

Islamic finance update

May 2009

On 30 April 2009 in Sharjah, United Arab Emirates, the International Islamic Fiqh Academy (Academy) of the Organisation of Islamic Conference (OIC) closed its 19th session. The Academy is composed of senior Shari'ah scholars representing Muslim member countries of the OIC. It is considered to be the most prestigious and high-ranking body of Shari'ah scholars in the Muslim world. Compliance with its resolutions, while not statutorily binding, is considered to be extremely important and persuasive.

Shaikh Muddassir Siddiqui, a partner in our Dubai office, attended all meetings of the session, which lasted four days. Shaikh Muddassir, as well as being a US attorney, is a Shari'ah scholar.

During the meeting, the Academy looked at several subjects and issued resolutions on Islamic finance.

Some of its main resolutions were as follows:

1 Tawarruq (commodity murabaha)

- (a) Tawarruq is permissible in the limited context of one-off transactions between individuals, provided it strictly complies with the Shari'ah rules of sale.
- (b) Organised tawarruq and reverse tawarruq are not permissible. The Academy considered it a "trick" to get cash now for more cash paid later, which is prohibited in Islam.
- (c) Organised tawarruq is defined as the purchase of commodities from local or international markets and their on-ward sale (on a deferred payment basis) to the customer. The seller then (as agent for the customer) on-sells the commodities (to a person who must be different from the first supplier) for a price that is lower than the deferred payment obligation owed by the customer. The result is the customer gets a cash amount for its required business or personal purposes.
- (d) Reverse tawarruq is the same as the organised tawarruq, with the difference that the buyer in the reverse tawarruq is a financial institution in need of liquidity.

If tawarruq were suddenly withdrawn, this would have a dramatic effect because many Islamic financiers routinely use this instrument as a means of liquidity management and to provide their customers with working capital facilities.

2 Purchase undertakings

- (a) The Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) is based in Bahrain, and issues standards dealing with various Islamic financial instruments. In February 2008 it issued a statement on sukuk. Part of that statement reiterated its earlier rulings prohibiting a manager, partner or investment agent undertaking to re-purchase the sukuk assets for their nominal value.
- (b) Purchase undertakings are provided by the obligor in a financing in which it promises to buy the financed asset, equity interest, etc, for a predetermined nominal price on the occurrence of stated events (i.e., pre-arranged dates or a default).
- (c) The Academy agreed with AAOIFI's position and resolved that:
 - (i) An undertaking to redeem a sukuk at its nominal price is not allowed; it must be redeemed at either the market price or the price agreed at the time of redemption.
 - (ii) A sukuk manager cannot provide liquidity facilities or other voluntary funding arrangements to make sure the sukuk holders receive their expected rate of return in circumstances when the income from the sukuk assets is not enough to pay that expected rate of return. However, the Academy allowed the manager to voluntarily pay the difference after the appearance of the loss; whether this will assist in terms of practical application is uncertain.



3 Tradability of sukuk

The Academy confirmed its earlier Resolution No. 30 (4/3) and reiterated as follows:

- (a) If the underlying asset of the sukuk is cash, the sukuk can only be traded in accordance with the rules related to the sale of cash (sarf).
- (b) If the underlying asset of the sukuk is debt, it can only be traded in accordance with the rules related to sale of debt.
- (c) If the underlying assets are a mix of cash, debt and physical assets and usufruct, sukuk can be traded provided the value of the assets and usufruct is more than the value of cash and debt.

The Academy will issue a resolution in the future dealing with when the value of the assets and usufruct is less than the value of cash and debt.

Further information

If you would like further information on these issues, please contact:

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