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# ANALYSING SUKUK DEFAULT CASES: CAUSES, REMEDIES AND REGULATORY IMPLICATIONS

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## ABSTRACT

The growing significance of Sukuk as a Shariah-compliant financial instrument has been accompanied by a rise in default cases, highlighting critical financial, legal, and governance vulnerabilities. This article examines the principal causes of Sukuk defaults, including inefficient liquidity management, regulatory inconsistencies, and governance deficiencies, as evidenced in the cases of *Menara ABS Berhad*, *MEX II Sdn Bhd*, and *Serba Dinamik Holdings Berhad*. Distinguishing between asset-backed and asset-based Sukuk is crucial for understanding investor risk exposure, especially in relation to ownership rights and bankruptcy protections. Legal uncertainties, jurisdictional conflicts, and ineffective enforcement measures exacerbate challenges in resolving defaults. This study employs a qualitative methodology, combining doctrinal and

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empirical analyses to explore regulatory deficiencies and suggest reforms. The findings emphasise the need for stronger governance, harmonised legal frameworks, and proactive risk management strategies to strengthen the Sukuk market against default risks, thereby ensuring its sustainability within the global Islamic finance ecosystem.

**Keywords:** Sukuk Default Causes, Remedies, Governance Deficiencies, Regulatory Framework, Risk Management.

## ANALISIS KES KEMUNGKIRAN SUKUK: FAKTOR, REMEDI DAN IMPLIKASI PERUNDANGAN

## ABSTRAK

Kepentingan Sukuk yang semakin meningkat sebagai instrumen kewangan patuh Syariah turut diiringi dengan peningkatan kes kemungkiran, menonjolkan kelemahan kewangan, perundangan dan tadbir urus yang kritikal. Makalah ini mengkaji punca utama kemungkiran Sukuk, termasuk pengurusan kecairan tunai yang tidak cekap, ketidaktekalan kawal selia, dan kelemahan tadbir urus, seperti yang dibuktikan dalam kes *Menara ABS Berhad*, *MEX II Sdn Bhd*, dan *Serba Dinamik Holdings Berhad*. Membezakan antara Sukuk bersandarkan aset (*asset-backed Sukuk*) dan Sukuk berdasarkan aset (*asset-based Sukuk*) adalah penting untuk memahami pendedahan risiko pelabur, terutamanya berkaitan hak pemilikan dan perlindungan kebankrapan. Kekaburan undang-undang, konflik bidang kuasa dan langkah penguatkuasaan yang tidak berkesan memburukkan lagi cabaran dalam menyelesaikan kemungkiran. Kajian ini menggunakan metodologi kualitatif, menggabungkan analisis doktrin dan empirikal untuk meneroka kekurangan peraturan dan mencadangkan pembaharuan. Penemuan ini menekankan keperluan untuk tadbir urus yang lebih kukuh, rangka kerja undang-undang yang diselaraskan, dan strategi pengurusan risiko yang proaktif untuk mengukuhkan pasaran Sukuk terhadap risiko kemungkiran, sekali gus memastikan kemapanannya dalam ekosistem kewangan Islam global.

**Kata Kunci:** Punca Keingkaran Sukuk, Remedi, Kelemahan Tadbir Urus, Rangka Kerja Undang-Undang, Pengurusan Risiko.

## INTRODUCTION

The global sukuk market is projected to grow at a CAGR of 13.44%, reaching USD 3,991.35 billion by 2033, up from USD 1,213.64 billion in 2024. This growth is attributed to increasing demand for Shariah-compliant financial instruments, favourable government regulations, and a rise in ESG-linked investments. Southeast Asia remains the dominant region, contributing over 57% of the market share in 2024, with Malaysia leading in sukuk issuance, supported by its established Islamic finance ecosystem and government-backed initiatives. The market is further driven by rising urbanisation, growing infrastructure needs, and the adoption of digital financial services, which enhance sukuk accessibility and transparency.[1] Fitch reported that the outstanding Sukuk rated by the agency surpassed USD 150 billion, reflecting a 12.2% increase, with 79.8% categorised as investment grade.[2] This expansion indicates the increasing assurance in Sukuk as a legitimate investment instrument; however, issues such as regulatory inconsistencies and discrepancies in Shariah governance persist in influencing market dynamics.

The intricacies of Sukuk defaults arise from a combination of financial, legal, and regulatory elements. A fundamental distinction in Sukuk structures is between asset-backed and asset-based Sukuk, which is instrumental in assessing default risk. Asset-backed Sukuk grants investors absolute possession of the underlying assets, thereby offering a degree of bankruptcy protection.[3] Conversely, asset-based Sukuk, although linked to assets, does not confer legal ownership, rendering investors vulnerable as unsecured creditors.[4] The absence of

[1]IMARC Group. Sukuk Market Size, Share, Trends and Forecast by Sukuk Type, Currency, Issuer Type, and Region, 2025-2033. Report ID: SR112025A2263. (https://www.imarcgroup.com/sukuk-market).

[2] Fitch Ratings, "Global Outstanding Sukuk Market Reaches $823.4 Billion in Q3 2023," December 13, 2023, https://www.wam.ae/en/article/aq9kls6-global-outstanding-sukuk-market-surged-823-billion.

[3]Mashiyat Tasnia, Is'haq Muhammad Mustapha and Mohammad Hassan Shakil, "Critical Assessment of the Legal Recourse for the Case of Sukuk Default for the Asset-Backed Sukuk and Asset-Based Sukuk Structures," *European Journal of Islamic Finance* 7 (2017): 1-6.

[4]Tasnia, "Critical Assessment of the Legal Recourse," 1-6; Abdirahman Herzi, "A Comparative Study of Asset-Based and Asset-Backed Sukuk from the

standardised regulatory frameworks exacerbates enforcement challenges, as varying legal interpretations across jurisdictions generate uncertainties in dispute resolution and investor recourse mechanisms.[5] These disparities have been particularly pronounced in instances of Sukuk defaults leading to extended legal conflicts, as demonstrated by the *Dana Gas Sukuk* dispute, where contradictory court decisions between the UAE and UK jurisdictions demonstrated the lack of a unified legal framework.[6]

Furthermore, deficiencies in governance have consistently been a key factor in numerous Sukuk defaults. Inadequate financial disclosures, poor cash flow management, and discrepancies in Shariah compliance have led to investor uncertainty and market instability.[7] Instances like *Menara ABS Berhad*[8]*,MEX II Sdn Bhd,*[9] and *Serba*

Shariah Compliance Perspective," *Journal of Muamalat and Islamic Finance Research* 13, no. 1 (2016): 25–34; Tasnia, "Critical Assessment of the Legal Recourse," 1-6.

[5]Saheed Abdullahi Busari et al., "Dana Gas Sukuk Default: A Juristic Analysis of Court Judgement," *International Journal of Islamic and Middle Eastern Finance and Management* 12, no. 4 (2019): 569-585; Najeeb Zada and Marjan Muhammad, "The Intricacies of Default in Islamic Finance: A Case Study of Dana Gas Sukuk Litigation," *Journal of Islamic Business and Management* 8, no. S (2018): 286–292.

[6]Saheed Abdullahi Busari et al., "Dana Gas Sukuk Default," 569-585; Zada and Muhammad, "The Intricacies of Default in Islamic Finance," *Journal of Islamic Business and Management* 8, no. S (2018): 287; *Dana Gas PJSC v. Dana Gas Sukuk Ltd*. and Others, [2017] EWHC 2928 (Comm) (High Court of Justice, Queen's Bench Division, Commercial Court, 2017).

[7]Berrahlia, Badreddine, and Mourad Benseghir. 2025. "Limits of Legal Certainty: A Commentary on the 'Dana Gas' Case." *Laws* 14, no. 2: 22. https://doi.org/10.3390/laws14020022; Alyamani, Ghalib Mohammed, Aisyah Abdul Rahman, Syajarul Imna Mohd Amin, and Mohd Hafizuddin Syah Bangaan Abdullah. "The Effect of Institutional and Shariah Governance on Sukuk and Bond Performance in the Asian Region." *Revista de Gestão Social e Ambiental* 18, no. 5 (2024): 1-26.

[8]Intan Farhana Zainul,"Sale of Menara TM stuck in office glut, as are sukuk holders" *The Edge Malaysia*, 13 Nov 2023.https://theedgemalaysia.com/node/688977.

[9]MARC."Mex II Ratings Downgraded to D." January 7, 2022. https://www.marc.com.my/rating-announcements/mex-ii-ratings-downgraded-to-d/.

*Dinamik Holdings Berhad*[10] manifest the difficulties stemming from inadequate governance, liquidity inefficiency, and regulatory inefficiencies. These defaults have had considerable repercussions, eroding investor faith and prompting fundamental inquiries regarding the robustness of Islamic financial markets.[11] Addressing these challenges requires a comprehensive strategy that incorporates strong governance frameworks, uniform legal systems, and improved regulatory supervision. Robust risk mitigation strategies, encompassing enhanced disclosure requirements, more explicit enforcement mechanisms, and the standardisation of Shariah governance protocols, are crucial for strengthening the Sukuk market against default risks.[12]

The current study aims to address gaps in the literature through a comprehensive qualitative analysis that employs both doctrinal and empirical methods, providing insights into the legal, financial, and governance dimensions of Sukuk defaults. The results provide essential guidance to regulators, industry professionals, and policymakers in formulating effective strategies to reduce default risks and maintain the stability of Islamic financial instruments. The organisation of this paper is as follows: Section 2 presents an extensive literature assessment of Sukuk defaults, whereas Section 3 delineates the research approach. Section 4 outlines the findings and discussions derived from case studies, whilst Section 5 culminates with policy recommendations and proposals for improving regulatory frameworks in Sukuk markets.

[10]Serba Dinamik Holdings Berhad, "Default in interest payment pursuant to paragraph 9.19A of the Main Market Listing Requirements of Bursa Malaysia Securities Berhad",company announcement 15 December 2021.

[11]Aziz, Adam. "Serba Dinamik Sees Significant Financial Impact from US$222M Sukuk Default." *The Edge Malaysia*, December 15, 2021. https://theedgemalaysia.com/article/serba-dinamik-sees-significant-financial-impact-us222m-Sukuk-default; MARC, "Mex II Ratings Downgraded to D."; Zainul, "Sale of Menara TM Stuck in Office Glut," *The Edge Malaysia*.

[12]Arjun Neil Alim, John Reed, and Joseph Cotterill, "Maldives Hunts for Bailout to Avoid First Islamic Sovereign Debt Default," *Financial Times*, September 11, 2024,https://www.ft.com/content/595863b5-7fdc-43de-9e13-224bbf6320e0.

## LITERATURE REVIEW

The study of Sukuk defaults has attracted considerable interest in both academic and financial domains, owing to the rising incidence of default cases and the difficulties they present to the Islamic finance sector. Sukuk, a Shariah-compliant financial instrument, was initially created to provide a feasible alternative to traditional bonds while being compliant with Islamic principles of risk-sharing and asset-backed financing.

The emergence of post and recent high-profile Sukuk default cases have raised significant concerns about their financial stability, legal enforceability, and regulatory oversight. Academic discussion on this topic has primarily concentrated on three interconnected themes: the reasons for Sukuk defaults, the corrective measures implemented to alleviate financial distress, and the regulatory consequences stemming from these defaults. Numerous studies indicate that Sukuk defaults are frequently exacerbated by credit risks, structural inadequacies, and legal uncertainties, intensified by overarching macroeconomic instabilities.[13] The differentiation between asset-backed and asset-based Sukuk is pivotal in influencing default risks, as asset-backed structures provide investors direct ownership and bankruptcy protection, while asset-based Sukuk expose them to the risks associated with being unsecured creditors.

Additionally, regulatory inconsistencies across jurisdictions, notably in Malaysia, the Middle East, and Western financial markets, have resulted in uneven enforcement mechanisms, hindering investor recovery options and legal processes.[14] The literature accentuates the

[13]Sajjad Zaheer and Sweder van Wijnbergen, "Sukuk Defaults: On Distress Resolution in Islamic Finance," *Qualitative Research in Financial Markets* 17, no. 2 (2025): 292–311.

[14]Ziarmal Abdullah, and Muchtim Humaidi. "Advancing Sukuk Markets: Legal Frameworks, Regulatory Developments, and Default Challenges in Malaysia and the United Arab Emirates." Etihad: *Journal of Islamic Banking and Finance,* vol. 5, no. 1, Jan.–June 2025, pp. 45-57; Saheed Abdullahi Busari, Luqman Zakariyah, and Akhtarzaite Binti Abdul Aziz. "Sukuk Default Regulation in Malaysia and United Arab Emirates: Comparative Analysis." *International Journal of Fiqh and Usul al-Fiqh Studies*, vol. 3, no. 1, 1440/2019, pp. 90–102. IIUM Press, 2019; Jhordy Kashoogie Nazar. "Regulatory and Financial Implications of Sukuk's

significance of remedial actions, such as Sukuk restructuring, legal arbitration, and insolvency proceedings. Case studies like East Cameron, Nakheel, Saad Group, and Investment Dar Company Sukuk defaults signify the intricacies of default resolution, where legal ambiguities often delay resolutions.[15] The function of international Shariah standard-setting bodies and regulatory entities, such as the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), has been discussed regarding the standardisation of governance frameworks and the enhancement of transparency. Despite the expanding research, substantial gaps persist in comprehending the interaction between Sukuk default risks, legal frameworks, and market resilience, necessitating additional academic assessment into this developing financial sector.

Salim Al-Ali stresses critical issues pertaining to the causes, solutions, and regulatory ramifications of failures in the Islamic finance sector.[16] In addition, Sukuk defaults have prompted critical inquiries regarding the dependability of Islamic financial instruments, especially the distinction between asset-backed and asset-based Sukuk structures. The research indicates that the fundamental causes of Sukuk defaults are attributable to credit risks, structural inadequacies, and overarching market instabilities. The global financial crisis exacerbated these difficulties, as many Sukuk issuances were vulnerable to market downturns and excessive reliance on external finance sources. An example is the *East Cameron Sukuk,*[17] when the issuer encountered considerable financial hardship due to dependence on the oil and gas market volatility. Furthermore, legal inconsistencies in Sukuk contracts have exacerbated instances of default, as some Sukuk structures incorporate traditional bond terms, resulting in uncertainties regarding investors' rights and claims on underlying assets. The *Dana Gas Sukuk*

Legal Challenges for Sustainable Sukuk Development in Islamic Capital Market." In Ethics, *Governance and Regulation in Islamic Finance*, edited by Hatem A. El-Karanshawy et al., 135–143. Doha, Qatar: Bloomsbury Qatar Foundation, 2015.

[15]Zaheer and van Wijnbergen, "Sukuk Defaults," 292–311.

[16]Salim Al-Ali, *Raising Capital on Ṣukūk Markets: Structural, Legal and Regulatory Issues* (Springer, 2019), 1–255.

[17]*East Cameron Partners, LLC. East Cameron Partners* Sukuk Default Case. 2009.

failure case exemplified the complications stemming from divergent legal interpretations between investors and issuers, intensifying the difficulties of restructuring. The regulatory framework for Sukuk defaults is complex, as different countries employ varied approaches to manage default scenarios. Jurisdictions like the Middle East have faced heightened scrutiny, shown by the *Saad Group's* Sukuk default in Saudi Arabia, where insufficient regulatory clarity and openness exacerbated the resolution process. The study delineates the need for a standardised methodology to define Sukuk default, as there is presently no universally recognised framework differentiating between actual and technical defaults.

Remedial actions implemented in response to Sukuk defaults have differed significantly, encompassing formal bankruptcy proceedings, restructuring initiatives, asset liquidations, and third-party bailouts. Case studies like the *East Cameron Sukuk* default illustrate the legal intricacies in differentiating between asset-backed and asset-based Sukuk during an issuer's financial turmoil. The legal resolution of Sukuk defaults frequently hinges on the governing jurisdiction and its approach to creditors' rights. The regulatory consequences of Sukuk defaults indicate an immediate necessity for reform within the Islamic financial system. The absence of explicit insolvency legislation for Islamic financial instruments has been recognised as a significant impediment to the effective resolution of defaults. Although traditional financial markets possess established insolvency frameworks, the Islamic finance sector continues to face difficulties in aligning Shariah principles with contemporary legal systems.[18]

Salah Alhammadi stresses the intricate relationship among financial risks, legal frameworks, and regulatory structures that influence the stability and sustainability of Islamic financial instruments.[19] Sukuk, as Shariah-compliant investment instruments, fundamentally differ from conventional bonds due to their dependence on asset-backed or asset-based structures, which subsequently affect the risk exposure of both issuers and investors. The research indicates that a principal challenge is the differentiation between asset-backed and asset-based Sukuk. A key difference between Asset-backed Sukuk

[18]Salim Al-Ali, *Raising Capital on Ṣukūk Markets*. 1–255

[19]Salah Alhammadi, Simon Archer, and Dalal Aloumi, "Sukuk Structure and Risk Exposures: Evidence from an Originator Perspective," *Journal of Islamic Accounting and Business Research* 15, no. 4 (2024): 1–15.

and asset-based Sukuk is that the former gives investors direct rights to the underlying assets, making them less vulnerable to bankruptcy, and the latter makes investors ordinary creditors in the case of default.[20] The structural distinction is pivotal in assessing the risk factors linked to Sukuk defaults, illustrated by notable instances like the *Tamweel Residential Mortgage-Backed Sukuk (RMBS)* and *Tamweel Sukuk Limited (TSL),* each encountering unique risk exposures attributable to their structural variances.[21] The study underlines that Sukuk defaults frequently arise from overarching financial turmoil within the issuing organisation, exacerbated by legal uncertainties concerning investor remedies.

The potential of Shariah non-compliance risk is a significant issue in Sukuk markets, as differing scholarly interpretations have historically generated structural ambiguity and diminished investor confidence. The risks are exacerbated by legislative discrepancies among jurisdictions, especially in asset-based Sukuk, where the legal title of the underlying assets remains with the originator, thus restricting investor protection in default situations. The disparity between regulatory frameworks in Malaysia and the Middle East intensifies the difficulty of attaining uniform governance norms. Historical defaults illustrate that remedial measures have varied, from consensual restructuring to complete liquidation, indicating a lack of standardised enforcement tools. In this context, Special Purpose Vehicles (SPVs) are crucial for risk mitigation by ensuring bankruptcy remoteness in asset-backed Sukuk, as the asset transfer to the SPV protects them from the originator's insolvency. In instances where Sukuk are asset-based, SPVs fail to offer sufficient protection, resulting in increased default risks for investors. The *East Cameron Sukuk*[22] default illustrates how legal ambiguities concerning asset ownership resulted in substantial complications during bankruptcy proceedings. [23]

[20]Alhammadi, Archer, and Aloumi, "Sukuk Structure and Risk Exposures," 1–15.

[21]Alhammadi, Archer, and Aloumi, "Sukuk Structure and Risk Exposures," 1–15.

[22]*East Cameron Partners, LLC. East Cameron Partners* Sukuk Default Case. 2009.

[23]Alhammadi, Archer, and Aloumi, "Sukuk Structure and Risk Exposures," 1–15.

Salman Syed Ali accentuates Sukuk default cases, the paucity of both theoretical and empirical research regarding Sukuk default resolution, the regulatory deficiencies, and the Shariah challenges in managing such defaults.[24] The study emphasises that while Sukuk issuance has significantly risen since its creation, the market has simultaneously faced notable defaults, heightening concerns about the legal, regulatory, and institutional frameworks governing Sukuk. Recent instances, such as the impending default on a $500 million Sukuk issued by the Maldives, underscore the difficulties in enforcing Sukuk structures, particularly in sovereign contexts, intensifying investor apprehensions about legal recourse and the overall stability of Sukuk markets.[25] Furthermore, research has indicated that numerous Sukuk structures, akin to conventional bonds, included provisions such as repurchase obligations and credit enhancements, yet did not offer adequate protection for Sukuk holders during defaults because they are restricted to access the underlying assets.[26]

Furthermore, the regulatory system overseeing Sukuk is insufficiently developed. The AAOIFI provides only general guidance on default and does not particularly tackle Sukuk-related issues. The unsatisfactory application of AAOIFI's Standard 62, which regulates Sukuk structures, has resulted in legal fragmentation, since many jurisdictions apply these norms unevenly, thereby eroding the confidence of investors and market participants.[27] The study posits that Shariah principles, which prioritise transparency, equity, and risk-sharing, should facilitate the effective resolution of financial distress. In practice, Sukuk defaults are often prolonged due to an inadequate governance framework, ambiguous default resolution frameworks, and inconsistency between conventional financial legal systems and Islamic finance principles. The study critiques the absence of contractual provisions in Sukuk documentation that address default scenarios, noting that many Sukuk structures resemble conventional debt

[24]Salman Syed Ali, "Ṣukūk Default and Issues in Their Resolution: The Case of Villamar Ṣukūk," in Developments in Islamic Finance, ed. S.A.R. Rizvi and I. Saba, *Palgrave CIBFR Studies in Islamic Finance* (2017): 65–88.

[25]Alim, Reed, and Cotterill, "Maldives Hunts for Bailout,"

[26]Zaheer and van Wijnbergen, "Sukuk Defaults," 292–311.

[27]Kurt Davis. "$1tn Sukuk Market at Risk of Unintended Disruption." *Financial Times*, May 29, 2025. https://www.ft.com/content/7c170437-4ae3-423c-ab2a-5a12e0304f64.

instruments instead of representing genuine risk-sharing mechanisms.[28]

Habeebullah Zakariyah examines the factors and regulatory obstacles related to Sukuk failures within the framework of Islamic financing.[29] Sukuk distinguishes itself from conventional bonds by functioning within a distinct legal and ethical framework that ensures adherence to Shariah law. Defaults in Sukuk arise when the obligor fails to fulfil the financial commitments outlined in the contract, usually owing to credit risks, liquidity issues, or structural inadequacies in the Sukuk agreement.[30] Comprehending the difference between a Sukuk default and general default events is essential, as multiple variables such as economic recessions, credit downgrades, and cross-default provisions can precipitate defaults in Sukuk.[31] Cross-default agreements derived from traditional finance pose questions regarding their conformity with Islamic law.[32] These clauses may elevate the risk of defaults when Sukuk issuers encounter difficulties, as they could trigger defaults on various financial obligations.

The incidence of Sukuk defaults reveals a substantial deficiency in current legal frameworks, emphasising the necessity for enhanced rules that more effectively reconcile investor protection with Islamic finance principles.[33] Sukuk, as asset-based or asset-backed instruments, were created to reduce risks by linking investments to

[28]Syed Ali, "Ṣukūk Default and Issues in Their Resolution," 65–88; Zaheer and van Wijnbergen, "Sukuk Defaults," 292–311; Fitch Ratings. "Default Resolution Regimes Untested in Most Islamic Finance Markets." Fitch Ratings, November 17, 2020. https://www.fitchratings.com/research/islamic-finance/default-resolution-regimes-untested-in-most-islamic-finance-markets-17-11-2020

[29]Habeebullah Zakariyah and Saheed Abdullahi Busari, "Analysis of Sukuk Cross-Default Clause: A Fiqh Perspective," *Journal of Islamic Finance* 8, no. 2 (2019): 50–57.

[30]Tasnia, Mustapha, and Shakil, "Critical Assessment of the Legal Recourse," *European Journal of Islamic Finance* 7 (2017): 1–6.

[31]Fitch Ratings. Guide to Islamic Finance: Fitch Ratings' Perspective. Credit Encyclopedia Series. Fitch Ratings. 2020.https://www.fitchratings.com/research/islamic-finance/guide-to-islamic-finance-fitch-ratings-perspective.

[32]Zaheer and van Wijnbergen, "Sukuk Defaults," 292–311.

[33]Tasnia, Mustapha, and Shakil, "Critical Assessment of the Legal Recourse," *European Journal of Islamic Finance* 7 (2017): 1–6.

tangible and intangible assets. Legal ambiguities concerning asset ownership and recoverability in default scenarios have posed issues. Furthermore, some jurisdictions continue to exhibit inconsistent legal interpretations, complicating the resolution of Sukuk defaults and exacerbating challenges for investors.[34] Given these challenges, remedial actions like restructuring or asset liquidation vary considerably among markets, necessitating the establishment of standardised legal frameworks to facilitate more efficient and uniform default remedies.[35]

Saheed Abdullahi Busari et al stress an examination of financial distress and default within the Islamic finance sector, concentrating on the *Dana Gas Sukuk*[36] default case.[37] The *Dana Gas Sukuk* default case emphasises the contradiction between Shariah compliance and the enforceability of Sukuk under conventional legal systems. *Dana Gas PJSC* contended that the Sukuk contravened Shariah principles, specifically the prohibition on ensuring returns; however, the English High Court affirmed the enforceability of the purchase undertaking under English law, notwithstanding the Sharjah Court's decision grounded in UAE law. This disparity illustrates the difficulties of implementing Shariah rules in international Sukuk transactions and reveals the insufficiency of existing frameworks, such as AAOIFI norms, in resolving these issues. The case underscores the necessity for a universal, standardised legal and Shariah-compliant structure for Sukuk, especially with cross-border defaults.[38]

Saheed Abdullahi Busari et al also examine the causes, remedies, and regulatory ramifications of Sukuk defaults, specifically Islamic finance markets like Malaysia and the United Arab Emirates.[39] Notwithstanding the prospective advantages of Sukuk, its execution has faced considerable obstacles. These issues largely arise from legal

[34]Fitch Ratings. Guide to Islamic Finance: Fitch Ratings' Perspective. Credit Encyclopedia Series. Fitch Ratings. 2020.

[35]Habeebullah Zakariyah and Saheed Abdullahi Busari, "Analysis of Sukuk Cross-Default Clause," *Journal of Islamic Finance* 8, no. 2 (2019): 50-57.

[36]*Dana Gas PJSC v. Dana Gas Sukuk Ltd*., [2017] EWHC 2928 (Comm).

[37]Saheed Abdullahi Busari et al., "Dana Gas Sukuk Default," 569-585.

[38]Saheed Abdullahi Busari et al., "Dana Gas Sukuk Default," 569-585.

[39]Busari, Zakariyah, and Abdul Aziz, "Sukuk Default Regulation," *International Journal of Fiqh and Usul al-Fiqh Studies* 3, no. 1 (2019): 90–102.

ambiguities, regulatory discrepancies, and divergent interpretations of Shariah conformity. Saheed Abdullahi Busari et al perceive that the reaction to Sukuk defaults is mostly contingent upon the stipulations of the contractual agreement, the relevant legal framework, and the jurisdiction of regulatory authorities and courts.

A primary reason contributing to Sukuk defaults is the variance of regulatory regimes among various countries. The UAE has faced challenges due to fragmented legislation, as seen by the *Dana Gas Sukuk* default case. The *Dana Gas* case illustrates the risks linked to inconsistent regulatory frameworks. *Dana Gas PJSC* said that its Sukuk lacked Shariah compliance and sought to circumvent its responsibilities upon maturity. This resulted in contradictory judgements: the Sharjah court favoured the *Dana Gas* in accordance with UAE law, whilst the English High Court affirmed the legitimacy of the purchase commitment, ruling in favour of the Sukuk holders. This case underscored how issuers may strategically leverage non-compliance claims to evade responsibilities, so increasing issues over moral hazard and diminishing investor confidence in the Sukuk market. It also highlights the ongoing difficulties of cross-border enforcement when legal frameworks and Shariah interpretations differ.

International regulatory entities, such as the IFSB and the Accounting and AAOIFI, have endeavoured to formulate standards, such as IFSB-19, which delineate disclosure criteria. Nevertheless, these standards have been inconsistently implemented across markets, leading to considerable disparities in harmonisation. This dispersion hinders the establishment of a stable and unified global Sukuk market. In reaction to Sukuk defaults, corrective measures often encompass the rearrangement of agreements, arbitration, and insolvency processes. Nevertheless, legal ambiguities frequently complicate these remedies. In asset-based Sukuk structures, investors lack direct ownership of the underlying assets, hence constraining their recourse in the case of default. The case of *Maybank Trustee Berhad v. CIMB Bank Berhad.*[40] in Malaysia exemplifies the potential liability of trustees and arrangers for carelessness in protecting investor interests. This underscores the significance of regulatory clarity in safeguarding stakeholders. A

[40]*CIMB Bank Berhad v. Maybank Trustees Berhad* & Other Appeals, Civil Appeals, Federal Court (Malaysia), 10 February 2014, [2014] CLJ JT (3) (Malays.).

further troubling matter is the propensity of defaulting issuers to seek modifications of contractual terms post-issuance by citing Shariah non-compliance. The opportunistic arguments seen in the *Dana Gas* case compromise the ethical and legal integrity of Sukuk contracts. This matter highlights the essential requirement for thorough pre-issuance Shariah scrutiny, uniform contractual frameworks, and enhanced enforcement measures. The study advocates for improved regulatory monitoring, standardised contractual frameworks, and synchronised cross-border enforcement to ensure the stability of the Sukuk market.[41]

Mohammed Kabir Adisa analyses the complex relationship between governance failures and Sukuk defaults, emphasising the essential requirement for a strong regulatory framework to protect investor trust and ensure market stability.[42] His study emphasises several significant Sukuk defaults, including *Nakheel*,[43] *Saad Group*,[44] *Investment Dar Company*,[45] *East Cameron Partners*,[46] and *Dana Gas*,[47] which collectively expose persistent governance deficiencies such as misrepresentation of financial stability, exaggerated asset valuations, and efforts to evade contractual commitments under the pretext of Shariah non-compliance. The *Nakheel*[48] Sukuk collapse in

[41]Busari, Zakariyah, and Abdul Aziz, "Sukuk Default Regulation," *International Journal of Fiqh and Usul al-Fiqh Studies* 3, no. 1 (2019): 90–102.

[42]Mohammed Kabir Adisa, "Sukuk Default/Near Default and Governance Failure: The Need for a Strong and Sound Governance Framework (The Role of Securities Commissions and Other Regulatory Authorities)" (Executive Master's project paper, INCEIF University, 2022), 45, INCEIF Knowledge Repository.

[43] *Dubai World v. International Petroleum Investment Company* (IPIC). High Court of Justice, England and Wales. [2010] EWHC 3372 (Ch). November 25, 2010.

[44]*Byers v. Saudi National Bank.* Supreme Court of the United Kingdom. [2023] UKSC 51. December 20, 2023.

[45]*Al Sanea v. Saad Investments Company Ltd*. High Court of Justice, England and Wales. [2012] EWHC 2748 (Ch). October 12, 2012.

[46]*East Cameron Partners, LP v. Louisiana Offshore Holdings*, LLC. United States Bankruptcy Court, Western District of Louisiana. Case No. 08-51207. December 12, 2008.

[47]*Dana Gas PJSC v. Dana Gas Sukuk Ltd*., [2017] EWHC 2928 (Comm).

[48]*Dubai World v. International Petroleum Investment Company* (IPIC). High Court of Justice, England and Wales. [2010] EWHC 3372 (Ch). November 25, 2010.

2009 exemplified how inadequate governance processes, including the overvaluation of assets by USD 4.6 billion, resulted in a misleading representation of financial sustainability. This inadequacy, stemming from inadequate board monitoring and insufficient transparency, led to Dubai World's incapacity to fulfil its USD 3.5 billion Sukuk obligations. The *Saad Group's*[49] Golden Belt I Sukuk default was associated with fraudulent activities and a lack of transparency, as the controlling shareholder misappropriated funds and neglected corporate governance, highlighting the risks of excessive power concentration and inadequate oversight mechanisms.

The *Investment Dar Company*[50] case in Kuwait exemplifies this issue: its default on two Musharakah Sukuk totalling USD 250 million was precipitated by significant exposure to connected parties, violating central bank regulations. This indicated inadequate internal controls and a failure to adhere to regulatory norms. In another case, *East Cameron Partners,*[51] the issuer of the inaugural US-based Sukuk, defaulted after a natural calamity. Although the immediate cause was external, the company's effort to reclassify Sukuk holders as secured creditors instead of co-owners of assets compromised the integrity anticipated in governance standards, illustrating how crises can reveal underlying governance deficiencies.

The *Dana Gas Sukuk* case was arguably the most contentious, as the issuer unilaterally asserted that its Sukuk structure was Shariah non-compliant to avoid repayment obligations. The courts finally dismissed this position, ruling in favour of the investors. This episode underscored how governance failings undermine corporate stability and public trust, particularly when Shariah compliance is opportunistically employed as a defence against valid claims. On the other hand, Malaysia also faced the most Sukuk default cases in 2009. Malaysia experienced nine corporate Sukuk defaults, involving issuers

[49] *Byers v. Saudi National Bank*. Supreme Court of the United Kingdom. [2023] UKSC 51. December 20, 2023.

[50] *Al Sanea v. Saad Investments Company Ltd*. High Court of Justice, England and Wales. [2012] EWHC 2748 (Ch). October 12, 2012.

[51] *East Cameron Partners, LP v. Louisiana Offshore Holdings*, LLC. United States Bankruptcy Court, Western District of Louisiana. Case No. 08-51207. December 12, 2008.

such as *Oxbridge Height Sdn Bhd*,[52] *Oilcorp Berhad*,[53] and *Ingress Sukuk Berhad*,[54] which highlighted systemic deficiencies in disclosure, cash flow management, and asset appraisal. While Malaysia's legislative framework enabled restructuring and alternative dispute settlement, thus preventing protracted litigation, the aggregation of defaults highlighted the crucial necessity to enhance corporate governance structures and investor protection systems. Adisa's analysis emphasises the significance of credit ratings and transparency obligations. Although ratings serve as a preliminary assessment of risk, the defaults of highly rated Sukuk reveal their inadequacies when governance failures are obscured by misrepresentations or selective disclosures. This signifies that regulatory supervision, especially by securities commissioners, must go beyond dependence on ratings to assure thorough pre- and post-issuance scrutiny. The analysed examples reveal a predominant theme: Sukuk failures are primarily attributable to inadequate governance rather than the intrinsic limits of Shariah-compliant frameworks. Rectifying these deficiencies via more robust regulatory mandates, increased transparency, and heightened accountability is essential for maintaining Sukuk as a reputable and resilient asset within the Islamic capital market.[55]

Randi Swandaru examines the underlying causes, remedial actions, and regulatory implications that affect the robustness of Islamic financial markets. Sukuk, a Shariah-compliant financial product, has evolved into an essential tool for liquidity management and investment in corporate and sovereign markets. The rise in Sukuk defaults and near-default occurrences in the 21st century has shown institutional inadequacies, governance challenges, and legal ambiguities that necessitate comprehensive scrutiny.[56]

The research highlights that a primary factor leading to Sukuk defaults is the lack of a strong Shariah governance framework. The

[52]*Oxbridge Height Sdn Bhd v Abdul Razak Mohd Yusof & Anor* [2015] 3 MLRA 59.

[53]*Securities Commission Malaysia v Oilcorp Berhad* [2004] 2 CLJ 424.

[54]*Ingress Sukuk Berhad, "In re Ingress Sukuk Berhad*," High Court of Malaysia, 2009.

[55]Adisa, "Sukuk Default/Near Default and Governance Failure," 45.

[56]Randi Swandaru and Aishath Muneeza, "Causes for Near Default Sukuk Cases in the 21st Century and Their Rescue Mechanisms," JIHBIZ: Journal of Islamic Economy, Finance, and Banking 8, no. 1 (2024): 1-13.

divergence in Shariah interpretations among countries and the absence of standardised legislation frequently result in anomalies in contract enforcement, hence exposing Sukuk holders to vulnerability in default scenarios. In the *East Cameron Gas Sukuk* case, Sukuk holders asserted ownership rights over the underlying gas assets during the issuer's bankruptcy proceedings. Nevertheless, U.S. courts finally determined that the Sukuk holders were unsecured creditors rather than proprietors of the assets. This result underscored the issue of inadequate legal enforceability of Sukuk contracts in asset-based frameworks, as the rights of Sukuk holders were contingent upon the issuer's solvency rather than being ensured by actual asset ownership.

The problem is exacerbated by insufficient risk management throughout the life cycle of foundational projects, rendering Sukuk vulnerable to adverse market circumstances. The 2009 default of the *Saad Group Sukuk* illustrates this risk. Inadequate corporate governance, insufficient disclosure, and excessive leverage precipitated financial catastrophe, while the absence of standardised enforcement procedures deprived investors of effective remedies. Such instances demonstrate that governance deficiencies and inadequate oversight markedly increase default risk.

A significant discussion in the literature pertains to the structural differentiation between asset-based and asset-backed Sukuk, which substantially impacts the degree of protection provided to investors. Although asset-based Sukuk are theoretically associated with assets, Sukuk holders do not acquire actual ownership, so positioning them akin to unsecured creditors. In contrast, asset-backed Sukuk provide genuine asset ownership, hence improving bankruptcy protection. The *East Cameron* case exemplifies the perils of asset-based Sukuk, whilst the *Nakheel Sukuk* case reveals an alternative aspect. The Dubai government intervened in *Nakheel* to alleviate the issuer's debt obligations, safeguarding investors and averting systemic contagion. This remarkable sovereign intervention mitigated short-term concerns but also revealed the market's excessive dependence on government bailouts, a solution that cannot be generally implemented, particularly for privately issued Sukuk.

These instances collectively highlight the pressing necessity for the harmonisation of Shariah principles and the fortification of legal frameworks to ensure the enforceability of Sukuk contracts across countries. Nevertheless, some locations, especially in the Middle East,

persist in contending with varying interpretations of Shariah and ongoing legal issues, which obstruct the establishment of a cohesive and transparent Sukuk market. International regulatory and standard-setting entities, including the IFSB and the AAOIFI, have commenced initiatives to establish standardised Shariah and legal frameworks; however, their execution is characterised by fragmentation and inconsistency. Thus, the article asserts that although Sukuk are essential for Islamic capital markets, their robustness is unsound by governance deficiencies, legal ambiguities, and structural vulnerabilities. It is essential to tackle these challenges through unified Shariah governance, standardised laws, and enhanced enforcement mechanisms to safeguard investors and maintain confidence in global Sukuk markets.[57]

Najeeb Zada's examination of the *Dana Gas Sukuk* case underscores the intricacies and multifarious aspects of defaults in Islamic finance, particularly with Sukuk nonpayment. His research builds upon current literature by illustrating that Sukuk, although intended as Shariah-compliant financial products, is vulnerable to legal, financial, and Shariah-related difficulties.[58]

A primary concern recognised is the variability in the interpretation of contractual duties among several jurisdictions, potentially resulting in legal conflicts. The Dana Gas case illustrates the substantial difficulties encountered by the company's Sukuk, stemming from discrepancies in governing legislation and interpretations of Shariah.

The *Dana Gas* case exemplifies how external macroeconomic factors such as political instability and volatile oil prices can intensify financial difficulty, ultimately resulting in default. Zada's analysis underscores that these characteristics, along with internal management challenges, engendered an optimal scenario for default, illustrating the vulnerability of Sukuk under unstable economic conditions.

The study examines restructuring as a corrective measure for Sukuk defaults. Zada notes that although restructuring may provide

[57]Swandaru and Muneeza, "Causes for Near Default Sukuk Cases," JIHBIZ: *Journal of Islamic Economy, Finance*, and Banking 8, no. 1 (2024): 1-13.

[58]Zada and Muhammad, "The Intricacies of Default in Islamic Finance," *Journal of Islamic Business and Management* 8, no. S (2018): 286-292.

temporary relief, such efforts are frequently obstructed by legal and financial conflicts between Sukuk issuers and holders. The *Dana Gas* case exemplifies this dynamic, as attempts to modify the Sukuk encountered opposition and legal disputes from both parties. The analysis highlights the troubling tendency of employing Shariah non-compliance allegations as a legal tactic to evade repaying responsibilities. This strategy, frequently observed in Sukuk defaults, underscores the intricate relationship between legal manoeuvres and Shariah adherence.

A primary focus of the research is the lack of a cohesive worldwide regulatory framework for Sukuk. This discrepancy is a persistent issue in the Islamic finance literature, as demonstrated by the contradictory court decisions in the *Dana Gas* case. The divergent rulings of the UK and UAE courts highlight the jurisdictional complexities that emerge in the absence of a standardised governance structure for Sukuk instruments. The divergence in legal interpretations and the absence of a unified regulatory framework present a substantial hazard to Sukuk markets and investors.

Hence, Zada's research underscores the pressing necessity for a more cohesive regulatory framework regarding Sukuk and Islamic financial conflicts. The *Dana Gas* case exemplifies the significant risks associated with Sukuk defaults, the difficulties of restructuring within a legally fragmented context, and the consequences of Shariah non-compliance allegations. A more coherent and standardised worldwide regulatory framework could alleviate these risks, enhancing stability in the Islamic finance sector and ensuring improved protection for both issuers and investors against the uncertainty related to Sukuk defaults.[59]

Mohammed Imad Ali delineates the critical causes contributing to financial crisis in Islamic capital markets, with particular emphasis on governance concerns, legal ambiguity, and issues pertaining to Shariah compliance.[60] The paper employs *Dana Gas Sukuk* as a case study. The *Dana Gas* declared its Mudarabah Sukuk non-compliant,

[59]Zada and Muhammad, "The Intricacies of Default in Islamic Finance," *Journal of Islamic Business and Management* 8, no. S (2018): 286-292.

[60]Mohammed Imad Ali, Aznan Hasan, and Ashurov Sharofiddin, "Evaluating Sukuk Default Factors: A Case Study on Dana Gas Sukuk in the UAE," *Journal of Islamic Finance* 11, no. 1 (2022): 385-422.

citing evolving interpretations of Shariah principles. This case illustrates the legal uncertainties arising from varying interpretations of Shariah across jurisdictions, leading to issues on contract validity and investor rights, which are a significant cause of Sukuk defaults. Furthermore, the paper examines how legal and regulatory inconsistencies intensify Sukuk default risks, referencing the discord between English law and UAE law in the *Dana Gas* case. The Sharjah Court initially favoured the *Dana Gas*, however the English High Court affirmed the Sukuk duties, resulting in a jurisdictional deadlock that extended uncertainty for investors. This underscores the article's focus on the necessity for standardised legal paperwork and universally acknowledged regulatory frameworks to ensure the enforceability of Sukuk across various jurisdictions. The paper advocates for centralised Shariah governance to mitigate discrepancies in compliance interpretations, as the decentralised Shariah supervision in the UAE has led to ambiguity about the *Dana Gas Sukuk*.[61]

Mohamed Ghezal's study analyses the diverse legal, regulatory, and structural obstacles affecting the stability and sustainability of Islamic financial markets, with a specific focus on Sukuk issuance. It underscores the difficulties presented by varying legal systems among jurisdictions such as Indonesia, Malaysia, and the United Kingdom.[62] Each of these nations utilises unique legal frameworks to enhance transparency and safeguard investors; nonetheless, substantial challenges persist. A significant difficulty in the Sukuk market is the legal ambiguity about Sukuk contracts, particularly in differentiating between asset-backed and asset-based arrangements. The absence of a definitive legal framework in certain jurisdictions has resulted in Sukuk being governed by conventional bond regulations, potentially conflicting with Shariah principles. This regulatory deficiency heightens the risk of default, since both issuers and investors encounter uncertainty concerning asset ownership, recoverability, and bankruptcy protection. In areas where Sukuk is regarded as similar to conventional debt instruments, default remedies frequently favour

[61]Ali, Hasan, and Sharofiddin, "Evaluating Sukuk Default Factors," *Journal of Islamic Finance* 11, no. 1 (2022): 385-422.

[62]Mohamed Ghezal, Rusni Hassan, and Ahcene Lahsasna, "Legal and Regulatory Approaches in Ṣukūk Issuance: A Comparative Analysis," *UUM Journal of Legal Studies* 13, no. 1 (2022): 249–281.

issuers, compromising investor protections. A primary reason for Sukuk failures is the inadequate legal protection for investors, particularly when Sukuk arrangements do not confer authentic asset ownership. In the absence of strong legal protections, Sukuk holders may discover that their rights are insufficiently safeguarded during defaults or bankruptcy processes. This issue is particularly pronounced in Indonesia, where Sukuk was first regulated by conventional financial legislation, and in the UK, where the regulatory approach to Sukuk has occasionally led to ambiguity and inconsistent application.

The existence of Shariah monitoring bodies is essential for ensuring that Sukuk complies with Islamic standards. In areas where Shariah governance is either deficient or disjointed, investors face increased risks due to conflicting interpretations of Shariah compliance, which may result in regulatory failures or misinterpretations of investor rights. The research indicates that remedial actions for Sukuk defaults differ markedly among jurisdictions. Some nations emphasise Sukuk restructuring, whereas others depend on judicial or regulatory measures to address conflicts. The absence of standardisation among countries hinders enforcement, particularly in cases of cross-border Sukuk defaults. The global standardisation of Sukuk governance is essential for maintaining the stability and credibility of these financial instruments. The study emphasises the necessity for clearer and more standardised regulatory frameworks across jurisdictions. A cohesive framework for Sukuk regulation will improve legal clarity and bolster investor confidence, ensuring Sukuk remains a viable alternative to traditional bonds in the global capital markets.[63]

Nor Balkish Zakaria's examination of the regulatory environment pertaining to Sukuk issuance and default resolution reveals some significant findings pertinent to the analysis of Sukuk defaults. Inconsistencies in the regulatory framework, especially concerning Shariah compliance and investor protection mechanisms are seen as major factors leading to Sukuk defaults. [64] The absence of a unified legal framework to manage Sukuk defaults typically

[63]Ghezal, Hassan, and Lahsasna, "Legal and Regulatory Approaches in Ṣukūk Issuance," *UUM Journal of Legal Studies* 13, no. 1 (2022): 249–281.

[64]Nor Balkish Zakaria et al., "The Impact of Geopolitical Risk and COVID-19 Pandemic Stringency on Sukuk Issuance in Malaysia," *Journal of Islamic Accounting and Business Research* 15, no. 1 (2024): 5.

exacerbates these differences, leading to protracted litigation between issuers and investors. This absence of uniformity sharply contrasts with conventional bond markets, where established legal frameworks assure clarity in default settlement. The literature underscores that improving legal clarity, particularly with asset ownership frameworks and default resolution strategies, may alleviate risks associated with Sukuk investments. These enhancements could bolster investor confidence, especially during geopolitical risks (GPRs) and unexpected occurrences such as the COVID-19 pandemic, which have revealed the vulnerability of Sukuk to external disruptions.

Zakaria's research also delineates potential solutions for Sukuk defaults, including the fortification of credit enhancement procedures, the augmentation of transparency in Sukuk structures, and the increase of investor education. These procedures seek to ensure that investors are well informed, which is essential for alleviating the risks linked to asset-backed and asset-based Sukuk arrangements. The study advocates for a more stringent regulatory framework that requires securities prompt disclosures from issuers and enhances protections against the risks associated with Sukuk defaults. The paper recommends that regulatory authorities establish frameworks to enable investor recourse in instances of Sukuk defaults, especially in cross-border transactions where jurisdictional complexities may hinder settlement. The necessity of establishing explicit regulatory frameworks for managing Sukuk defaults both nationally and globally has become increasingly critical, particularly due to the financial volatility induced by the COVID-19 epidemic and geopolitical conflicts.[65]

The literature on Sukuk defaults provides important insights into the causes, remedies, and regulatory implications; yet many gaps persist unresolved. A significant gap exists in empirical research investigating the effects of diverse Sukuk structures, particularly asset-backed and asset-based Sukuk, on default resolution outcomes in various jurisdictions. Despite theoretical distinctions between these two structures, there is a notable lack of comparative studies evaluating how these differences influence investor protection in actual default

[65]Zakaria et al., "The Impact of Geopolitical Risk and COVID-19 Pandemic Stringency," *Journal of Islamic Accounting and Business Research* 15, no. 1 (2024): 5.

scenarios.[66] This disparity is significant since asset-backed Sukuk, by facilitating direct ownership and bankruptcy protection, ostensibly provides enhanced security for investors relative to asset-based Sukuk, which subjects investors to increased risks as they are regarded as unsecured creditors. The lack of comparable research creates a substantial gap in comprehending the practical effects of Sukuk structure on investor recovery in default situations. The unsolved legal issues surrounding Sukuk contracts, particularly in cross-border scenarios, further exacerbate this imbalance.[67]

The literature suggests that differing legal interpretations between Shariah-compliant frameworks and conventional legal systems frequently prolong the default resolution process, as exemplified by notable examples such as the *Dana Gas*.[68] In many instances, Shariah principles and conventional legal systems have conflicted, resulting in prolonged litigation and ambiguities concerning investor entitlements. This underscores the essential requirement for a globally harmonised legal framework that amalgamates Islamic financial principles with contemporary legal procedures. The lack of such a framework now obstructs the effective resolution of Sukuk defaults, as various countries implement divergent legal standards. Furthermore, the current literature underscores regulatory discrepancies among jurisdictions, notwithstanding the initiatives by regulatory entities like as the AAOIFI and IFSB to promulgate comprehensive rules for Sukuk governance. Nonetheless, these rules lack enforceability, and there is a notable deficiency of particular insolvency legislation designed for Sukuk. This regulatory deficiency poses a significant barrier to efficient default resolution and investor

[66]Essia Ries Ahmed, Ramyar Rzgar Ahmed, Fathyah Hashim, and Md. Aminul Islam. "Asset-Based and Asset-Backed Sukuk: Structure and Legitimacy." Opción 35, no. Especial No. 21 (2019): 1248-1262. (https://dialnet.unirioja.es/descarga/articulo/8348562.pdf); Herzi, "A Comparative Study of Asset-Based and Asset-Backed Sukuk," 25-34.

[67]Tasnia, "Critical Assessment of the Legal Recourse," 1–6; Busari et al., "Dana Gas Sukuk Default," *International Journal of Islamic and Middle Eastern Finance and Management* 12, no. 4 (2019), 569-585; Fitch Ratings, "Default Resolution Regimes Untested."

[68]Ercanbrack, J. "Standardization of Islamic Financial Law: Lawmaking in the Shadow of the Dana Gas Sukuk Default." *American Journal of Comparative Law* 67, no. 4 (2019): 825–845.https://academic.oup.com/ajcl/article/67/4/825/5739749 (accessed January 25, 2025).

safeguarding, as there exists no globally acknowledged framework to regulate Sukuk defaults. Thus, legislative deficiencies impede the establishment of unified and standardised protocols to protect investor interests and mitigate systemic risks in Sukuk markets. This regulatory fragmentation creates an unstable environment, heightening risks for investors and compromising market stability. The literature lacks predictive models capable of assessing early warning indications and default likelihood in Sukuk markets. The absence of such models limits proactive risk management, hindering stakeholders from detecting prospective defaults prior to their occurrence. The absence of these instruments leaves market participants, regulators, and investors responding to defaults instead of predicting them, thus diminishing their capacity to effectively mitigate risks. An additional underexplored aspect in the literature is the impact of governance and regulatory monitoring on mitigating Sukuk default risks. Despite prior studies highlighting regulatory differences between countries, there has been no investigation into the practical effectiveness of planned standardisation projects and their execution.[69]

In the absence of a strong and enforceable governance framework, Sukuk defaults are likely to be intensified by inadequate oversight, insufficient transparency, and poor risk management. Recent Sukuk defaults, such as those of *Menara ABS Berhad,*[70] *MEX II Sdn Bhd,*[71] and *Serba Dinamik Holdings Berhad,*[72] exemplify the noticeable repercussions of these deficiencies. These cases underscore many challenges, including as liquidity limits, obstacles in asset liquidation, governance deficiencies, and legal uncertainties, which

[69]Ercanbrack, "The Standardization of Islamic Financial Law," 825; Awais Ur Rehman, Muhammad Abdullah bin Zaidel, Mohamad bin Jais, and Arslan Haneef Malik. "Sukuk Default: Could Corporate Governance & Sustainability Be the Defenders?" *International Journal of Academic Research in Business and Social Sciences* 10, no. 5 (2020): 533-545. (https://doi.org/10.6007/IJARBSS/v10-i5/7226); Ahmet Ulusoy, and Mehmet Ela. "Lack of Standardization in Sukuk Market." *Journal of Islamic Economics, Banking and Finance* 13, no. 1 (2017): 148-160. (https://doi.org/10.12816/0051160).

[70]Zainul, "Sale of Menara TM stuck in office glut."

[71]"Mex II Ratings Downgraded To D" Jan 07, 2022. MARC. https://www.marc.com.my/rating-announcements/mex-ii-ratings-downgraded-to-d/.

[72]Serba Dinamik, "Default in Interest Payment."

impede efficient default resolution. These incidents illustrate that, despite the theoretical advantages of Sukuk in alleviating financial risk, their practical implementation often encounters issues, including refinancing difficulties, inadequate risk assessment frameworks, and inconsistencies in regulatory compliance. The lack of standardised frameworks for default settlement greatly increases investor uncertainty, often leading to prolonged conflicts and reduced market stability. Given these ongoing discrepancies, there is a distinct necessity to address the understanding of Sukuk defaults. This encompasses the augmentation of theoretical and empirical literature regarding the structural, legal, and regulatory dimensions of Sukuk defaults, alongside the creation of predictive instruments for the early identification of default risks. Rectifying these inadequacies is crucial for enhancing the resilience of Sukuk instruments and creating a more robust regulatory and legal framework that safeguards investor interests while promoting market stability. Addressing these difficulties will foster a more transparent, stable, and sustainable Islamic financial ecosystem.

## RESEARCH METHODOLOGY

This study adopts a qualitative methodology that combines doctrinal and empirical approaches to examine Sukuk default cases. The doctrinal method entails a thorough analysis of primary legal sources, encompassing regulatory frameworks, financial statements, and contractual agreements pertinent to Sukuk issuances. A comparative legal analysis is conducted to evaluate enforcement mechanisms in various jurisdictions, with an emphasis on regulatory discrepancies and their implications. The empirical component comprises case study analyses of considerable Sukuk defaults, including *Menara ABS Berhad, MEX II Sdn Bhd*, and *Serba Dinamik Holdings Berhad*. This analysis explores governance deficiencies, liquidity challenges, and legal uncertainties contributing to Sukuk defaults. A comparative analysis of three notable Malaysian legal cases provides valuable insights into the legal intricacies of default resolution.[73] The data

[73] *Vahana Offshore (M) Sdn Bhd & Ors v. MIDF Amanah Investment Bank Bhd,* [2024] MLJU 288 (High Ct. Kuala Lumpur); *Bursa Malaysia Securities v. Serba Dinamik Holdings Bhd*, 2022 MLJU 1999 (High Ct.

collection process involves a comprehensive analysis of financial disclosures, judicial decisions, and regulatory frameworks, enabling a detailed evaluation of the systemic risks inherent in Sukuk structures. The study aims to develop policy recommendations for improving governance, standardising legal frameworks, and enhancing enforcement mechanisms to reduce Sukuk default risks and strengthen market resilience.

## FINDINGS AND DISCUSSION

Examining Sukuk default instances is essential for comprehending financial distress trends, governance deficiencies, and regulatory oversights that impact the stability of Islamic financing systems. Although Sukuk intended to comply with Shariah principles and mitigate excessive risk, recent high-profile defaults expose substantial vulnerabilities in these instruments. Understanding the risks associated with Sukuk defaults is essential for developing robust governance structures, enhancing legal frameworks, and preserving investor trust in Islamic financial markets. The recent examination of the Sukuk default cases, encompassing *Menara ABS Berhad, MEX II Sdn Bhd,* and *Serba Dinamik Holdings Berhad*, reveals substantial flaws in Sukuk default cash flow management and regulatory enforcement. Additionally, comparative analyses of three distinguished Malaysian legal cases *Bank Islam Malaysia Berhad v. TMF Trustees Malaysia Berhad & Ors [2019] MLJU 1380, Bursa Malaysia Securities v. Serba Dinamik Holdings Bhd [2022] MLJU 1999 and Vahana Offshore (M) Sdn Bhd & Ors v MIDF Amanah Investment Bank Bhd [2024] MLJU 288* offer a comprehensive view of the legal and regulatory deficiencies in managing Sukuk defaults. The study identifies key obstacles in these instances, including inadequate asset disposal strategies, liquidity limitations, governance vulnerabilities, and legal uncertainties that impede effective Sukuk default resolutions. The intrinsic risks of Sukuk structures stem from multiple reasons, including liquidity risk management, economic downturns, and legal ambiguities. Sukuk issuers, while seeking to provide a Shariah-compliant alternative to conventional bonds, often have difficulties in securing refinancing,

Kuala Lumpur); *Bank Islam Malaysia Berhad v. TMF Trustees Malaysia Berhad* & Ors, 2019 MLJU 1380 (High Ct. Kuala Lumpur).

selling underlying assets, and maintaining consistent cash flow for periodic payouts.

*Menara ABS Berhad* encountered difficulties in asset disposal, exacerbated by declining property market conditions, resulting in its default. *MEX II Sdn Bhd* faced considerable liquidity issues due to an overreliance on unrealistic toll income projections that did not come to fruition, leading to financial turmoil and eventual default. The case of *Serba Dinamik Holdings Berhad* focuses on the importance of governance and transparency, as accounting irregularities and regulatory disputes eroded investor assurance and resulted in legal complications. These incidents illustrate that despite the structural benefits of Sukuk, they are vulnerable to financial, operational, and legal insufficiencies that necessitate an improved governance framework. The cruciality of governance and regulatory enforcement is essential in alleviating these lapses. The lack of standardised enforcement tools and explicit legal requirements for managing

Sukuk defaults leads to prolonged conflicts and legal uncertainty. An examination of the three Malaysian judicial cases reveals the imperative for enhanced contractual safeguards, proactive risk management approaches, and augmented trustee responsibilities to protect the interests of Sukuk holders. In *Bank Islam Malaysia Berhad v. TMF Trustees Malaysia Berhad & Ors [2019] MLJU 1380,*[74] the insufficiency of remedies for Sukuk holders became apparent when the Issuer defaulted on the principal payment due on the Maturity Date, resulting in inadequate funds in the Sukuk Ijarah MTN Sinking Fund Account (SFA) to fulfill the obligations. The Sukuk holders encountered restrictions in asserting their rights due to the lack of a specified Event of Default under clause 6.1 of the Trust Deed, which would have activated immediate repayment duties irrespective of the Maturity Dates. The Trustee, TMF Trustees Malaysia Berhad, maintained a neutral position yet did not declare an Event of Default, despite the Issuer's failure to fulfill its payment commitments, thereby leaving Sukuk investors without a definitive enforcement remedy. The Corporate Debt Restructuring Committee (CDRC) assumed a controversial position, as their informal call for a standstill hindered the declaration of an Event of Default, so complicating the resolution

[74] *Bank Islam Malaysia Berhad v. TMF Trustees Malaysia Berhad* & Ors, 2019 MLJU 1380 (High Ct. Kuala Lumpur).

process. The court finally determined that the funds in the SFA should be allocated equitably among Sukuk holders whose Sukuk matured on the default date, underscoring the contractual duties stipulated in the Trust Deed. This ruling revealed the absence of effective remedies for Sukuk holders in default situations, especially where the Trustee's role is passive and other entities such as the CDRC obstruct formal recovery efforts. Thus, the judgement in *Bank Islam Malaysia Berhad v. TMF Trustees Malaysia Berhad* discloses notable governance deficiencies, including the Trustee's passive involvement and the absence of prompt measures in response to defaults. Consequently, the failure of governance and regulatory enforcement was shown, as the lack of explicit responsibilities for Trustees to act in the case of a default resulted in delays in protecting the interests of Sukuk holders.

In *Bursa Malaysia Securities v. Serba Dinamik Holdings Bhd [2022] MLJU 1999,*[75] the insufficient remedies for Sukuk holders arose from ineffective enforcement tools and a lack of openness in disclosing notable financial irregularities. The regulatory measures implemented, such as the suspension of trade and mandates for financial disclosures, encountered significant opposition from the issuer, *Serba Dinamik Holdings Bhd.* Notwithstanding the considerable apprehensions expressed by auditors about the veracity of transactions and financial statements, the remedies available under the Malaysian regulatory framework did not furnish prompt or direct redress to Sukuk holders. The procedure depended profoundly on regulatory intervention, which the issuer contested through legal means. The deficiencies in addressing the Sukuk default were apparent in the issuer's noncompliance with disclosure mandates and the ensuing intricate legal issues. This extended legal dispute postponed the resolution of financial ambiguities, resulting in Sukuk holders remaining in a prolonged condition of uncertainty. The regulatory structure, albeit imposing penalties and trade suspensions, lacked effective procedures to provide rapid investor protection or financial restitution for impacted stakeholders.

The case of *Vahana Offshore (M) Sdn Bhd & Ors v. MIDF Amanah Investment Bank Bhd [2024] MLJU 288*[76] demonstrates the

[75] *Bursa Malaysia Securities v. Serba Dinamik Holdings Bhd*, 2022 MLJU 1999 (High Ct. Kuala Lumpur).

[76] *Vahana Offshore (M) Sdn Bhd & Ors v. MIDF Amanah Investment Bank Bhd*, [2024] MLJU 288 (High Ct. Kuala Lumpur).

insufficient remedies accessible to Sukuk holders in instances of default, primarily attributable to the absence of direct enforcement mechanisms and the inherent constraints of the financing structure. The plaintiffs contended that the defendant, acting as both the lender and Sukuk arranger, neglected to secure the requisite Sukuk financing, resulting in a default situation where the defendant pursued enforcement of security rights instead of meeting its commitment to obtain cash. This case demonstrates significant deficiencies in addressing Sukuk defaults, such as conflicts of interest, the lack of a definitive dispute resolution mechanism that prioritises investors, and the restricted capacity of Sukuk holders to pursue remedies outside court injunctions. The plaintiffs' effort to contest the enforcement of securities revealed the inadequacies in investor safeguards, as their main recourse was injunctive remedies instead of substantial cash reparations. This case exemplifies the necessity for enhanced regulatory protections and more explicit contractual frameworks within Sukuk structures.

These cases jointly demonstrate the delays in announcing an Event of Default, as evidenced in *Bank Islam v. TMF Trustees*[77] and the imperative for stringent financial reporting and independent oversight, as emphasised in *Bursa Malaysia v. Serba Dinamik*. These findings suggest that regulatory authorities must prioritise the harmonisation of Shariah and legal frameworks to ensure the stability of Islamic financial instruments. The trust of investors in the Sukuk market is profoundly influenced by the transparency and enforceability of default settlement methods. The examined instances demonstrate that insufficient stakeholder communication, delayed enforcement actions, and unclear legal outcomes impair steadiness in the Sukuk market. It is imperative to furnish Sukuk holders with clear processes for dispute resolution, immediate access to legal remedies, and enforceable contractual protections to foster a more resilient investment environment. Standardising contractual provisions, augmenting financial transparency requirements, and establishing systematic asset recovery mechanisms can mitigate the risks of protracted litigation and financial losses for investors. The incidents of *Menara ABS Berhad, MEX II Sdn Bhd*, and *Serba Dinamik Holdings Berhad*, along with three Malaysian judicial proceedings, demonstrate

[77] *Bank Islam Malaysia Berhad v. TMF Trustees Malaysia Berhad* & Ors, 2019 MLJU 1380 (High Ct. Kuala Lumpur).

that rebuilding investor assurance requires comprehensive regulatory reforms, proactive governance measures, and transparent financial practices. Ensuring the sustained growth of the Sukuk market necessitates a unified strategy that aligns financial stability with Shariah principles. Rectifying the structural and legal inadequacies in default resolution systems can enhance market resilience and prevent future financial crises.

Insights from prior defaults affirm the imperative of including more adaptable risk management strategies, such as dynamic refinancing techniques, contingency planning, and legal precision in Sukuk documents. Policymakers and industry stakeholders must cooperate to establish an amalgamated regulatory framework that promotes the sustainable development of Sukuk instruments. Enhancing governance, bolstering legal protections, and augmenting investor safeguards cultivate a more stable and dependable Sukuk market, thereby ensuring its survival as a crucial component of Islamic finance.

The case study of *Menara ABS Berhad* illustrates the intrinsic structural risks associated with asset-backed Sukuk and the challenges of asset liquidation amid financial crises. *Menara ABS Berhad*, established as a special-purpose vehicle (SPV) for the securitisation of Telekom Malaysia's assets, issued RM1 billion in Sukuk on an Ijarah (lease-based) framework. The issuance was divided into multiple tranches, with rental payments from Telekom Malaysia serving as the primary source of monthly payouts to Sukuk holders. The default resulted from a failure to swiftly dispose of the underlying assets, compounded by declining property values and difficulties in refinancing. The inability to generate the requisite cash flow to redeem the Sukuk before maturity led to credit downgrades and significant losses for investors. The resolution processes outlined in the Principal Terms and Conditions (PTC) encompassed asset liquidation strategies; nevertheless, the unfavourable property market conditions rendered these efforts futile. This scenario underscores the necessity of proactive asset management measures and contingency planning to alleviate potential liquidity deficiencies in Sukuk transactions.

The financial crisis faced by *MEX II Sdn Bhd* underscores the perils of liquidity limitations and governance deficiencies in Sukuk design. The firm issued RM1.3 billion in Sukuk Murabahah to finance the expansion of the Maju Expressway, depending on anticipated toll

revenue to meet its debt commitments. However, the anticipated financial flow from toll collecting failed to materialise, leading to a substantial liquidity shortfall. Nonetheless, after several extensions granted by Sukuk holders, the company defaulted on its principal and profit payments, leading to credit downgrades and legal disputes. The remedies specified in the Information Memorandum included the enforcement of security interests, such as fixed and floating charges on the company's assets; nevertheless, the lack of alternative revenue streams diminished the effectiveness of these measures. The *MEX II* instance illustrates the necessity for improved financial planning, realistic revenue projections, and proactive engagement with Sukuk holders to avoid liquidity difficulties.

The Sukuk default of *Serba Dinamik Holdings Berhad* emphasises the critical significance of governance and transparency in ensuring financial stability. The company's USD 300 million Sukuk, structured under Wakalah and Murabahah contracts, faced default due to Significant cash flow constraints, regulatory scrutiny, and legal disputes. Accounting irregularities and the company's failure to address auditor concerns resulted in an extensive decrease in investor confidence, ultimately leading to default. The legal actions initiated by creditors, including winding-up petitions and asset recovery claims, exacerbated the resolution process. The remedies specified in the Information Memorandum included the enforcement of security measures and financial assurances; however, the absence of efficient governance structures compromised these processes. The *Serba Dinamik* case highlights the imperative for rigorous financial oversight, independent audits, and aggressive regulatory interventions to mitigate corporate governance risks in Sukuk transactions.

A comparative review of Sukuk defaults and their remedies reveals common issues in the situations studied, including inadequate legal frameworks for default settlement, prolonged enforcement efforts, and governance deficiencies. The examined Malaysian judicial cases provide valuable ideas for improving Sukuk default procedures. The primary flaws are the lack of systematic enforcement processes, the absence of dispute resolution systems, and insufficient investor protection measures. Mitigating these inadequacies necessitates the establishment of more stringent legal safeguards, enhanced financial transparency, and augmented regulatory oversight. Standardised contractual clauses, proactive risk mitigation methods, and

independent trustee oversight can substantially enhance the resilience of Sukuk structures. The analysis of Sukuk default instances highlights the necessity for regulatory enhancements, governance changes, and legal precision in the Islamic banking industry. Improving Sukuk default procedures requires a thorough plan that includes rigorous risk management methods, standardised documentation, and effective legal enforcement. Policymakers and industry stakeholders may improve the sustainable development of the Sukuk market by addressing structural deficiencies and governance gaps, thereby reinforcing its position as a robust and viable component of the global Islamic financial system.

## CONCLUSION

The analysis of Sukuk default instances reveals substantial inadequacies in the legal, financial, and governance structures supporting these Islamic financial instruments. Examining the defaults associated with *Menara ABS Berhad, MEX II Sdn Bhd*, and *Serba Dinamik Holdings Berhad* uncover persistent issues like insufficient liquidity management, inadequate governance framework, and legal ambiguities that lead to financial turmoil.

The fundamental difference between asset-backed and asset-based Sukuk significantly impacts investor risk exposure and affects the resolution procedure after defaults. The lack of uniform enforcement methods and variations in legal interpretations among jurisdictions complicate Sukuk default resolutions, frequently resulting in extended legal disputes and reduced investor confidence. Regulatory organisations should concentrate on aligning Shariah principles with modern legal frameworks to establish a solid foundation for Islamic capital markets. Improving financial transparency mandates, strengthening corporate governance procedures, and instituting more efficient default resolution mechanisms are essential measures for bolstering the Sukuk market. The deployment of proactive risk management methods, such as structured refinancing options and detailed contingency planning, is crucial to limit default risks.

The results underscore the necessity for a collaborative initiative among policymakers, financial entities, and regulators to mitigate the systemic vulnerabilities jeopardising Sukuk stability. Implementing

extensive changes to enhance transparency, enforceability, and investor protection can bolster market confidence, hence securing Sukuk's enduring viability as a pivotal financing instrument in the Islamic financial industry.

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