
PURCHASE UNDERTAKING IN EQUITY-BASED SUKUK: DOES IT AMOUNT TO GUARANTEE?

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ABSTRACT

Purchase undertaking has been adopted widely in sukuk product especially with regard to the equity-based sukuk, structured under Mudharabah, Musyarakah or Wakalah contracts. Undoubtedly, the objective is to minimize the risks faced by investors in holding the sukuk asset throughout the period. Indeed, the value of the sukuk underlying asset is not stable. On the other, hand, the sukuk issuer could not provide direct guarantee as this is against the principle of those contracts. Thus, the purchase undertaking is utilized here to preserve the value of the asset so that the investors will regain their capital plus the profit at the end of the maturity period. This practice has been seen as contentious since the purchase undertaking applied here is just like a guarantee of capital which is not allowed in Shari'ah. Therefore, this paper aims to study the practice of the purchase undertaking as applied in equity based sukuk whether it amount to guarantee and thus prohibited or not. Finally, this paper will explore some practical solution for the issue.

Keywords: Purchase undertaking, equity based sukuk, guarantee

INTRODUCTION

Sukuk or Islamic investment certificate has received positive reaction from investors worldwide. The return of investment derived from various Islamic contracts make this kind of investment different from other types of investments especially from its' conventional counterpart. The return from investment together with its capital cannot be simply guaranteed like in the case of conventional bonds but there are certain mechanisms that have been used to safeguard the interest of the investors. Among that mechanisms namely purchase undertaking at nominal value which has been adopted in most of the sukuk structures in order to ensure the return from the investment and the capital remain secured uninterrupted especially during the hardship period.

However, there are a lot of critics toward the application of the purchase undertaking since it has similarities with the conventional bond in the way that it seem to guarantee the investment capital which is not allowed according to the Shari'ah law, thus makes sukuk unislamic. This paper discusses the practice of purchase undertaking at nominal value in sukuk transaction whether it is a type of guarantee or it is just merely a promise that may be pronounced at anytime and any place without any restriction.

DEFINITION

Taking from the Shari'ah point of view may be seen as either *al-wa'd* or *al-ta'ahhud* whereby both represent the meaning of promise. *Al-wa'd* literally means a promise made by someone in binding himself to carry out certain obligations whereby he has intention to perform it (Ibn Manzur, 1993). Whereas *al-ta'ahhud* or *al-ʿAhd* means securing and taking care of something whereby it is used to represent an agreement that must be given consideration, (Al-Jurjani, 1983) or it is an agreement that bind the contracting parties to perform such agreement (Ibn Manzur, 1993). It differs from *wa'd* in the sense that *ta'ahhud* is a promise associated with a condition, such as "if you do such-and-such, I will do such and such" (Al-Askari, 1968).

According to an opinion, there is no pledge from the promisor in *aal-wa'd*, whereby in another type of promise which is *al-ta'ahhud*, it does carry the connotation of a pledge, hence it is a binding promise that requires compensation in case of breach (Abu Ghuddah, 2010). This opinion held that undertaking is not just merely a promise but it is a binding promise that binds the promisor to execute his promise.

Hence, according to this view, the undertaking is equal to *al-ta'ahhud* and not *wa'd*.

However, in most of the time, undertaking is determined as *wa'd* (Shabnam, 2009). However, the similarity between the two is *wa'd* and *ta'ahhud* both are unilateral promises which binding only on the promisor.

Obviously, in sukuk transaction, a purchase undertaking is a promise made by the originator or issuer to repurchase the underlying asset upon the maturity dates or upon any occurrence of trigger event. The goal is to give a bigger score in credit ratings so that the investors will be more confident to invest due to that guarantee. In other word, the investors will not afraid to invest their money because they will get back their money at the end of the day by executing the purchase undertaking by either the originator or the issuer. The purchase undertaking is an important rating factor in sukuk transaction as it changes the risk metrics of the transaction and fundamentally shifts the credit-risk driver to the entity providing the undertaking (Liza, 2008).

The undertakings even though permissible according to Shari'ah, however it becomes contentious when it is applied in equity-based contract namely *mudarabah*, *musharakah* and *wakalah*. The main feature of these contracts is the capital and the profit of an investment is not allowed to be guaranteed. The reason is because of the nature of these contracts which are classified as trust contract which based on the principle of "*amanah*" or trust. As a trustee, his is not liable for any loss unless there is transgression, or dereliction, or a violation of terms. He also cannot guarantee the profit because it will change the nature of the contract into the interest-based loan contract which is *riba*. Therefore, the guarantee is not permissible at all.

In this analysis, the researcher will examine the real practice of the purchase undertaking in asset-based and asset-backed sukuk issuance by looking into the terms and conditions provided in the sukuk's Principles, Terms and Conditions (PTC). This is very important to determine whether the undertakings really meant to guarantee the returns and capital or not.

LEGAL STATUS OF UNDERTAKING IN THE SHARI'AH

Undertaking or promise conceptually is not new to Islam, whereby fulfilling the promise is considered as praiseworthy. Indeed, Allah has promised those who believe in Allah and doing good deeds with

paradise or *jannah*. Allah says:

وَالَّذِينَ آمَنُوا وَعَمِلُوا الصَّالِحَاتِ أُولَٰئِكَ أَصْحَابُ الْجَنَّةِ هُمْ فِيهَا خَالِدُونَ

“And those who believe (in the Oneness of Allah - Islamic Monotheism) and do righteous good deeds, they are dwellers of Paradise, they will dwell therein forever”

(Al-Baqarah:82)

Moreover, Allah’s promise is true. Allah says:

أَلَا إِنَّ وَعْدَ اللَّهِ حَقٌّ

“No doubt, surely, Allah’s Promise is true”

(Yunus:55)

Indeed, Allah will never break His promises, Allah says:

وَعْدَ اللَّهِ لَا يُخْلِفُ اللَّهُ الْمِيعَادَ

“[It is] the promise of Allah. Verily, Allah does not break His promise.”

(Al-Zumar:20)

In addition, the fulfillment of promises is a characteristic of a good Muslim. As long as he is capable, to fulfill the promise then it is obligatory for him to perform it. Whenever a Muslims intentionally breaking his promise without any reason then he is considered as one who possesses the characteristic of a *munafiq* person. The Messenger of Allah said:

آيَةُ الْمُنَافِقِ ثَلَاثٌ: إِذَا حَدَّثَ كَذَبَ، وَإِذَا وَعَدَ أَخْلَفَ، وَإِذَا أُؤْتِمِنَ خَانَ

“The signs of a hypocrite are three: When he speaks, he lies; when he promises, he breaks his promise; and when he is entrusted, he betrayed the trust.”

(Al-Bukhari,1862)

Promises are permissible (*mubah*), (Al-Jassas, 1984) which could be understood from the previous texts that mentioned the application of promise in the Quran and hadith. While the fulfillment of promise is obligatory to the promisor whereby Allah says:

وَأَوْفُوا بِالْعَهْدِ إِنَّ الْعَهْدَ كَانَ مَسْئُولًا

And fulfil (every) covenant. Verily! The covenant, will be questioned about).

(Al-Isra':34)

Indeed promise is part of an important component in a contract especially a financial contract. For instance, in the event that the subject of sale will only be available in the future like in the case of *salam* and *istisna'* contracts, the seller is actually promises to provide that goods as ordered by the customer whereby the customer is actually promises to pay the price upon the delivery of goods (*Istisna'*). This is just a simple indicator of promise in a financial contract. It is obligatory of both parties to fulfill that promises. Allah says:

يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ

“O you who believe, fulfill all contracts.”

(Al-Ma'idah:1)

Although everyone can makes any promise he wants, but only good and lawful promises are allowed by Shari'ah (Mohamad Akram, 2009). For example, a promise to enter into a binding contract like a promise marry or to buy or to sell, or a promise to enter into non-binding contract, such as *wakalah* (agency) or *ju'alah*. No one should promise something forbidden such as a promise to kill or to give an interest-based loan. Promises form a binding contract indeed. Hence, the promisor has no choice but to fulfill the promises as commanded by the Almighty.

FULFILLMENT OF PROMISES IS LEGALLY BINDING OR NOT?

Muslims scholars were divided in determining the rulings regarding the fulfillment of promises. There are three approaches according to the opinions of the scholars on this matter.

The first group held the opinion that fulfilling promises is praiseworthy (*mustahab*) but not obligatory (*wajib*); however, when the promisor break up his promise, he has lost advantage and done something extremely hated; still it is not a sin. This is the view of majority of scholars including Abu Hanifah(Al-Zayla'i, 1895), Imam al-Shaf'is(Al-Nawawi, 1994), Imam Ahmad(Al-Bahuti, 1968), the Zahiris(Ibn Hazm, 2000) and some Malikis(Al-Qarrafi, 1928).

The second group held that it is obligatory to fulfill promises. This is the view of 'Umar 'Abd al-'Aziz, judge Ibn al-Ashwa' al-Kufi, al-Hamdani, Ibn Shubrumah.

The third group basically held the same opinion that the fulfillment of the promise is obligatory but it is depending on the situation on how the promise is given.

Firstly, if the promise is linked to a cause and, as a result of the promise, subsequently, the one to whom the promise was made enters into a course of action. Hence, it is obligatory to fulfill that promise and the judge should force the promisor to execute the promise. For example, if the promisor said: "I will lend you money if you get married" then the promisee get married because of this promise, consequently it becomes obligatory for the promisor to fulfill his promise. However if the promisee does not taken any action to, then it is not obligatory to execute the promise. This is the view of the Imam Malik, Ibn al-Qasim and Sahnun (Ibn Rushd, 1988).

Secondly, the promise must be fulfilled if it is linked to the cause of action even though the promisee does not enter in that cause of action. The judge may compel the promisor to execute his promise. For example, if the promisor promise to lend money to a person in order for him to marry but he dismisses his promise before the marriage or that person does not get married, the promisor still have to fulfill his promise and even compelled to do so by the judge. However, if the promise is not linked to any cause then it is not obligatory to perform the promise such one says: "I will lend you money" without stating any cause, the promisor is free to do or not to do but the fulfillment of promise in this case is a good ethic (Al-Qarafi, 1928).

The fourth opinion said that if the promise is associated to certain conditions then it is obligatory to fulfill the promise in the event that the conditions are fulfilled by the promisee. However, if there is no condition provided, consequently, it is not obligatory to execute the promise. For example, a promisor gives a promise to a promisee: “Sell this stuff to that person; if he does not pay you the price then I will pay for you.” It is obligatory for the promisor to pay the price if the buyer fails to do so. This is the view of Hanafis School (Ibn Nujaym, 1999).

The fifth opinion says that the fulfillment of promise is obligatory from the aspect of religious practice but not legally binding whereby a judge may not compel the promisor to fulfill his promise (The Ministry of Auqaf and Islamic Affairs Kuwait, 1983-2006). This is the view of al-Subki, a Shafi‘is scholar.

All of these views even though they are different in forms and consequences but they give a similar indicator that the execution of promise is very crucial in Islam. Although there is a view saying that the fulfillment of promise is only praiseworthy and not obligatory but it does not mean that he can break up his promise because at the end of the day, the action is strictly hated. Hence, everyone must fulfill his promise as good as possible unless the failure is not intentionally done.

In term of practice, a stern and firm opinion must be adopted in order to safeguard the general interest (*maslahah*) of society especially to maintain a good environment in business dealings among society. Imagine that the business worth billions dollar may be erupted in a second due to the failure of fulfilling promises that form an integral part of the transactions. Sometimes, the loss is also very high due to that failure. Thus, if the law does not take any step to legally bind the promise, the effect may be worst as people will take it for granted consequently might cause losses and damages to the other party. These consequences could be considered as a possible harmful situation or *darar* that must be avoided as proposed by the Shari‘ah maxim “*la darar wa la dirar*” which means “*Harm should neither be initiated nor reciprocated*”. Therefore, the opinion saying that the fulfilling the promise is obligatory and legally binding should be implemented and adopted by the law.

With regard to sukuk issuance that adopted the purchase undertaking to attract the investors, it should be done carefully to avoid any wrongful adoption of Shari‘ah principles. As we know, sukuk nowadays is an alternative to interest-based bond that is strictly

prohibited by Shari'ah. However, in order to attract the investors, the sukuk issuers tried very hard to offer some attractive features as enjoyed by the investors under conventional bond especially in term of security and protection of the capital. Subsequently, the purchase undertaking has been created in order to indirectly provide such feature. If sukuk do not have that feature, consequently, the rating will drop because of high risk faced by the investors.

IS PURCHASE UNDERTAKING A GUARANTEE?

Guarantee or *daman* is a promise by which one person assumes responsibility for paying another's debts or fulfilling another's responsibilities in the event that the guaranteed party fails to perform that payments or responsibilities (Faruqi, 2006). It is also defined as the assurance that a contract or legal act will be duly carried out (Black's Law, 2009). From technical Shari'ah meaning, it is a pledge to compensate, which make the person obliged to fulfill his promise financially or by an act (Abu Ghuddah, 2010). Guarantee also known as *kafalah* whereby it is a promise by guarantor to take a responsibility to pay debt on behalf of the guaranteed party and consequently both parties become responsible to pay that particular debt (Ibn Qudamah, 1968).

The legal practice has shown that the application of guarantee is always associated with debt payment whereby the guarantor agrees to pay on behalf of the debtor in any case of default. Whereas purchase undertaking although it is implicitly brings the meaning of guarantee but in term of practice, it is not really meant as guarantee because it does not involve the obligation to pay on behalf of another party. It is only a promise to buy just like other promises that pronounced in daily life except it is similar to the guarantee in the sense that both are binding promise.

According to Islamic law, the contracts with regard to guarantee are divided into two types. Firstly, the contracts that accept a guarantee namely the exchange contracts; and secondly, the contracts that are not allowed to be guaranteed namely the trust contracts (*'uqud al-amanat*), (The Ministry of Auqaf and Islamic Affairs Kuwait, 1983-2006) unless there is transgression, or infringement or negligence on behalf of the manager (Al-Kasani, 1986). Among the trust contracts applied in sukuk issuance are *musharakah*, *mudarabah* and *wakalah*.

Purchase Undertaking in Equity-Based Sukuk: Does it Amount to Guarantee?

According to the practice in asset-based sukuk mudarabah, the purchase undertaking is given by the obligor to purchase the underlying assets upon the maturity dates or upon the dissolution events at the price equal to mudarabah capital plus expected return less total periodic distribution. The following clause states the term of purchase undertaking as mentioned in the sukuk mudarabah's PTC:

"In respect of each series of the Sukuk Mudharabah, the Obligor shall grant an undertaking to the Trustee (acting on behalf of the Sukuk Mudharabah holders) pursuant to which the Obligor shall purchase the Trust Assets from the Trustee at the Exercise Price"(Securities Commission, 2005).

The formula of exercise price is clarified in the next clause that:

"the Exercise Price shall be the Mudharabah Capital plus Expected Return less total Periodic Distributions paid"(Securities Commission, 2005).

This clause clearly mentioned that the price of the underlying asset will be equal to the mudarabah capital and the expected profit which may be seen as a mean to guarantee the capital and profit so that the *rabb al-mal* may obtain back their capital and profit as well. This is the main factor of the critique by scholars whereby they hold the view that this type of undertaking does not comply with Shari'ah principles because it did indirectly guarantee the mudarabah capital and the profit which is not permissible (Muhammad, 2012). According to the Shari'ah rules on mudarabah, the mudarib is not allowed to guarantee the capital and the profit because the mudarib is only a trustee or *amin*(Al-Salami, 2008). As a trustee, he holds the hand of trust (*yad amanah*) and consequently he is not liable to give a guarantee to the *rabb al-mal* unless the loss occurs due to his failure or negligence so he must give the *rabb al-mal* compensation for that loss (Al-Salami, 2008).

This point is mentioned in para 1/2/2 of the Standard for Guarantees, issued by the Shariah Council, as follows:

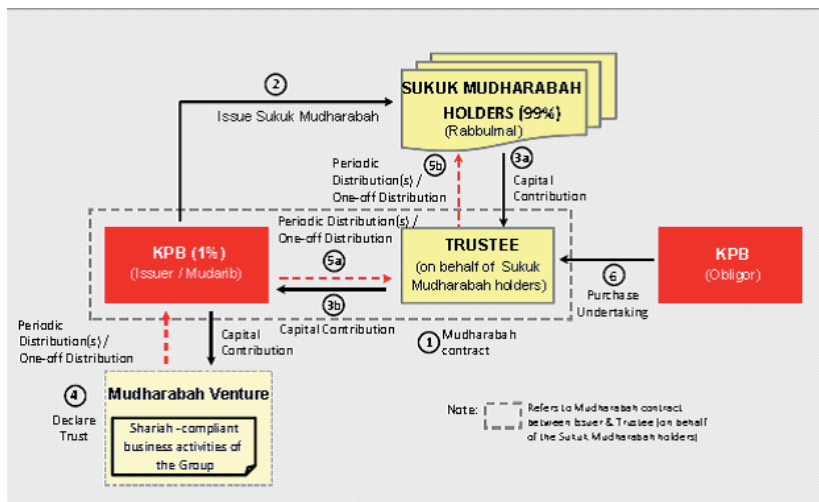
"It is not lawful to stipulate a guarantee from a mudarib, or an investment agent, or a partner among partners, regardless of whether the guarantee is for the principal or for the profits. Likewise, an operation may not be marketed on the basis that investor capital is guaranteed"

In the following paragraph, it is written:

“It is unlawful to combine agency with a guarantee in a single transaction because to do so is contrary to the requirements of both. This is because to stipulate a guarantee by an investment agent transforms the operation into a loan with ribawi interest, guaranteeing [the return of] principal while offering returns from the investment”

The following structure shows the flow of transactions in Kencana sukuk mudharabah and how the purchase undertaking is executed:

Diagram 1: Purchase Undertaking in Asset-Based Sukuk Mudharabah



Source: Securities Commission Malaysia (2005)

The PTC of sukuk Kencana mentioned that the sukuk mudharabah represent undivided proportionate beneficial interest in the mudharabah venture which allows the sukuk holders to get benefit from the assets. This make the sukuk to be asset-based in nature because the sukuk holders did not own the asset legally since the legal title remains with the originator.

In step 6, the obligor gives the purchase undertaking to the trustee in order to liquidate the assets upon the maturity date so that the investors will get back their capital together with an amount of profit expected. Finally, the sukuk dissolves.

It is important to determine at this point whether the purchase undertaking especially at nominal value is a form of guarantee consequently makes the contract null and void or it is merely a promise to buy that is permissible according to Shari'ah?

Firstly as claimed by Taqi ^Uthmani, this type of undertaking is actually an indirect guarantee because the price of the assets is determined based on the mudarabah capital and not the market price whereby the purpose of that purchase is to return the principal back to the investors (Muhammad, 2012).

The argument says that a purchase undertaking at certain agreed price (when given by someone from whom it is not valid) is an indirect guarantee that offers protection as long as the assets continue to exist (Abu Ghuddah, 2010). This is because the value of the assets is not permanently the same. It might decrease at any time especially during the times of crisis. A purchase undertaking at nominal value will protect the value of the assets even though its real market value already dropped. When the value of the assets is protected consequently the mudarabah capital becomes protected as well because the capital is linked to the assets. The value of the assets actually represents the amount of the capital indeed. Thus, the capital is made preserved by the existing underlying assets through the promise to buy at nominal value.

Secondly, there is a view that the purchase undertaking at face value is not a guarantee because it is linked to the continued existence of the subject matter; if the subject matter is destroyed, neither the effect nor the object of undertaking will exist (Abu Ghuddah, 2010). Consequently, the purchase cannot be executed because it is not permissible to buy or to sell something that not exists as it was prohibited by the Messenger of Allah in his hadith:

لَا تَبِعْ مَا لَيْسَ عِنْدَكَ

“Donot sell something that you do not have”(Al-Tirmizi,1975)

This is far from the meaning of guarantee whereby it is an obligation by a guarantor regardless the assets still exist or not, the guarantor is obliged to fulfill the payment. In contrast, in the purchase undertaking, if the asset is destroyed, the mudarib is not obliged to purchase the assets or to pay the compensation unless the loss is caused

by his negligence (Hussein, 2008). The mudarabah contract will be cancelled due to that destruction indeed (Al-Kasani, 1986). Hence, in this case there is no relation between purchase undertaking and guarantee.

In the case of partial loss or damage, the guarantor is responsible to compensate the beneficiary in all cases to the extent of such partial loss or damage to the assets. However, in case of an undertaking to purchase at face value, the sukuk manager is not responsible to compensate until the causes of the loss are determined at the first place, whether it is due to embezzlement or mismanagement of the capital by the sukuk manager (mudarib), his negligence in protecting the capital, gross errors in taking proper decisions or breaching the terms of contract and therefore he will be held liable to compensate the sukuk holders; or the loss is not attributable to his acts, and hence the loss shall be borne by the sukuk holders without any responsibility on the part of the sukuk manager (Hussain, 2008).

In this case, it is obvious that the consequences are different according to different circumstances. No choice is given to the guarantor but to be held liable for any loss and damage even though it is caused by negligence of the sukuk manager. On the other hand, the purchase undertaker at face value will not be held liable for the loss caused by him. The purchase undertaking only can be considered as guarantee if it has to be exercised under all circumstances without any excuse.

In the contract of trust like mudarabah, Shari'ah will never ignore the rights of both parties and always protect their rights. At the first place, the sukuk manager (mudarib) will never held liable for the loss unless it is caused by his negligence, but on the other hand, the rights of the fund providers is also protected as well by requiring the mudarib to produce convincing evidence that a real loss has occurred and that he had no hand in causing that loss and no reasonable capability to take corrective measure (Hussain, 2008). If the sukuk manager fails to prove that the loss is not caused by his negligence then he must be responsible to compensate the sukuk holders to the extent of the face value.

This is based on the maxims which state:

Whosoever takes something has to return it (على اليد ما أخذت) (حتى تؤديه أو ترده) (Al-Jassas, 1994). In this case, the sukuk manager has taken the capital and he must return it in the form that he takes it at the first place.

The claimant has to produce evidence proving his claim and the party who denies the claim must swear that his stand is correct. (البينة على المدعي واليمين على من أنكر). The Claimant here refers to a person who claims an event which is not common or the norm (Al-Qarafi, 1928). In this case, the sukuk manager is the party who claims such event which is the loss and damage.

Therefore, the sukuk manager must provide evidence to prove the following circumstances:

That the sukuk assets have been destroyed totally or partially or that a loss has been incurred;

The above loss, damage or defect is not due to his default, negligence, misconduct or breach.

The above circumstances are abnormal and uncommon because normally the asset or fund taken by someone for the purpose of investment remains intact or grows. Therefore, the claim that it has been destroyed or incurred a loss needs to be substantiated by evidence (Hussain, 2008).

Thus, the sukuk manager will be responsible to return the face value (i.e. the capital) in following cases (Hussain, 2008).

Embezzlement and mismanagement of the capital (التعدي على المال);

Negligence in protecting the capital (التقصير في الحفظ);

Committing gross errors in taking proper investment decisions (الخطأ في اتخاذ القرار الاستثماري);

Breach or violation of the terms of contract (مخالفة شروط العقد)

Obviously, the nature of mudarabah contract already indicates indirectly the promise of the mudarib to return back the capital of the rabb al-mal. It is a rule whereby at the end of the mudarabah, the mudarib must firstly return the amount of capital and subsequently after

that dividing the profit among mudarib and rabb al-mal (Ibn Qudamah, 1968). Therefore, since the beginning of the contract, the mudarib is actually and indirectly promise to the rabb al-mal to give back his money plus the profit if the mudarabah successful. In contrast, if the mudarabah suffers loss, the mudarib still obligated to return back the capital by deducting from the existing profit unless all the money has gone together with the destruction. This is on the basis of a principle in mudarabah which states:

الرَّيْحُ وَقَايَةُ لِرَأْسِ الْمَالِ

“The profit is a protection for the capital”

(Ibn Qudamah, v.5, p.46).

Therefore if there is loss and profit in the mudarabah venture, the profit must be used to secure the capital and to cover the loss (Al-Kasani, 1986). In the case of sukuk investment, the profit is generated continuously based on the performance of the business. The business may give lot of profits in the future even though it had suffered losses in the previous days. This future profit may be used to maintain the amount of the capital and to cover previous losses. Thus, it is implied that the practice of giving advance payment to maintain the expected profit is permissible based on this rule since the advance payment will be set off from the future profit.

Base on the fact that the purchase undertaking at face value is not compulsory on the promisor in all circumstances, thus it is obvious that the purchase undertaking at face value does not amount to guarantee of capital. Therefore, it should be allowed for the sukuk manager to grant such undertaking to safeguard the rights of the sukuk holders.

Further, by giving the undertaking, it does not deny the existence of minimum risk that should be borne by the sukuk holders as stated by the maxims (الغرم بالغنم) and (الخراج بالضمان). They still have to take the risk indeed especially the liability of the mudarabah assets that might be damage or loss for unexpected reason. In this case, the sukuk manager is not liable to substitute the broken asset with another asset unless he is voluntarily doing that without prior condition from the sukuk holders. This is considered as a volunteer guarantee by mudarib

and it is allowed based on an opinion from Maliki's school stated as follows:

وَأَمَّا لَوْ تَطَوَّعَ الْعَامِلُ بِالضَّمَانِ فَفِي صِحَّةِ ذَلِكَ الْقَرَضِ وَعَدَمِهَا خِلَافٌ*

“However if the manager (*mudarib*) voluntarily guarantee [the capital] then the permissibility of that *mudarabah* is disputable between valid and invalid”

(Al-Dusuki, 1996).

Al-Jaziri also mentioned this matter in his book:

أما إذا تطوع العامل بالضمان من تلقاء نفسه بدون طلب من رب المال فقيل... تصح المضاربة

“If the manager (*mudarib*) volunteers to give guaranty by himself without any request from the capital provider (*rabb al-mal*), the *mudarabah* is said to be valid...”

(Al-Jaziri, 2003).

Dr. Nazih Hamad has quoted the same view in his research on this matter saying that the guarantee of capital; if it is given voluntarily by *mudarib* without any request from the *rabb al-mal*, the guarantee is permissible. It is valid even though the manager offers it during the contract (Hamad, 2000).

This is in the event that if we accept the view that the purchase undertaking at face value is a guarantee of capital, then even though it is a guarantee but this guarantee is offered by the sukuk manager voluntarily without any request from the sukuk holders. In this situation, the “hand of trust” (يد الأمانة) has changed into the “hand of guarantee” (يد الضمان) because according to Nazih Hamad; among the reasons that may convert the status of a trustee (أمين) to the status of guarantor (ضامن) is because of the volunteer offer made by the trustee himself after the contract being concluded or even during the contract (Hamad, 2000).

This makes sense because the capital provider is not allowed to request any guarantee from the *mudarib* since the capital provider put a trust on the *mudarib* to grow his money without any payment unless the business gains profit. If there is no profit, nothing will be given to the

manager. Therefore, it is unfair to allow the capital provider to seek for guarantee from the manager. However, the manager in order to instill confident in the capital provider, he may volunteer to provide certain guarantee to safeguard the interest of the capital provider whereby at the same time the manager will also enjoy the profit. This is better for the capital provider or sukuk holders to avoid them from the conventional products which clearly based on interest.

Furthermore, the form of guarantee that forbidden by the jurists is different from the purchase undertaking at face value. The guarantee which has been disallowed is a promise to return back the amount of principal in all circumstances regardless the causes of the loss or destruction. While in purchase undertaking, it is not a promise to return the capital but it is actually a promise to purchase the *mudarabah* asset when the project ends. The promised purchase price which is equal to the capital value is not meant to guarantee the capital but it is actually a means to return the capital back to the investors. It should be noted that it is the obligation of the manager to return back the capital at the end of the venture unless the business suffers a total loss whereby there is nothing left to pay back the capital. Consequently, the capital provider will bear all the losses.

In the case of sukuk, the profit normally distributed to the sukuk holders before the project ends. In the case of *Kencana sukuk mudarabah*, it is distributed semi-annually upon the periodic distribution date that takes place during the tenure of the sukuk (Securities Commission, 2005). This type of distribution is slightly different from the traditional *mudarabah* whereby the profit is distributed upon the end of the venture. The *rabb al-mal* will get his capital first then after that, the profit will be divided among the *rabb al-mal* and the *mudarib*. Meaning that, in the current *mudarabah*, the *rabb al-mal* has obtained the profit earlier before the end of the project.

Therefore, there is no issue of capital guarantee anymore even though the price of the assets is equal to the capital value because the *rabb al-mal* already gets his profit showing that the venture is successful. This is not impossible since the *mudarib* normally will do a preliminary study in order to ensure the feasibility of the project. Since the profit is there, so the capital should be returned as well. In order to return it back to the *rabb al-mal*, all the assets are liquidated by selling it to the issuer or the originator at the price equal to capital value. Hence, this is only a means to return the capital and not a way to

guarantee it. As we mentioned before, the capital must be returned back in its original form,(Al-Zayla'i, 1895) which is in cash and not in form of tangible asset like buildings and lands. This is based on the maxims: "Whosoever takes something has to return it" (Al-Jassas, 1994).

DETERMINATION OF PURCHASE PRICE AT NOMINAL VALUE

Generally, Shari'ah does not put any limit on the price and profit acquisition in a sale transaction. It is the discretion of the seller to decide the price for the goods but normally the price always based on the customary practice or *urf* especially among traders. The price may reduce upon the bargain between the seller and the buyer. Basically, it is based on the mutual consent of the contracting parties. This is based on the maxims said: "It is a fundamental principle that a contract is based on a mutual consent between the contracting parties"(Al-Zuhayli, 2006). Allah says:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِنْكُمْ

"O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent. And do not kill yourselves (nor kill one another). Surely, Allah is Most Merciful to you"

(Al-Nisa':29).

The Messenger of Allah also said:

إِنَّمَا الْبَيْعُ عَنْ تَرَاضٍ

"Verily, the contract of sale is based on mutual consent"

(Ibn Majah, 1954).

The mutual consent in this verse and hadith clarifies everything about a trade. The mutual consent is vital in all transactions especially in sale transaction. It is a main condition in a contract which is governed by an offer (*ijab*) and acceptance (*qabul*). Whenever both parties agree upon the conditions stated in the contract then the contract is valid and

legal. Without the mutual consent as indicated by *ijab* and *qabul*, the contract is deemed invalid. Therefore, it is illegal to force another party to enter into a contract. This includes the determination of price for the goods. If the buyer agrees with the price stated by the seller, he can proceed with the transaction but if he disagrees, he may console the buyer to reduce the price or turn to another seller who offers a better price. The seller may put any price for his goods either higher from the market price or lower than the market price as long as the contracting parties agree with the stated price.

Allah has allowed a trade that occurred on the basis of a mutual consent regardless whether the profit is less or greater, whenever there is a mutual consent consequently the trade and its profit are permissible (Al-Salami, 2008). Furthermore, the Messenger of Allah (PBUH) never prohibit his companion when his companion acquired profit two times higher than the cost price. In a hadith narrated from ^oUrwah bin al-Bariqi (PBUH):

أَنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ أَعْطَاهُ دِينَارًا يَشْتَرِي لَهُ بِهِ شَاةً، فَاشْتَرَى لَهُ بِهِ شَاتَيْنِ، فَبَاعَ إِحْدَاهُمَا بِدِينَارٍ، وَجَاءَهُ بِدِينَارٍ وَشَاةٍ، فَدَعَا لَهُ بِالْبَرَكَةِ فِي بَيْعِهِ، وَكَانَ لَوْ اشْتَرَى التُّرَابَ لَرَبِحَ فِيهِ

“Verily that the Prophet (peace be upon him) gave ^oUrwah one dinar and asked him to buy a sheep, afterward he bought for the Prophet two sheeps with one dinar, then he sold one of them for one dinar and he went to the Prophet with one dinar and a sheep, subsequently the Prophet asked a blessing prayer for him and his sale, then the Prophet said: and if ^oUrwah buys soil, definitely he will get profit from soil.”

(Al-Bukhari, 2001).

This hadith clearly describes the practice of *sahabah* (^oUrwah) in his sale. He got profit two times higher than usual and the Prophet (PBUH) never stop him, indeed he praised him for his brilliant approach in trading. Moreover the Prophet has prayed him with blessing. Let say the value of one dinar today is RM700, ^oUrwah bought two sheeps for RM700 then he sold one of the sheep for RM700 and at the same time he gave another sheep to the Prophet. Meaning that, ^oUrwah had obtained RM1400 as profit from the trade since the value of a sheep become

RM700, so for two sheep, the value is RM1400. As a conclusion, the price is not an issue a sale. As long as it is agreed by the contracting parties then it is permissible.

Therefore, the price of asset in purchase undertaking should not be an issue since the seller and the purchase undertaker agree with the stated price although it is equal to the principal. It is not a guarantee but it is a promise to buy whereby it is only applicable if the asset still around and valid for sale. In the event of total loss or destruction, the promise is not anymore applicable because it is not permissible to buy something does not exist. In contrast, guarantee means you have to pay even though the asset is not exist anymore.

In the event that the market price is higher or lower than the stated price, it is also not an issue because the stated price is a price agreed by mutual consent of the contracting parties. Any price is relevant as long as it is agreed by them. It is obvious that the promise is indeed a promise to purchase and not a promise to guarantee. Therefore, based on its appearance as a promise to purchase, then it should be permissible because a matter is judged based on its appearance as mentioned by the Messenger of Allah:

أمرت ان أحكم بالظاهر والله يتولى السرائر

“I have been ordered to judge based on the external appearance and Allah will take care the unseen matters”

(Al-Syafici, 1951).

Furthermore, the legal maxims on this matter have stated that:

الأصل في العقود والشروط الجواز والصحة

“It is a fundamental principle that the contracts and conditions according to Shari’ah are permissible and legal”

(Al-Zuhayli, 2006).

It is not allowed to breach any condition in a contract unless the condition is contrary to the Shari’ah principles or it was already disallowed by the text (Al-Zuhayli, 2006). Therefore, since the purchase

undertaking at a price equal to face value is not contrary to any Shari'ah principles and it is not disallowed by any legal texts either from Qur'an or sunnah, thus it should be allowed and permissible.

However, it has been noted that the purchase undertaking at face value is very contentious among the scholars, they believed that it is a way to guarantee the capital then the other alternative proposed by the scholars is to undertake to purchase at market price. This is the best solution indeed. However, the investors will not prefer to adhere with this approach because they have to bear the market risk whereby they might loss billions due to unexpected failure like economic crisis.

CALL OPTION

Call option is another form of undertaking that provides the option to purchase for the originator in asset-backed sukuk. Based on the practice, the originator and the issuer will enter into call option agreement prior the issuance of sukuk whereby the issuer will grant the originator certain call options to allow the originator to call upon the issuer to sell the underlying assets to the originator at an agreed market price. For example, in the structure of Golden Crop asset-backed sukuk Ijarah, it was stated that:

"The Issuer and the Originators will enter into three (3) Call Option Agreements (in such form and substance as shall be agreed between the Issuer and the Originators prior to the issuance of the Sukuk), pursuant to which the Issuer shall grant the Originators three (3) Call Options (as defined herein) under which the Originators are entitled to call on the Issuer to sell identified Plantation Assets to the Originators based on the terms of the Call Options for the Exercise Price..." (Securities Commission, 2005).

Further, the originators may exercise the rights to purchase whereby it was stated that:

"Pursuant to the Call Option Agreements, the Originators are entitled to exercise the Call Options to purchase the relevant Plantation Assets (as attached in Attachment A) at the Exercise Price at any time during the Exercise Period" (Securities Commission, 2005).

The call option is different from the purchase undertaking in the way that it is a sale undertaking given by the issuer whereby the issuer promises to sell the underlying assets upon the call made by the originator (Shabnam, 2009, v.4, p.7). Meaning that, it is the obligation of the issuer to sell the asset if requested by the originator. However, the

originator is not obliged to make the call. The originator has the right not to exercise the call option whereby in this situation, the trustee will immediately initiate a process to sell the asset to third parties (Securities Commission, 2005).

This approach is claimed to be friendlier to the Shari'ah principles since the sukuk holders have the full rights and control over their assets. This makes them independent to deal freely with their assets include to dispose it to the third party whereas it is not allowed to do so in asset-based sukuk because they are bound with the purchase undertaking whereby the sale of assets to the third parties is not allowed. Furthermore, the purchase price will be based on the market which makes the transaction more transparent. The following table shows the application of undertaking in asset-backed sukuk in Malaysia:

Table 1: Purchase Undertaking in Asset-Backed Sukuk

Issuer	Date issued	Amount (Myr)	Use Wa'ad	Type of Wa'ad	Price of wa'ad	Right of Disposal
Golden Crop Return	22/11/05	442	Yes	Call option	Market value	yes
Dura Palms	28/06/06	284	Yes	Put option	Outstanding+ Expenses	yes
Abs Logistic	8/5/07	300	Yes	Call option	Higher of market value or redemption amount	yes
Menara ABS	15/1/08	1100	Yes	Right of first refusal	Market value	yes

Source: Securities Commission (2005).

The application of call option/put option in asset-backed sukuk makes the sukuk holders independent to deal with their assets including the disposal of the assets to third parties. The existence of undertaking does not restrict the sukuk holders to exercise their rights on the assets. The originator is also free to purchase or not to purchase

the assets. Thus make the transaction free from any guarantee either profit or capital that prohibited by Shari'ah. In contrast, the originators in asset-based sukuk provide the purchase undertaking to ensure that they will get back their asset and to safeguard the sukuk holders from the market risk so they may enjoy the profit beside they may obtain back their principal. Although the sukuk holders are the owner of the assets but they are not allowed to sell the sukuk assets to third parties especially upon the occurrence of the trigger events. Indeed, they are only allowed to sell the assets to the originator by exercising the purchase undertaking. Thus, no wonder why the investors prefer to invest in asset-based sukuk since they are not worry about the market risk. The purchase undertaking makes them secured even though they may not allowed to practice their rights as an owner.

Indeed, the investors do not prefer asset-backed approach since they have to face the market risk of the asset. Eventually, the market price is not stable, it might go down gravely. This makes the investors hesitate to choose this form of sukuk. They prefer to invest in asset-based sukuk. This is reflected in the number of asset-backed sukuk issued in Malaysia to be only seven, while the rest are asset-based sukuk.

CONCLUSION

This paper argued that the purchase undertaking is not a guarantee but it is merely a promise that has been adopted as a mechanism to instill strong believes in sukuk investment. However, the purchase undertaking has been criticized for the price stated in the undertaking which is based on the nominal value whereby it has been claimed as an indirect guarantee that is not allowed in the contract of trust.

Nevertheless, the researcher found that there was another opinion saying that even the price is based on the nominal value but it still valid in accordance with the principal of Shari'ah since there is no evident forbidding the practice. Furthermore, it is the right of the contracting parties to agree upon the purchase price.

Regarding the guarantee of capital that is not allowed in Shari'ah law, it is true but bear in mind that it is permissible to guarantee the capital if the offer comes voluntarily from the guarantor. This volunteer guaranty is considered as a good deed for the guarantor as long as there is no prior agreement on the matter. Meaning that, the capital provider is not allowed to ask for the guarantee if it is not

provided by the party who manages the capital. In contrast, there is no obstacle if the manager voluntarily offers to guarantee the capital.

Finally, every weakness with regard to the application of purchase undertaking in sukuk issuance should be rectified in order to attract more investors to subscribe sukuk. The issue of capital guarantee in purchase undertaking and the issue of market risk of the asset need further examinations so that the investors become confident to invest in the product.

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