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The detailed analysis of Islamic Banking Product, Sukuk

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Abstract

This article is about to understand the concept of sukuk, and its contemporary issues, implementation in the view of primary sharia resources. The objective is to explain the Islamic investment Sukuk with current terminologies in brought way, so as to provide the reader to collect the modern concept of economic and finance in Islamic structure, due to the recent banking chain, and different financial investment products are introduced. The word, financial investment, especially in Islamic law, has wide and large concept. that's why it is a very important to understand its basic and current practices. In this research all elementary components have been presented to define the method of this concept. Financial certificates are advanced practices in the banking sector and according to the human basic need like interest-based banking system, they are trying to suppress non-interest-based banking system. In the same way insurance and other financial organizations are doing the same. likewise, bonds. According to its basic object it is based on real Islamic rules. Islamic bonds are called certificate of Islamia too. Interest and gambling are not allowed in Islamic Law. Alternatively, financial documents have introduced in the name of Sukuk.

Key words: Bonds, Certificate, Sukuk, Risk, Security.

Sukuk introduction and Definition :

In the present era there are many financial institutions that have come into existence are certainly related to human basic and economic concerns. In addition to this, they worked on banking and insurance system as well, to make change the interest banking system subject to non -interest and Shariah orders, as so financial documents and certificates.

There has also been an attempt to mold the Shariah rules and terms to its basic purposes. this Shariah attempt doesn't contradict the mood of Islamic

finance. Such an attempt is also made by Islamic financial institutions in the form of "Sukuk" against interest-based bonds, which is based on different Shariah contracts.

Sukuk's literal meaning: Sak: Document, Confession, Check, Financial Document, Collection (1)

SUKUK In Dictionary:

Sukuk is an Arabic word which is plural of singular word SUK. It is also used for cheques, receipts, paper, certificate, etc., also this word is in Quran, فصحك, in new contemporary terminology, SUKUK, is referred to certificates issued by Islamic financial institutions, substitute of the prize bonds. This word is written, red in all languages, even in English too.

It is not translated, now it has become a new term. And now it has been added to the modern Islamic dictionary. In Arabic dictionary word, Suk, is basically derived from Persian to Arabic. It refers to a document which is used for financial matters and reports. (2)

Historical development of Sukuk-1978-2009 :

The concept of *Mudarabah Certificates (Bonds)* was first introduced by the Government of Jordan in 1978, during the legislative process for the establishment of the Jordan Islamic Bank. The objective was to create instruments that could facilitate long-term investments for financing large-scale development projects. The intellectual credit for the idea of *Mudarabah Certificates (Sukuk)* and its practical implementation is attributed to Dr. Abdul Salam Abbadi, who, at that time, was conducting research on these instruments within scholarly committees established by the Ministry of Awqaf. His efforts bore fruit when the Government of Jordan prepared the first regulations for Mudarabah Certificates, issuing them on the basis of *fiqhi ijtiḥad* (juristic reasoning) in a novel and distinctive form. These were subsequently presented to the International Islamic Fiqh Academy, which approved them from a Shariah perspective. Following this decision, the Islamic Development Bank issued investment certificates that represented investors' ownership in underlying assets. (3)

In October 1986, upon the completion of work on *Mudarabah Sukuk* and *Investment Sukuk*, the International Islamic Fiqh Academy underscored the significance of Sukuk and entrusted qualified scholars with drafting an authoritative resolution on the matter. By February 1988, the Academy issued an acceptable framework for Mudarabah Sukuk in light of the Qur'an and Sunnah. In March 1990, the Academy further issued a *fatwa* declaring conventional bonds to be prohibited (*haram*), recommending instead the adoption of Sukuk based on Mudarabah as Shariah-compliant alternatives. A significant milestone occurred in 1999 when the Central Bank of Sudan introduced *Central Bank Musharakah Certificates* and *Government Musharakah Certificates*. Designed as Islamic financial Sukuk, these instruments enabled

open market operations in compliance with Shariah principles. Their foundation rested on the principle of *al-ghunm bil-ghurm*—the equitable sharing of both profits and losses. Moreover, these certificates were distinguished by their tradability, allowing conversion into cash.(4)

In January 2002, the Muslim World League issued a *fatwa* prohibiting conventional interest-based bonds and declaring that *debt-based Sukuk* could not be traded in secondary markets. In May 2003, the **Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)** further systematized the field by classifying Sukuk into various categories, defining their essential features, and laying down the Shariah principles and regulatory standards required for their issuance.

In March 2004, the International Islamic Fiqh Academy articulated the Shariah principles and regulations governing *Ijārah Sukuk*. It also recommended examination of other types of Sukuk, such as those representing ownership of leased assets and those based on *Ijārah mawṣūfah fi al-dhimmah* (forward lease contracts), particularly regarding their issuance and tradability. In June 2006, the Academy recommended convening a special session to address an important issue concerning *Mudarabah Sukuk*: namely, the case in which the underlying assets consist of a heterogeneous pool—including tangible assets, usufructs, cash, and debts—rather than a single asset type. The Academy stressed the necessity of determining the Shariah rulings applicable in such scenarios.

In 2008, *specialized Ijārah Sukuk* were introduced following the European Council for Fatwa and Research's ruling that contracts involving usufructs derived from tangible assets were permissible. This ruling paved the way for the practical utilization of such Sukuk. Notably, *Ijārah Sukuk*, owing to their structural simplicity and regulatory clarity, have since become the most widely used type of Sukuk globally.

In January 2009, the Shariah Advisory Council of Malaysia's Islamic Financial Services Board (IFSB) defined the structure and legal framework of Sukuk, elaborated its definition, and identified the various risks associated with Sukuk issuance for financial institutions. The Council also set out the practical requirements for Sukuk structuring and issuance.(5)

Finally, in April 2009, the International Islamic Fiqh Academy declared that the endowment (*waqf*) of Sukuk is permissible, since Sukuk are recognized as valid assets under Shariah law. It outlined the Shariah principles and regulations applicable to such endowments, while simultaneously re-examining the essential characteristics and rulings of Sukuk. The Academy emphasized the importance of developing a comprehensive governance framework for Sukuk to ensure their Shariah compliance and financial integrity.(6)

Sukuk In Sharia Standards:

According to Accounting & Auditing organization for Islamic Financing Institutions-AAOIFI call this term as an Islamic Financial Certificate to differentiate from conventional bonds. (7)

Differences Between Sukuk and bonds:

Both Sukuk and Bonds are shared products, which is buy and purchased and the main purpose of both is financing.

many important economic duties can be carried out by sukuk and bonds, such as controlling the amount of rotation and current amount deficit. And providing funds for different things.

Sukuk and bonds are also ranked in the sense that they are shares that are considered to be quite stable and are a very low risk. Scholars and practitioners strive to incorporate these fundamental characteristics into financial instruments, employing varied methodologies and frameworks that conform to the tenets of Islamic jurisprudence. (8)

Important Features of Interest-Based (Conventional) Bonds:

1. These bonds do not represent ownership in the commercial or industrial projects for which they are issued. Instead, they are like a certificate or receipt of a loan with interest. The bondholder gives this money as a loan to the project owner who has issued the bonds.
 2. Bondholders receive fixed returns (interest/profit) regularly. The return is usually calculated based on the amount of money (capital) invested — not on the actual profit made from the project. Sometimes this return is fixed in advance, but it often changes over time, especially in the case of long-term bonds.
 3. In conventional bonds, it is guaranteed that the original amount (principal) will be returned at the end of the bond term — regardless of whether the project made a profit or loss. The bond issuer is only required to return the principal amount along with the agreed interest. If the project makes any extra profit, that goes entirely to the issuer. Bondholders have no right to demand a share in any extra profit beyond the fixed interest.
- All the above features are not found directly in Islamic Sukuk. However, nowadays, those who issue Islamic Sukuk try to indirectly include these features in some way. To achieve this, they have created different methods and mechanisms. In the following, I will try to review these methods through three key points.
1. The key distinction between *Sukuk* and conventional interest-based bonds lies in ownership: *Sukuk* typically represent joint ownership in a project's underlying assets or capital. However, not all *Sukuk* maintain this structure. Some merely offer profit rights without genuine asset ownership, resembling prohibited practices like trading in share profits. Furthermore, modern *Sukuk* often combine

multiple financial contracts—such as *Ijarah*, *Istisna'*, and *Murabaha*—raising concerns over legitimacy, especially when debt-based elements like *Murabaha* dominate. These evolving structures require careful Shariah review to ensure compliance.

2. Modern *Sukuk* structures often mimic conventional bonds by distributing profits to holders based on predetermined interest-rate benchmarks. To justify this under *Shariah*, contracts include clauses where any surplus profit is awarded to the director as a performance incentive. If profits fall short, the director must compensate the *Sukuk* holders through an interest-free loan, which is later recovered via surplus returns or by reducing the asset's repurchase value. This structure raises concerns about the convergence of *Sukuk* with conventional financial instruments.
3. A key issue in modern *Sukuk* structures is the guarantee of returning the principal amount to holders at maturity—just like conventional interest-bearing bonds. This assurance is typically formalized through a binding promise by the issuer or its director to repurchase the *Sukuk* at face value, regardless of the actual or market value at the time of maturity. As a result, these *Sukuk* replicate key features of interest-based bonds: they not only provide fixed returns based on benchmark rates but also ensure full capital repayment. This dual structure raises significant concerns from both a fiqh (Islamic jurisprudence) perspective and within the broader framework of Islamic economic principles. (09)

Type of Sukuk:

According to the Shariah standards developed by AAOIFI, there are fourteen (14) types of *Sukuk* that are deemed permissible from a Shariah perspective. However, not all of these are practically implemented in the market. In fact, some of them have perhaps never been utilized and remain of historical or theoretical interest only.

This is evident from the record of *Sukuk* issued between 2001 and 2007, which, despite some repetition, amounted to a total of 302 *Sukuk* issuances. Among these:

- *Ijārah Sukuk*: 149
- *Murābahah Sukuk*: 64
- *Mushārahah Sukuk*: 55
- *Muḍārahah Sukuk*: 12
- *Istisnā' Sukuk*: 11
- *Salam Sukuk*: 11
- Other than these, only one *Sukuk al-Manfa'ah* was issued, which originated from Saudi Arabia in 2007.

This demonstrates that, in practice, only a few types of *Sukuk* have been commonly used, while the rest remain largely unapplied or theoretical. (10)

Sharia Standard about Risk and Risk in Sukuk:

The term "risk" is largely self-explanatory and, in most cases, does not require an elaborate definition, as its meaning is inherently understood. In other words, the Shari'ah-based or technical definition of risk does not differ significantly from its linguistic meaning. Accordingly, risk refers to the possibility or probability of loss.

Therefore, if there is no likelihood of loss—as in the case of guaranteed interest-based loans—or if loss is certain and intended, such as in donations (where the objective is to give without expecting anything in return), or in guarantees designed solely to offer something without reciprocal compensation—then all such cases fall outside the definitional scope of risk. Nonetheless, measuring and classifying risk remains essential in order to determine whether a risk is high or low, and to allow investors or decision-makers to prepare accordingly. The rationale behind this is that if risks cannot be measured, categorized, or compared across various investment decisions, the concept of risk loses its practical and academic significance.

To assess and classify the risks associated with any given project, one may employ the method of probabilistic distribution of potential outcomes (expected risk estimations). In other words, the degree of assumed risk is connected to the expected return. (This means that the indicated level of risk does not necessarily materialize in every instance; rather, it is related to the likelihood of profit—if profit is expected, some level of risk may also exist.

Furthermore, the presence of higher levels of risk in a project does not automatically disqualify it from investment consideration. As long as the risks can be measured, and the expected return corresponds appropriately to the level of risk ("higher risk, higher return"), the project may still be considered viable for investments. (11)

Prohibited Means of Risk Mitigation in Sukuk Structures:

It is impermissible to stipulate that all risks associated with Sukuk are to be borne solely by the Sukuk manager (director). Thus, the entity responsible for operating the Sukuk may not provide a guarantee against potential losses, regardless of the operational model employed. Furthermore, Sukuk holders bear no liability for losses arising in the process of managing the Sukuk.

Accordingly, if the underlying assets—provided as capital—are partially or fully lost without any misconduct, negligence, or breach by the manager, the loss cannot be attributed to the Sukuk operator, nor is he held liable for it.

It is important to note that the operation of Sukuk must be based on one of three Shari'ah-compliant contractual structures: Mushārah (partnership), Muḍārah (trust-based investment), or Wakālah (agency-based investment). Since all three contracts are founded on the principles of trust and fiduciary responsibility, it is impermissible to impose a personal guarantee on the Sukuk operator—whether he is acting as a Muḍārib (investment manager), Sharik (partner), or Wakīl (agent). Even if such a guarantee were contractually stipulated, it would be religiously and legally void, as these roles do not entail liability for losses, except in cases involving negligence, misconduct, or a breach of contract terms.

In summary, guarantees are fundamentally incompatible with Muḍārah, Mushārah, or Wakālah contracts. Consequently, the Sukuk director is not liable for any loss, nor is he responsible for guaranteeing the capital of Sukuk holders. Any attempt to enforce such guarantees would transform the Sukuk arrangement into a conventional interest-bearing transaction, wherein the investor receives a return without bearing any risk. The Prophet Muhammad ﷺ explicitly prohibited profits that are not accompanied by risk or liability, thereby establishing the foundational principle that “profit is justified only when risk is assumed. (12)

Types of Risks Involved in Sukuk Investment :

Investing in Sukuk involves various types of risks that may relate to assets, income, currency, or Sukuk management. These risks include:

- Asset-Related Risks: These are associated with the assets acquired using the principal capital.
- Currency Risks: These arise when there is a mismatch between the currency used during Sukuk registration and the one in which the investment is actually deployed.
- Management Risks: These pertain to the operational and administrative handling of the Sukuk. (13)

Classification of Sukuk Investment Risks :

1. Insurance Risk: This occurs when Sukuk funds are invested in activities that may result in debt accumulation.
2. Market Risk: This includes fluctuations in market conditions such as changes in currency exchange rates and overall market volatility.
3. Inflation Risk in Sukuk Operations: The risk of devaluation of returns due to inflation over the investment period.
4. Contractual Risk: This relates to ambiguity or vulnerability in the wording of the Sukuk contract.
5. Moral Risk: This arises from a lack of trustworthiness and integrity in the first party (issuer or operator).
6. Operating Risk: This concerns the Sukuk operator's ability to generate profit. It also includes non-compliance with Shariah guidelines by the managing institution.

The Difference Between Capital Protection and Guarantee:

Protection refers to efforts made to safeguard the principal capital from loss. However, these efforts do not always yield the desired outcomes. A fitting example is the guarding of property—despite the presence of security, the assets are sometimes not fully protected. Similarly, a country may have defence systems in place, yet its security may still be compromised at times.

Guarantee, on the other hand, implies that any loss will be borne by the party demanding or requiring the guarantee. This concept is linked to outcomes, not to the means or causes, nor to the efficiency of the measures and tools employed for safeguarding the capital. Whether those methods are effective or not is not a concern of the guarantee itself.

This is why financial institutions often use the term "protection" in advertisements rather than "guarantee", particularly in contracts involving trust-based structures such as *musharakah* (partnership), *mudarabah* (investment partnership), and *wakalah bil istithmar* (agency for investment). The term "protection" is closely tied to the principle of asset preservation, which is one of the key objectives of Shariah. These *Maqasid al-Shariah* (objectives of Islamic law) include the preservation of:

1. Religion (*Hifz al-Deen*),
2. Life (*Hifz al-Nafs*),
3. Intellect (*Hifz al-'Aql*),
4. Lineage (*Hifz al-Nasl*),
5. Wealth (*Hifz al-Mal*),

As elaborated by Imam Al-Shatibi in his seminal work *Al-Muwafaqat*.(14)

No Conflict Between the Principle of Wealth Protection and the Principle of Faith Protection :

The principle of "wealth protection" does not conflict with the principle of "faith protection", which is regarded as the most significant objective among the higher objectives (*Maqasid*) of Shariah. However, it is important to note that some interpretations tend to extend the meaning of "protection" (*tahaffuz*) to imply "absolute security" (*amaan* or complete safety), which is not accurate. In such cases, the capital is neither guaranteed nor absolutely secure. Rather, protection is being provided with due caution, but it must be recognized that such caution and protective measures may succeed at times and fail at others. (15)

Risk Mitigation and Prevention :

It should not be misunderstood that the presence of risk in a lawful investment implies that if those risks are eliminated—whether naturally or through permissible strategies—the investment itself would then become impermissible. On the contrary, Shariah strictly prohibits self-destruction or

wilfully exposing oneself to harm. It also encourages individuals to seek benefit and pursue interests while avoiding harm and corruption.

The Prophet Muhammad (peace be upon him) advised:

“Be keen on that which benefits you, seek help from Allah, and do not be lazy.” (Hadith Sahih)

Another well-known hadith states:

“Tie your camel first, then place your trust in Allah.” (Hadith Sahih)

Similarly, in Islamic commercial jurisprudence (fiqh al-mu‘amalat), there are contracts that are directly linked to guarantees—such as kafalah (suretyship) and rahn (pledge). Even in partnership contracts where making guarantees is prohibited—like *mudarabah* or *musharakah*—certain conditions can still be included to reduce risk. For example:

- In *mudarabah*, specific constraints may be imposed.
- In *wakalah*, it may be stipulated that the agent will refer back to the principal for approval.

Therefore, even if complete protection cannot be ensured, risk minimization remains a legitimate and desired objective in Shariah. (16)

Collective Cooperation in Case of Loss:

Despite implementing all possible precautions, if risks do materialize, then mutual cooperation is essential to mitigate their impact and losses. Islamic tradition offers various mechanisms for this, such as:

- The *‘aqilah* system (a collective compensation system for unintentional murder),
 - Takaful (Islamic cooperative insurance), and other similar models.
- (17)

Conclusion of the topic

In the modern financial system, *investment sukuk* remains a relatively tough subject in research literature. This scarcity of research became the primary motivation for undertaking the present study, which attempts to shed light on all essential dimensions of this topic.

The fundamental purpose behind the emergence of sukuk is to provide an alternative to interest-based bonds and thereby offer the Muslim community a legitimate, Shariah-compliant financial instrument. The permissibility of issuing investment sukuk rests on the principle that they are structured upon contracts recognized as valid in Islamic jurisprudence. In this context, the prospectus of sukuk may be considered as an *offer*, while participation in them constitutes *acceptance*. Islamic law validates contracts through mutual consent, without the necessity of specific wording or formula, and there is no restriction if the offer is made by one party and accepted by a large number of investors.

Holders of sukuk are considered owners of the underlying assets represented by these certificates, and consequently, they retain the right of management since management is inherently linked to ownership.

Moreover, when sukuk represent tangible assets or usufructs, their subsequent trade is permissible, as it essentially amounts to the sale of those underlying assets themselves, which is legitimate under Shariah.

Thus, in the contemporary banking system, investment sukuk can play a vital role in the development of Islamic capital markets. Increasingly, a wide range of new investors are being drawn towards sukuk as a Shariah-compliant mode of investment.

In the modern banking system, sukuk serve as a major instrument through which both public and private sectors attract large-scale participation of investors in financing infrastructure projects such as bridges, roads, airports, seaports, and other developmental initiatives.

The issuance of sukuk must be based on a valid contract in which all essential pillars and conditions are fulfilled, and it must not contain any stipulation that contradicts the requirements or rulings of that contract.

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