jordanian legislative framework which is, relatively, still unfamiliar with sukuk issuance matters. The study found that there is some type of contradiction between the provisions of the Law, and that the Jordanian legal infrastructure is not yet, optimally, prepared to support and regulate issuance of Islamic finance sukuk. The study recommends that Article 3 of the Jordanian Islamic Finance Sukuk Law be modified to enable the establishment of a Committee of Islamic financial and economic expert devoted to assist in sukuk issuance matters.

Keywords: Islamic Finance Sukuk, Beneficiary Ownership, Legal Ownership.

ABBREVIATIONS
ICM: Islamic Capital Market.
JIFS Law: Jordanian Islamic Finance Sukuk Law.
SPV: Special Purpose Company.

Introduction
Sukuk came to the surface in Islamic Capital Market [hereinafter “ICM”] and became a key player for smoothing liquidity, resource mobilization, and enhancing economic growth within the country through real sector development initiatives. Prior to the issuance of the Jordanian Islamic Finance Sukuk Law, the Jordanian legal system did not include any reference to Islamic Sukuk issuance except the Muqarada Bonds Law number 10 of the Year 1981 which regulated one type of Islamic finance Sukuk, that type was the Muqarada Sukuk.

The legal rules govern the relationship between Sukuk issuer and Sukuk holders refer primarily to shari’a principles and laws and regulations governing Sukuk. The Jordanian Islamic Finance Sukuk Law (hereinafter: “JIFS Law”) law required that all matters related to issuing Islamic Sukuk shall be in full compliance with Shari’a principles. The Special Purpose Company (hereinafter: “SPV”) established for the purpose of Sukuk issuing is, in many aspects, based on a “trust” arrangement which is found in English law and which has arisen from equity. This study seeks to shed some light on the various provisions of the JIFS Law in critical context to show some of the shortages of the law. Examination will also include the SPV Company established for sukuk issuing. The scope of the study will be limited to examining significant provisions of the JIFS Law from a legal perspective.

Explaining the Concept of Sukuk
Developing an ICM is a vital prerequisite for the creation and sustenance of Islamic finance. Effective and efficient Mobilization and allocation of resources is considered as a long term objective for Islamic Capital Market(1) The accomplishment of such long term objective may be done through a real sector development financing. Moreover, it has been argued that the ICM has been considered as an avenue for liquidity management for Islamic financial industry by way of Islamic money market operations. (2)

Within the sphere of financial market, liquidity management is considered as a key element for ICM in the short run as it is crucially needed for securing long-
run survival of Islamic financial institutions.\(^{(3)}\) As the liquidity management issue became an urgent requirement for Islamic banks, countries such as Malaysia, Bahrain, Kuwait, Sudan, and Iran, were induced to bring in Islamic financial instruments in order to support the progress related to the management of assets by Islamic financial institutions.\(^{(4)}\) Hence, Sukuk came to the surface in ICM and became a key player for smoothing liquidity and resource mobilization and enhancing economic growth within the country through real sector development initiatives.\(^{(5)}\)

The word “Sukuk” is the plural form of the Arabic Word “SUK” which is the singular form. In Arabic language the Word “Suk” refers to a “certificate evidencing a financial obligation”. “Sukuk” has also been defined as: “tradable certificates that offer predictable return as relatively lower risk”.\(^{(6)}\) On the other side Sukuk has been defined by the Accounting and Auditing Organization for Islamic Financial Institutions “AAOIFI” as:

“Certificates of equal value representing undivided shares (in ownership of) tangible assets, usufruct, and services or (in the ownership of) the assets of particular projects or special investment activity”.\(^{(7)}\)

The JIFS Law number 30 of the Year 2013 adopted a similar definition when defining Islamic Finance Sukuk as:

“Certificates of equal value representing undivided shares in ownership of a project issued in the names of owners in return for their financial contributions for the execution, utilization, and achievement of returns of the project for a period specified in the prospectus in accordance with the principles and rules of Islamic Sharia”.\(^{(8)}\)

Some researchers refer to Sukuk as Islamic bonds, and that is incorrect, since bonds are financial instruments that are different from Sukuk. Bonds are debt instruments which are primarily based on interest and when a person subscribes to bonds a contractual relationship will be established between the subscriber who becomes the creditor and the (issuer) company issuing the bonds which becomes the borrower.\(^{(9)}\)

Thus, a loan relationship is established between the creditor and the borrower and under such loan contract the borrower is obliged to pay the value of security or the bond and also the applicable interest as determined in the bond certificate on the due date.\(^{(10)}\) In the case of bonds the loan relationship between the borrower and the creditor implies a contract characterized by earning money on money. The applicable interest is the term referred to in shari’a as Riba or Usury and it is strictly forbidden.\(^{(11)}\) If bond holders needed liquidity they can trade their bonds easily in secondary markets and obtain liquidity.\(^{(12)}\)

In contrast, and in the case of Sukuk, the issuer passes the asset ownership to the sukuk holders under a contractual relationship conforming to Shari’a rules such as lease, partnership, or sale contract, arising from trade or business activities.\(^{(13)}\) The result will be an undivided ownership in real assets that generate profits. Thus, in the case of sukuk, no “money on money earning” or interest (Riba) involved in the activity.\(^{(14)}\)

**Legal Regulation Sukuk in Jordan**

Prior to the issuance of JIFS Law, the Jordanian legal system did not include any reference to Islamic Sukuk issuance except the Muqarada Bonds Law number 10 of the Year 1981 which regulated one type of Islamic finance Sukuk, that type was the Muqarada Sukuk. That was one big obstacle which created difficulties in framing the legal form of Islamic Finance Sukuk in Jordan.\(^{(15)}\)

The JIFS Law number 30 of the year 2012 was issued on 16 of September 2012, although the Law represents a major step forward in terms of establishing a complete legal framework governing all aspects of Islamic financing Sukuk, however, the Law has missed several aspects related to Sukuk issuance. The JIFS Law stated that many aspects of Sukuk issuance are to be regulated in accordance with regulations to be issued in light with the Law. Such regulation will provide more details on issues that were not addressed by the Law. Until the time this research paper was written, the relevant regulation has not been issued yet. Therefore our discussion will be focused on some of the issues addressed by the Law only which will be explained in the following subsections.

**Sukuk Issuance**

Under Article 8 (A) of the JIFS Law, Islamic Finance Sukuk may be issued in accordance with the following contracts: Ijara Sukuk, Mudaraba or Muqarada Sukuk, Murabaha Sukuk, Musharaka Sukuk, Salam Sukuk, Istisna’a Sukuk, Sale of right to benefit, and any other contract approved by the Shari’a Central Control Body established in accordance with the JIFS Law.\(^{(16)}\)

Article 3 (d) of the JIFS Law authorizes the Financial
securities Board of Commissioners to draw the general policy for issuance of Islamic Finance Sukuk, the Board is also authorized to perform appraisals and follow-ups on matters related to Sukuk issuing. (17) Under Article 8 (c) and after permission to issue Sukuk is granted by Shari’a Central Control Body, Sukuk issuance shall also be approved by the Securities Commission’s Board of Commissioners. (18) Islamic finance Sukuk are issued to finance projects and economic activities that are considered Shari’a compliant activities and therefore, it has to be always related to one of the Islamic finance forms. That can be concluded from Article 2 of the JIFS Law which clarified the nature of the economic activity or the project to be financed by indicating that the term project shall mean any income-generating economic activity permitted by shari’a. (19)

Under Article 10 (a) of the JIFS Law, it is permitted for the party wishing to issue Islamic Finance Sukuk to establish an SPV. Such SPV will be entitled to own all available assets, benefits, or rights against which Islamic Finance Sukuk will be issued. (20) The SPV shall be registered at the Department of Companies Registrar. All matters related to the SPV will be governed by regulations to be issued specially to regulate all affairs of its affairs. (21) The SPV will be involved in the Sukuk issuance project and it will take ownership of the whole project and it will also be responsible for issuing the Islamic Finance Sukuk. (22)

Under Article 10 (c), the law permits the transfer of ownership of assets to the SPV for the sole purpose of issuing Islamic Finance Sukuk. The SPV distributes the returns of the project on sukuk holders. (23) According to Article 11, Islamic Finance Sukuk may be issued directly by the government, public establishments, Islamic Banks, Islamic finance Servicing companies, companies and establishments that obtain the approval of the Securities Commission’s Board of Commissioners. (24)

According to the JIFS Law, the created SPV enjoys an independent legal personality from its originator; the originator shall not be liable for any obligations related to the SPV project. The originator’s liability will be limited to the extent of its contributed proportion in the SPV’s capital. (25) The SPV is exempted by the law from all due tax liabilities, registration or licensing fees. It is also exempted from the obligation related to pre-registration capital payment. It is not liable to pay any real estate sale taxes, land registration fees due on property transfer between the SPV and its originator. (26)

JIFS law did not provide sufficient details regarding the nature of the SPV which will be responsible for Sukuk issuing. The Law stated for relevant regulations, yet to be issued, that will regulate the SPV’s affairs.

In terms of liability, an SPV company might take different forms of liability depending on the form of the company the SPV takes. For example, an SPV might take the form of a limited liability company, general partnership, and limited partnership. In the case of partnership, the company will have the disadvantage of exposing the general partner to the risk of unlimited personal liability. That is not the case in limited liability SPV where liability is limited to the share owned by the shareholder in the company’s capital.

**Relationship between Sukuk Issuer and Sukuk Holders**

The legal rules governing the relationship between Sukuk issuer and Sukuk holders refer primarily to shari’a principles and laws and regulations governing Sukuk. The JIFS law required that all matters related to issuing Islamic Sukuk shall be in full compliance with Shari’a principles. When the SPV Company issues sukuk the subscriptions made by subscribing investors are considered an offer while the approval to such subscription by the issuing company is considered as an acceptance unless otherwise specified in the prospectus. (27) That gives rise to a contract between the issuer and the subscribing investors. The contract will determine rights and obligations of each side.

The prospectus which contains all conditions and provisions for subscription except a condition that guarantees the shareholders proportion in the SPV’s capital as such condition is not permitted by shari’a principles. Moreover, it shall not include any condition that guarantees a specific amount of return relevant to the company’s capital and any stipulation to that effect shall be considered void as it contradicts with Shari’a that requires profit and loss sharing. (28) Article 14, E (4) of JIFS Law emphasizes that Sukuk holders shall share profit and loss in accordance with the type and form of Sukuk being issued.

Shari’a forbids such guarantee as it is considered as Riba (Usury) and it contradicts rules of mudharabah and musharaka contracts that are “structured through contemporaneous underlying contracts of exchange”. Best examples on that are sale and purchase contracts in which the underlying real asset is deemed the subject matter of the contract and that differs from Riba or
According to JIFS Law, Sukuk owners enjoy all rights that are legally determined for the owner. Thus the owner of a property may have the right to sell, donate, mortgage, and all other rights and legally permitted actions. Moreover, the ownership of Sukuk shall last for as long as the project exists or until redemption whichever earlier. The JIFS Law did not provide any details regarding the redemption of Sukuk. Since Sukuk are issued against tangible or intangible assets, that means a common ownership of a proportion or a share in the assets of the company.

Generally, redemption of stock such as bonds is considered as a liquidation of all or a portion of the actual investment of the shareholder in the company. In other words, the company returns back to the shareholder his share, or part of it, in the company’s capital. In the case of Sukuk, for redemption to be consistent with Shari’a principles, it has to be done based on the market value of the Sukuk rather than its nominal or par value which was previously paid by the shareholder. Although the Securities commission Law in Jordan permits the redemption of shares in their nominal value or par value, such redemption contradicts with Shari’a principles. The reason is that redemption, based on the nominal value or par value of the Sukuk or even the shares, deprives the Sukuk holder from the growth or increase in the value of Sukuk over time. In many cases the market value of Sukuk increases to exceed their nominal value and thus, the shareholder or the investor shall not be deprived from such growth in the value.

In shari’a terms, redemption by returning back the nominal value of Sukuk to shareholders means that the contract was a loan contract rather than a sale contract and if the contract was a loan then the profits or returns paid to investors or Sukuk holders until the time of redemption will be regarded as interest (Riba or Usury) on that loan. And a loan which generates benefit to the lender is not permitted by shari’a rules. The JIFS Law does not provide any clarification on that, and it is the duty of the Central Shari’a Control Body to make sure that redemption of Sukuk complies with shari’a principles. Although compliance with shari’a principles is a matter that should be referred to Shari’a scholars, however, it is also considered a legal matter as the JIFS Law itself requires that all matters, related to Sukuk issuing and redemption, to be done in accordance with Shari’a principles.

Redemption of Sukuk in their Nominal value may also represent a problem when referring to contract law principles. Redemption based on nominal value takes out part of the subject matter of the contract of sale (assuming that it is a sale contract) and that means problem in one of the pillars needed for the validity of the contract. In addition, the redemption of Sukuk means that the shareholders ownership to the assets is temporary. Shari’a principles do not recognize temporary transfer of ownership (assuming that the transaction between the Sukuk holders and the SPV is considered as a sale contract).

**Special Purpose company- Trust Based Company**

The SPV Company established for the purpose of Sukuk issuing is, in many aspects, based on a “trust” arrangement which is found in English law and which has arisen from equity. Under English law a trust is considered as a device within which two types of ownership of property exist for the same property simultaneously. These two types of ownership are basically legal ownership and equitable or beneficiary ownership.

However, each type of ownership is different in terms of the kind of relationship each person will have to the owned property. Where a property is held on a trust, there has to be a legal owner and such legal owner is known as a “trustee”. The Trustee enjoys management role, being subject to duties resulting from the property, in addition to the task of administering the trust.

At the same time there is an owner in equity usually named as beneficiary. The beneficiary has the right to enjoy all benefits of the property that would be associated with the legal title when ownership is not separated. Thus, it can be said that if the legal owner (a) has a property and he desires to enable another person (b) to benefit from the property without transferring the legal title of the property to (b) and while he (a) remains the legal owner of the property, then the best device used to achieve A’s purpose is a Trust.

The equitable ownership (beneficial ownership) arises only when separation of title is sought. That was concluded by Lord Brown-Wilkinson in the House of Lords case of *Westdeutsche Landesbank Girozentrale V Islington London Borough Council* where he stated:

“A person solely entitled to the full beneficial ownership of money or property, both at law and in
equity, does not enjoy an equitable interest in that property. The legal title carries with it all rights. Unless and until there is a separation of the legal and equitable estates, there is no separate equitable title”.

When the company is established the Sukuk’s originator (being the transferor) transfer’s the assets to the SPV, and through the SPV the assets are transferred to the Sukuk holders as beneficiaries in the form of Sukuk. In such a case, the SPV acts as a trustee with good faith.

As a trust involves the separation between legal ownership and equitable ownership, laws and regulations governing Sukuk make no distinction between the two types of ownership. Jordanian Islamic Finance Sukuk Law indicates that the SPV holds ownership of assets, benefits, or rights against which Sukuk are issued. The concept of separation between legal ownership and equitable ownership is not properly explored.

Results and Recommendations

In spite of passing the JIFS Law, the legal and economic infrastructure in Jordan is still insufficient to enable optimal utilization of Islamic Sukuk. There is a need for issuing regulations that specifically regulate issuance of Sukuk, especially as the current Law came very brief.

There is some type of contradiction between the provisions of issued law. The reason is the absence of developed economic infrastructure that can serve the legal issues dealt with by the law. It seems that the JIFS Law was significantly affected by other laws which reflected experiences of other countries that have different economic and social circumstances. The law provisions suffer ambiguity and reflect lack of knowledge in relation to practical application.

Current Securities Commission’s law and Regulations can be beneficial; however, they were not specially designed to regulate Islamic Finance Sukuk, they mostly deal with interest-based bonds, which contradict Shari’a principles. That is also the case with current Jordanian Company Law.

I support calls and views suggesting that Article 3 of the JIFS Law shall be modified to enable the establishment of a committee of Islamic financial and economic experts devoted to assist in Sukuk issuance matters. Despite the abovementioned, The JIFS Law constitutes a significant and bold step forward on the way to create a developed legal and economic infrastructure for Islamic Finance Sukuk.

Conclusion

The JIFS law required that all matters related to issuing Islamic Sukuk shall be in full compliance with Shari’a principles. As a trust involves the separation between legal ownership and equitable ownership, laws and regulations governing Sukuk make no distinction between the two types of ownership. The SPV established for the purpose of Sukuk issuing is, in many aspects, based on a “trust” arrangement which is found in English law and which has arisen from equity.

There is some type of contradiction between the provisions of issued law. The reason is the absence of developed economic infrastructure that can serve the legal issues dealt with by the law. Current Securities Commission’s law and Regulations can be beneficial; however, they were not specially designed to regulate Islamic Finance Sukuk, they mostly deal with interest-based bonds, which contradict Shari’a principles.

NOTES


(2) Ibid.


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قانون صكوك التمويل الإسلامي الأردني
دراسة نقدية

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ملخص

يهدف هذا البحث إلى إجراء دراسة تحليلية وتنقية لقانون صكوك التمويل الإسلامي الأردني رقم 30 لسنة 2012 والصادر بتاريخ 16 أيول من العام 2012.

وتتضمن الدراسة تحليلًا تقيييًا للنصوص الأساسية في قانون صكوك التمويل الإسلامي وذلك لكشف مواطن القوة والضعف فيه في إطار المنظومة التشريعية الأردنية والتي تعتبر، نسبيًا، حديثة العهد وقليلة الخبرة في شؤون إصدار الصكوك الإسلامية.

وقد توصلت الدراسة إلى وجود تناقض بين نصوص قانون صكوك التمويل الإسلامي، وأن البنية التشريعية للنظام القانوني الأردني لا تزال غير مهيأة بشكل مثالي لدعم وتنظيم إصدار صكوك التمويل الإسلامي.

وفي النهاية توصي الدراسة بضرورة تعديل المادة الثلاثة من القانون وذلك للسماح بإنشاء لجنة من الخبراء في الاقتصاد والتمويل الإسلامي وذلك لتسخير جهودها للمساعدة في شؤون إصدار صكوك التمويل الإسلامي.

الكلمات الدالة: الملكية القانونية، ملكية المستغل اقتصاديًا، صكوك التمويل الإسلامي.