Ṣukūk structure for deficit financing during COVID-19 crisis

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Abstract

Purpose – This paper identified the *ṣukūk* structure suitable for deficit financing during the COVID-19 crisis. The study also explored the relevant Sharīʿah contracts that could be utilized to issue *ṣukūk* that is suitable for various jurisdictions and corporations in handling deficit financing during the COVID-19 crisis.

Design/methodology/approach – The authors have adopted a qualitative research approach in which primary and secondary sources available on the subject were reviewed, especially a number of cases related to *ṣukūk* structures prior to and during the COVID-19 crisis and analyzed their performances and drawn their conclusions.

Findings – The outcome of this paper suggests that certain *ṣukūk* structures used during the COVID-19 crisis aimed primarily at financing deficit have been successful. Furthermore, these *ṣukūk* structures are relied very much on the obligator's/issuer's cash flow position. It has been revealed that if the *ṣukūk* is structured on equity-based contracts with lower repayment amount or no payment, it would not trigger default because the nature of this *ṣukūk* is the sharing of profit and loss, in accordance with a Sharīʿah rule that there will be compensation for any loss only if deliberate and notable negligence is proven. However, if it is debt based or ijarah and wakalah contracts, then the payment to *ṣukūk* holders ought to be made as agreed and if not, it will trigger default. This payment is to be made from the cash flow of the issuer and if there is an issue in the cash flow of the issuer due to COVID-19, consent from the *ṣukūk* holders needs to be obtained to reschedule payment as found in the case of the Garuda Indonesia *ṣukūk*. However, as found in MASB's IMTN *ṣukūk* case, if the cash flow of the company is good, then the chances of default are very slim. However, so far, three new *ṣukūk* in the middle of COVID-19 were issued, one by a corporation and two issued by a sovereign, one of which addresses the liquidity issues during the pandemic, and all these proved that *ṣukūk* is definitely a viable alternative mode for deficit financing and a reliable option during the COVID-19 pandemic.

Research limitations/implications – This paper looked into the *ṣukūk* structure, especially the *ṣukūk* which are yet to mature and the new *ṣukūk* issued during the crisis caused by the COVID-19 pandemic.

Practical implications – It is anticipated that the outcome of this research will assist the stakeholders in *ṣukūk* markets to understand the *ṣukūk* impact on COVID-19 related deficit financing and suggest various structures that could be utilized in the *ṣukūk* market in an unprecedented situation such as the COVID-19 economic distress.

Social implications – Looking at the social aspect of *ṣukūk* markets, this paper has endeavored to provide solutions to the financing of deficit for social well-being as a tool to provide relief and social stability in the lives of the people.

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Originality/value – The novel COVID-19 pandemic has caused unprecedented economic difficulties and market distress on a global scale; and this research sought to identify the relevant *ṣukūk* structures to be used for deficit financing during the pandemic crisis, especially the *ṣukūk* which are yet to mature and new *ṣukūk* issued during the pandemic crisis. The former includes HDFC *Muḍārabah ṣukūk* (2019) Maldives and MAHB *ṣukūk*/IMTN program (2010) Malaysia, while the latter includes IsDB Trust Certificates, Phase 2 of the tranches (2020), the Federal Government of Nigeria Road *ṣukūk* (May, 2020) and Sharj'ah Government two billion Dirham *ṣukūk* (June, 2020).

Keywords *Ṣukūk*, COVID-19 crisis, Deficit financing

Paper type Research paper

1. Introduction

During the COVID-19 pandemic, many corporations and countries face difficulties in financing their projects, especially the short-term operations. This is because most businesses were closed and social activities were sanctioned in most countries to allow health workers to effectively contain the pandemic. With the closure of most economic activities, social interactions, *ṣukūk* and other Islamic banking and finance activities have also been affected and many investors and *ṣukūk* issuers are concern particularly for the *ṣukūk* approaching maturity and also the newly-issued *ṣukūk* in the markets. This study aims to investigate the appropriate *ṣukūk* structure to be used during the pandemic for deficit financing purposes. This is to be done by analyzing the *ṣukūk* which are yet to mature particularly *ṣukūk* which are issued in Malaysia and Maldives. The paper also aims to investigate the new *ṣukūk* issuances that coincided with the period during which the pandemic was active and began proliferating globally. These types of *ṣukūk* to be investigated were issued in Saudi Arabia, Nigeria and the United Arab Emirates, respectively.

Ṣukūk is an Islamic alternative to the conventional bond. It can also be defined as "an Islamic financial instrument issued in the global capital markets". *Ṣukūk* was defined by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOFI) as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity". The performance of the *ṣukūk* market in 2019 alone proved the confidence and the success of *ṣukūk* as a reliable financial instrument. RAM Rating Services Bhd (2020a) reported that "the global *ṣukūk* market delivered a noteworthy performance in 2019, notching up USD130.2 billion of gross issuance, which is a 41.6% jump from USD91.9 billion the previous year and the top five countries by incremental value were, Turkey (+320.4%), Qatar (+62.2%), Malaysia (+57.7%), Bahrain (+45.1%) and Indonesia (+26.2%). Even though issuance by non-core markets surged 138% to USD13.3 billion last year (2018: USD5.6 billion), the global *ṣukūk* market remained dominated by the Gulf Cooperation Council (GCC, 40%), Malaysia (34%) and Indonesia (15%)".

As for sovereigns, Saudi Arabia retained its leading position in the global sovereign *ṣukūk* market with a 28.9% (USD21.4 billion) share. Indonesia was a close second (25.3% or USD18.7 billion), while Malaysia (18.5% or USD13.7 billion) was next, and then Turkey (USD7.0 billion or 9.5%). The main fund-raising objective was to complement the respective countries' budget deficits (RAM Rating Services Bhd, 2020a). As for corporate *ṣukūk* issuances, Malaysia continued to lead with USD31.2 billion (or a 55.3% share), followed by the UAE with USD9.8 billion (17.3%). Saudi Arabia was next with USD9.1 billion or 16.2% ahead of Qatar (US$2.1 billion or 3.6%) (RAM Rating Services Bhd, 2020a). However, the structural dimension of *ṣukūk* issuances has changed during the dreaded COVID-19 pandemic.

COVID-19 is a pandemic that was first discovered in December 2019 in Wuhan, China, that went on to affect the whole world. Initially, it was anticipated that COVID-19 was merely a health crisis that would have no economic or financial implications. However, within less than five months of its discovery and the acknowledgment of its spread, worldwide economies and financial activities have come to a standstill. Today, the world is witnessing a situation it never ever anticipated and could prepare for. In light of this, like any other financial instrument, *ṣukūk* has also been significantly affected by this pandemic. As such, this qualitative research aimed to determine the effect of the COVID-19 pandemic on *ṣukūk* markets by specifically identifying its impact on *ṣukūk* yet to mature as well as new *ṣukūk* issuances. The method adopted for this research is a qualitative research method where a number of cases related to *ṣukūk* issuance prior to and during the COVID-19 crisis were analyzed to understand the relevant structure suitable for deficit financing during the pandemic.

This paper is organized in five different sections. Following the Introduction, section two discusses the literature review, focusing on the *modus operandi* of *ṣukūk,* while section three provides details of the impact of COVID-19 on the *ṣukūk* market. Section four offers recommendations for further research, and finally section five concludes the paper.

2. Literature review

Ṣukūk markets have been one of the most sustainable channels of financing in many economies today, with many corporate and government agencies worldwide turning to *ṣukūk* issuances to address their financing needs. The concept of *ṣukūk* was approved by the Council of the Islamic Fiqh Academy of the Organization of Islamic Conference (OIC) in its fourth session held in Jeddah, Kingdom of Saudi Arabia from 18–23 Jumada Al-Thani 1408H (6–11 February, 1988) (IIFM, 2011). The literature addresses the economic influence of COVID-19 during the global economic distress resulting from the pandemic. It also looks at the literature which has targeted the impact of Islamic finance and the general performance of Islamic financial institutions during the COVID-19 pandemic as well as the nature of *ṣukūk* and its *modus operandi* by highlighting the key differences between the *ṣukūk* and conventional bond.

Deficit financing is one of the reasons many Governments across the globe are having the interest in the issuance of *ṣukūk* for many reasons, one such reasons is the *ṣukūk* capability to support budget deficit financing. Salman *et al.* Compares *ṣukūk* and bond absorption i n deficit budge financing in Indonesia, and the research finding was very clear that *ṣukūk* has a very significant and positive effect on deficit financing budget in the country (Parisi and Rusydiana, 2016). *Ṣukūk* was also used to support the Nigeria's budget deficit to strengthen the country's economy. Baita, argued that *Ṣukūk* have been proven to be the alternative to other interest bearing financial instruments, and it is so efficient to effectively finance the budgetary and infrastructural deficit of the Nigeria's development projects (Baita, 2019).

Khanawaz and Rabbani (2020) in their book chapter highlighted that the effect of COVID-19 pandemic on the world economy is even greater than that of the Second World War, and the "Great Depression" of the 1930s, and even the financial crisis of 2008/2009. The COVID-19 pandemic has left a lot of businesses on the brink of collapse. Following this, there is a need to find some alternative ways to bail out the affected businesses in this dire economic situation. The chapter found that the Islamic financial system combined with the financial technology (FinTech) together could be the solution to help these small businesses and individuals impacted by the current pandemic-related economic distress. The study suggested the use of a FinTech model based on Artificial Intelligence of the *Qardh Al-Hasan* (Benevolent loan). The study proposed that *Qardh Al-Hasan* could be the landscape for the social and sustainable finance in fighting the persistent effect of COVID-19 on the Small and Medium Enterprises (SMEs) (Khanawaz and Rabbani, 2020).

In studying the empirical evidence the authors show that *ṣukūk* differs from the conventional bonds from the risk perspective. Some studies have also been done to highlight such reality through empirical study. Nasir and Farooq (2017) conducted a comparative risk analysis of *ṣukūk* and conventional bonds in Pakistan, and indicated that *ṣukūk* faced less risk and offered greater stability as a financial instrument in comparison with the conventional bonds. Risk and stability of *ṣukūk* can be clarified with the diversification theory and the liquidity perspective. They also reported that; "correlation among most of *ṣukūk* securities is less or negative, which helps in diversifying their risk. However, the attribute of stability can be due to the comparatively fewer days of trading in the case of *ṣukūk*."

It is important to highlight that the COVID-19 outbreak was not caused by the bad policies of the financial institutions or the weakness of the financial system; and the impact of the COVID-19 could be representing a temporary shock to the world economy. Therefore, when assigning the weightage on the good, bad and base case scenarios, financial institutions may be advised to evaluate if the economic slowdown may be expected to continue in future years, then, the highly affected industry borrowers could be more heavily weighted on the bad scenario for the longer term (e.g. 2–3 years for the tourism industry). The industrial sector that is expected to recover more rapidly could be more heavily weighted on the bad scenario in the short-term (e.g. a year for hypermarkets). On the other hand, in the long-term the base case scenario may continue to be more heavily weighted with the expectations of an economic recovery (Deloitte Financial Report, 2020).

In another study, Hamzah *et al.* (2018) examined the incentives for risk shifting in debt-based and equity-based contracts according to the critiques of the similarities between *ṣukūk* and bonds; this indicates that "there is a need for greater global awareness of the hazards related to debt, that should be increased as a means of minimizing the quantum debt outstanding globally." They also highlighted that many researchers and financial regulators state that "*ṣukūk* are designed to be a substitute for debt" and due to the global financial crisis, amid the desperate search for approaches to pre-empt future financial shocks, their study seeks to facilitate the creation of future stability by motivating market players to circumvent debt-based activities to promote equity-based instruments.

2.1 The nature of ṣukūk

Ṣukūk is an instrument of the Islamic debt market. However, some perceive it as a hybrid form of security, which has similar features of bonds and stocks (Zolfaghari, 2017). This view is expressed because, unlike in conventional bond, *ṣukūk* uses the Islamic commercial contracts of sale, lease, service or partnership, where the relationship between the *ṣukūk* issuer and the *ṣukūk* holders is derived from these contracts. Furthermore, these underlying contracts also determine the Sharīʿah rules are applicable to the transaction, including the economic activity the party engages in or the underlying asset that is used in the transaction. The most well-known definition used to define *ṣukūk* is the definition of *ṣukūk* by the AAOFI in their Sharīʿah Standard (17) on investment *ṣukūk,* where it is defined as "certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or in the ownership of the assets of particular projects or special investment activities" (AAOFI Standard No. 17, 2017).

2.2 Modus operandi of ṣukūk

The *modus operandi* of *ṣukūk* depends on the underlying Sharīʿah contract(s) used to structure such *ṣukūk*. Unlike conventional bond, *ṣukūk* does not have a uniform structure. Therefore, the *ṣukūk* structuring process becomes more complex than that of the conventional bond and the transaction cost also becomes more expensive than that of the conventional bond as the number of processes and the parties involved in the transaction depends on the *ṣukūk* structure. Due to the Sharīʿah-compliance feature embedded in *ṣukūk*, in all *ṣukūk* structures, the involvement of competent Sharīʿah advisers, whether a person or a firm, depending on the regulatory requirements of the jurisdiction in which the *ṣukūk* is issued, becomes a uniform and integral part of the *ṣukūk* structuring process.

There are two main types of *ṣukūk*; that are asset-based and, asset-backed *ṣukūk*. In asset-based *ṣukūk*, the principal is covered by the capital value of the asset but the returns and repayments to *ṣukūk* holders are not directly financed by these assets while in asset-backed *ṣukūk*, the principal is covered by the capital value of the asset but the returns and repayments to *ṣukūk* holders are directly financed by these assets (Zolfaghari, 2017, p. 8). The main differences between these two types of *ṣukūk* are summarized in Table 1.

To understand the *modus operandi* of *ṣukūk,* four different *ṣukūk* structures are discussed in this part; *ṣukūk* structured using debt contracts, lease contract, partnership contract and service-based contract.

2.2.1 Ṣukūk *structured using debt-based contracts.* Debt-based contracts utilized in Islamic finance are created using sales contracts where the contract obligation is paid on a deferred basis. Looking into the Sharīʿah rules, though it is a sales contract, the deferred obligation to pay becomes a debt liability from the side of the buyer. As a result, even if one installment is unpaid as per agreement made between the seller and buyer, default will be triggered. Likewise, since it is a debt obligation, which is created not by way of a loan, any extra amount charged due to late payment would be tantamount to *riba* (interest) and as such, except as *ta'widh* (compensation) or *gharamah* (penalty over penalty), rules laid down by the Sharīʿah scholars and *fatawas* issued, no extra amount can be charged above and beyond the price agreed at the time of the agreement in these types of Islamic finance contracts. The major debt contracts used in the Islamic finance include *murābahaḥ,* which is a trust sale, where it is mandatory to disclose the cost price plus the profit charged when selling it to the buyer; *tawarruq,* where the buyer first acquires a property from a seller on a deferred basis and then goes to market and sells it on spot and acquires cash to use for any purpose he needs; *salam,* where a forward sale is agreed of some defined homogenous goods (quantity and quality) that would be produced in future and the price for which will be paid on spot, but the goods will be delivered at a fixed future date; *istisna',* where it is used to produce manufactured goods, where the specification of goods to be manufactured is clearly given by the person who orders and the price payment mode and frequency have been agreed by the parties in specific terms.

Categories	Asset-based *ṣukūk*	Asset-backed *ṣukūk*
Source of Payment	Payment is from originator/obligor's cash flows	Payment is from the revenue generated by underlying asset
Presentation/ disclosure of the asset	The asset stays on the balance sheet of originator/obligor	The asset is separated from the originator's book
Types of *ṣukūk* holder's ownership	Beneficial ownership but with no right to dispose of the asset	Legal ownership with the right to dispose-off the asset
Recourse	Purchase undertaking at par from obligor is the ultimate recourse, which is only to obligor and not the asset	*Ṣukūk* holders only have recourse to asset, hence asset plays genuine role in defaults

Source(s): Zolfaghari (2017)

Table 1. The main differences between asset-based and asset-backed *ṣukūk*

In structuring *ṣukūk* using the above stated Sharīʿah contracts, the specific obligations between the parties are derived from the Sharīʿah contracts used. Furthermore, in selling of *ṣukūk* in the secondary market, the type of contract(s) used in *ṣukūk* structuring plays a vital role. Except for *salam* and *istisna'*-based *ṣukūk*, in all the other types of *ṣukūk*, default will occur upon default in the payment obligation as agreed in the contract which is supposed to be made periodically in future. In the case of *salam*, default will occur due to failure of delivery of goods agreed as per the description to the forward buyer and in *istisna'*, default will occur upon either failure of construction of the ordered goods as agreed or within the time frame by the manufacturer or if the person who orders to manufacture the goods fails to make payment as agreed, depending on how it is structured.

Chapter two, paragraph 2.01 of "Guidelines on Issuance of Corporate Bonds and *Ṣukūk* to Retail Investors" of the Securities Commission (SC) Malaysia defines *ṣukūk murābahah* as "certificates of equal value evidencing the certificate holder's undivided ownership of the asset, including the rights to the receivables arising from the underlying contract"; *ṣukūk istisna'* as "certificates of equal value evidencing the certificate holder's undivided ownership of the asset, including the rights to the receivables arising from the underlying contract." In this "Guidelines", it does not provide a definition of *ṣukūk tawarruq* and *ṣukūk salam*. The Sharīʿah Advisory Council (SAC) of Bank Negara Malaysia (BNM) in its 67th meeting held on 3rd May 2007 had resolved that "there is no objection in Sharīʿah for the issuance of *ṣukūk* commodity *murābahah* based on *tawarruq* as long as the sale transactions involve three or more contracting parties and the *modus operandi* of such *ṣukūk* is that *ṣukūk* involves commodity *murābahah* transaction through *tawarruq* contract to create indebtedness between the *ṣukūk* issuer and investors where the debt will be settled by the *ṣukūk* issuer on maturity date (Bank Negara Malaysia, 2010, p. 98). In *ṣukūk salam*, the issuer sells the *salam* asset and the subscribers or *ṣukūk* holders are the buyers of that asset where the price of *salam* is paid on spot by the *ṣukūk* holders and the *ṣukūk* issuer is obliged to deliver the *salam* asset on a future date. Parallel *salam* contracts are executed to ensure that the *salam ṣukūk* holders' benefit.

2.2.2 Ṣukūk *structured using lease-based contract.* Lease-based *ṣukūk* can be structured using the Sharīʿah commercial contract of *ijārah* where a Sharīʿah compliant defined object which is not perishable or gets exhausted when used could be given for a defined lease period for a defined rent. This is a famous contract used to structure *ṣukūk*. Like debt contracts, in *ijārah*, the rent is an obligation that shall be paid by the lessee and non-payment of it as agreed will trigger default. Therefore, these types of contract very much depend on the cash flow of the lessee.

Chapter two, paragraph 2.01 of "Guidelines on Issuance of Corporate Bonds and *Ṣukūk* to Retail Investors" of the SC Malaysia defines *ṣukūk ijarah* as "certificates of equal value evidencing the certificate holder's undivided ownership of the leased asset and/or usufruct and/or services and rights to the rental receivables from the said leased asset and/or usufruct and/or services."

2.2.3 Ṣukūk *structured using partnership-based contract. Ṣukūk* can be structured using two types of Sharīʿah commercial contracts. They are *muḍārabah,* which is a fund management partnership where one party gives funds and the other party manages it to invest in a Sharīʿah-compliant real economic activity where the parties agree to share profit as per a pre-agreed profit-sharing ratio and in case of loss except in case of negligence all financial losses will be borne by the person who invested the money; and *mushārakah* is when both parties agree to do a Sharīʿah-compliant activity on terms they agree, where a profit sharing ratio is agreed and loss depends on capital contribution. In these two types of partnership, or equity-based contracts, the profit cannot be guaranteed in any way. This means that profit generation shall depend on the real economic activity which they conduct and it shall be tied to the return generated from such activity. Therefore, in this type of contract, even if there is no payment due to loss, it does not trigger default. This is an inherent risk that ought to be noted by those participating in such a contract.

Chapter two, paragraph 2.01 of "Guidelines on Issuance of Corporate Bonds and *Ṣukūk* to Retail Investors" of the SC Malaysia defines *ṣukūk muḍārabah* as "certificates of equal value evidencing the certificate holder's undivided ownership in the *muḍārabah* venture" and *ṣukūk mushārakah* as "certificates of equal value evidencing the certificate holder's undivided ownership in the *mushārakah* venture."

2.2.4 Ṣukūk *structured using service-based contract.* *Wakālah* or agency for a fee is a service-based contract approved by Sharīʿah, which is used to structure *ṣukūk*. In a *Wakālah* contract, the principal appoints an agent to perform an act which is Sharīʿah-compliant on behalf of the agent creating a fiduciary duty between them. The breach of fiduciary duty of the agent will trigger default in this case. *Ṣukūk wakālah* for investment (*istithmar*) is a *ṣukūk* structure used in the market.

Chapter two, paragraph 2.01 of "Guidelines on Issuance of Corporate Bonds and *Ṣukūk* to Retail Investors of Securities" of the SC Malaysia defines *ṣukūk wakālah bi al istithmar* as "certificates of equal value evidencing the certificate holder's undivided ownership in the investment assets pursuant to his investment through the investment agent."

2.3 Differences between ṣukūk *and bond*

As evident from the earlier discussion, there are differences between *ṣukūk* and bond even though both are considered as debt instruments with maturity period in capital markets. The fundamental difference between *ṣukūk* and bond is that *ṣukūk* is a Sharīʿah-compliant instrument whereas bond is not. The *modus operandi* of bond is based on a loan relationship with maturity where the bond issuer promises the bond holder that the principal they pay to buy the bond will be returned upon maturity or as agreed with the interest of which from the Sharīʿah perspective is considered *riba*, prohibited in *Sharīʿah*, which is the *lex loci* applicable to all Islamic finance transactions including *ṣukūk*. The main differences between *ṣukūk* and bond are illustrated in Table 2.

	Ṣukūk	Bonds
Ownership	Partial ownership of an asset	Debt obligation
Compliance	The assets that back *ṣukūk* should be compliant with Sharīʿah	Compliance with laws of country/locality they are issued in
Pricing	The face value of a *ṣukūk* is priced according to the value of the assets backing them	Bond pricing is based on credit rating, i.e. the issuer's credit worthiness
Rewards and risks	*Ṣukūk* holder receives a share of profit from the underlying asset. *Ṣukūk* holder accepts a share of any loss incurred	Returns from the bonds correspond to fixed interest (making them *riba*) Their principal is guaranteed to be returned at the bond's maturity sate
Effect of costs	*Ṣukūk* holders are affected by costs related to the underlying assets Hight costs and translate to investor profits and vice versa	Bond holders generally are not affected by costs related to the assets, project, business or joint venture they support. The performance of the underlying asset does not affect investor rewards
Sales	Sale of ownership in the assets backing them	Sale of Debt

Source(s): Bond+*Ṣukūk* Information Exchange (bix) (2019)

Table 2. The differences between *ṣukūk* and bond

3. Impact of COVID-19 on *ṣukūk* market

Hidayat *et al.* (2020) observes that COVID-19 has had an adverse impact on the *ṣukūk* market using returns from five *ṣukūk* and bond indexes between December 2019 and April 2020 as shown in Figure 1, which clearly shows a sharp drop in *ṣukūk* returns in March 2020.

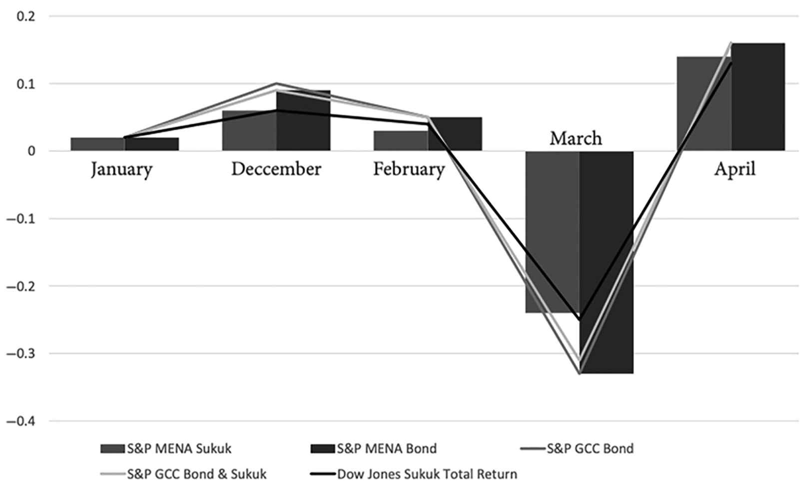
Due to COVID-19, new policies have been implemented by countries as part of fiscal stimulus and monetary policy to buy back the *ṣukūk* issued by the government. In this regard, for example, Sukmana *et al.* (2020) reported: “Now, Bank Indonesia, the central bank, is authorized to purchase sovereign bonds and *ṣukūk* directly in the primary market whereas previously, purchases were only possible in the secondary market to conduct monetary policy” (p. 34).

It is imperative to analyze the *ṣukūk* role in financing financial deficit resulted from the COVID-19 pandemic and to also understand the maximum protection and the rights the existing and potential *ṣukūk* holders might realize.

3.1 Ṣukūk *yet to mature*

Knowing the nature of the *modus operandi* of *ṣukūk*, it is *prima facie* clear that the *ṣukūk* which has been issued and has not yet matured will definitely be adversely affected. The rating of *ṣukūk* will be affected, at the same time there could be a possibility of those *ṣukūk* being defaulted due to poor performance of *ṣukūk* assets. The impact of COVID-19 on different *ṣukūk* will differ according to the type of the *ṣukūk*. The *Sharīʿah* contracts used and the underlying *ṣukūk* asset would be the contributory determinants. It is also said that there is a possibility of experiencing a number of defaults among *ṣukūk* issuers this year, especially for those with weak creditworthiness (Haroon, 2020). For illustration purposes and to explain the practical aspect of this type of *ṣukūk*, some examples of *ṣukūk* which are yet to mature will be analyzed in the following paragraphs.

3.1.1 Ṣukūk muḍārabah *issued by the housing development corporation (HDFC) PLC, Maldives.* There are three *ṣukūk muḍārabah* issued by HDFC Maldives and these three *ṣukūk* have no involvement of a special purpose vehicle (SPV) as illustrated in Figure 1. HDFC Maldives is owned by the government of Maldives (49%), International Finance Corporation



Source(s): Hidayat *et al.* (2020)

Figure 1. *Sukūk* index returns (December 2019–April 2020)

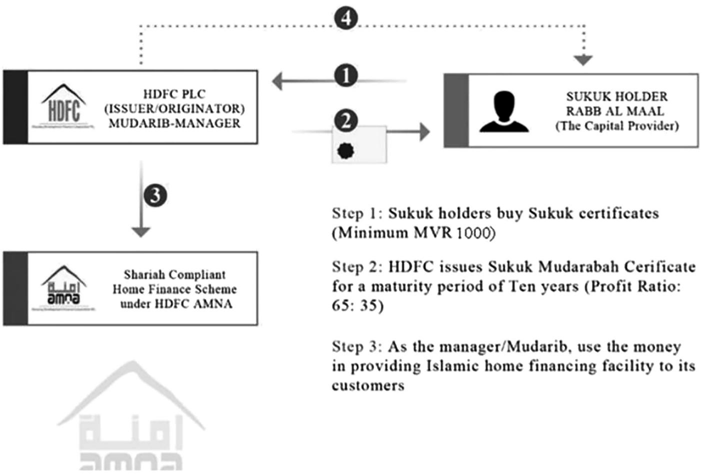
(18%), Asian Development Bank (18%) and HDFC Investments Ltd, India (15%) (HDFC Plc, 2019). Since the government of Maldives has requested to provide a six-month moratorium to customers of financial institutions affected by COVID-19, HDFC Amna, the Islamic window of HDFC via announcement number (IUL)/HDFC/2020/04 dated 26th March 2020 has also provided a moratorium from 1st March 2020 to 31st August 2020 to the customers. To finance the operations of HDFC Amna there are three *ṣukūk* issued by HDFC, which are based on the Shar'iah concept of *muḍārabah*. Figure 2 illustrates the *ṣukūk* structure.

Due to the moratorium, the *ṣukūk* holders will be adversely impacted as the *ṣukūk* holders are supposed to receive the money paid by the customers of HDFC Amna. Since the pandemic in this case can be considered as a *force majeure,* there is no case of negligence, that could be established on the part of *muḍārib* which is HDFC, and then there will be no compensation awarded to the *ṣukūk* holders. Therefore, in this case, the actual loss will be suffered by the *ṣukūk* holders if there is no payment or less periodic payment made to the *ṣukūk* holders, but there will be no default as the nature of this *ṣukūk* is *muḍārabah* that would last for the tenure of the *ṣukūk*.

3.1.1.1 Implications. First, HDFC has issued a *ṣukūk* based on *muḍārabah*, where the *ṣukūk* holders are supposed to be paid from the money received from the payment of HDFC Amna's customers who have obtained financing facilities. However, since the government has requested all financial institutions to give a six-month moratorium on financing facilities given, thus, the *ṣukūk* holders will not be able to get a return during the moratorium period. Therefore, there will be a question on how will the loss for *ṣukūk* holders which is the *rabb al mal* (capital provider) in this case be recovered.

Second, however, since HDFC *ṣukūk* is based on the *muḍārabah* concept, the inability to make the payment due to loss in a quarter, will not be tantamount to a default as the nature of the *muḍārabah* contract is that even loss can be suffered by the *ṣukūk* holders, if the business does not perform well. The actual profit and loss sharing ought to be evident in this type of a contract.

3.1.2 Malaysia airports holdings Berhad's (MAHB or the group) ṣukūk*/IMTN program, Malaysia.* On 30th August 2010, MAHB via its wholly-owned subsidiary, Malaysia Airports Capital Berhad, successfully completed its inaugural first tranche issuance of a 10-year RM



Source(s): HDFC Plc (2019)

Figure 2.
HDFC *muḍārabah* *ṣukūk* structure

1.0 billion Islamic Medium-Term Notes (Islamic MTN) at a yield of 4.55%, pursuant to its Islamic Commercial Paper Program and Islamic MTN Program with a combined aggregate nominal value of up to RM 3.1 billion (collectively known as the "*Ṣukūk*" program) (Malaysia Airports, 2010, p. 26). Since the maturity date of the *ṣukūk* is in August 2020 and due to the adverse effects of the pandemic which have substantially paralyzed the airline industry, it is perceived that there could be a default of the *ṣukūk* Islamic MTN by MAHB as they might face a cash flow issues. On 22nd April 2020, the RAM Rating Services Bhd issued a press release stating that "strong liquidity of MAHB allows it to manage negative impact of Covid-19" (RAM Rating Services Bhd, 2020b) where it is stated that:

> In the interim, MAHB's liquidity position is strong, with about RM2.7 billion of cash and liquid instruments (as of 2nd April 2020) against RM1.3 billion of short-term debts as at end-December 2019 (including RM1 billion of Islamic MTN maturing in August 2020). We understand that MAHB is in advanced stages of refinancing the maturing Islamic MTN through facilities from several financial institutions.

As per MAHB term sheet, the Sharīʿah structure used for Islamic MTN of MASB used is the Sharīʿah *ijārah* and *murābahaḥ* utilizing commodities ("Commodity *murābahaḥ*"). The facility description provided for this issuance is Islamic Commercial Papers ("ICPs") Program ("ICP Program") and an Islamic Medium-Term Notes ("IMTNs") Program ("IMTN Program") where collectively both ICPs and IMTNs are referred to as *ṣukūk*. The *ṣukūk ijārah* is described in Figure 3 while *ṣukūk* commodity *murābahaḥ* involved in this *ṣukūk* is described in Figure 4.

3.1.2.1 Implications. First, since the Islamic MTN program is based on debt and *ijārah*-based Sharīʿah contracts, the return needs to be paid from the cash flow of the issuer and fortunately for MAHB, their liquidity position was not affected by COVID-19 and the *ṣukūk* holders were paid.

Second, the lesson learned in this regard is that in Islamic debt contract *ṣukūk* papers, the payment is to be made by the issuer and as such, the behavior in this case has some similarities with that of a conventional bond.

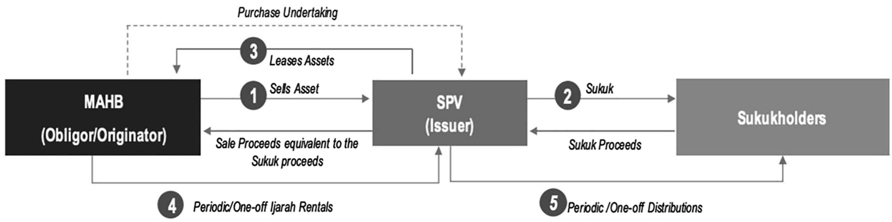
3.1.3 Garuda Indonesia Ṣukūk. Garuda Indonesia issued a five-year tenure US$496.8 million global *ṣukūk* with a return of 5.95% per annum (Mufti, 2020). This *ṣukūk* was to mature on 3rd June 2020. It is reported that Garuda Indonesia is drowning in debt (IFN, 2020) and in May 2020, it was reported that Garuda Indonesia was reaching out to its *ṣukūk* holders to "hold a discussion on repayments due in June as the airline struggles to maintain cash flow amid the turbulence caused by the Covid-19 outbreak" (Mufti, 2020). The *ṣukūk* is based on the concept of *wakālah* where the issuer is Garuda Indonesia Global *Ṣukūk* Limited and the purpose of the issuance was for *Sharīʿah*-compliant general corporate purposes, inclusive of the repayment of certain existing Islamic financing arrangements (COMCEC, 2018). This means that the *ṣukūk* repayment depends on the cash flow of the company. It is imperative to note that this is the first unrated US dollar *ṣukūk* from an Asia Pacific issuer (IFN, 2016). The *ṣukūk* structure is provided in the following Figure 5.

3.1.4.1 Implications. First, due to COVID-19, the transport industry has come to a complete halt and it has hit the airline industry badly. Therefore, any *ṣukūk* issued by any member of the airline industry is affected due to this, as cash flow management has become a daunting challenge.

Second, the *ṣukūk* shows that there is no much difference in case of default between a *ṣukūk* and conventional bond issued based on *wakālah* contract.

3.2 Islamic development band (IsDB) trust certificates ṣukūk

The IsDB's trust certificate was rated AAA and listed by three designated agencies, Moody, Bursa Malaysia and Nasdaq Dubai. A total of 61% of the issue size was allocated to investors



Note(s):

1. A special purpose vehicle, SPV ("issuer") shall be set-up. MAHB and the Issuer (acting on behalf of the *ṣukūk* holders) shall from time to time execute asset purchase agreement(s), under which MAHB shall sell certain leasable Sharīʿah-compliant assets (the Assets), by way of transfer of beneficial ownership, to the issuer for a mutually agreed asset purchase price which shall be at all times comply with the SC's Sharīʿah Advisory Council Pricing Guidelines, pursuant to the trust deed and Asset Declaration of Trust, the SPV shall hold the Assets on trust for the *ṣukūk* holders.

2. The Issuer shall issue the *ṣukūk* holders to evidence the *ṣukūk* holders' proportionate undivided beneficial ownership and/or interest in the Trust Assets (entitling the *ṣukūk* holders to, amongst others, receive the *ijārah* rentals and all other payments in relation to the Trust Assets). The proceed from the *ṣukūk* will be used by the issuer to purchase Assets from MAHB.

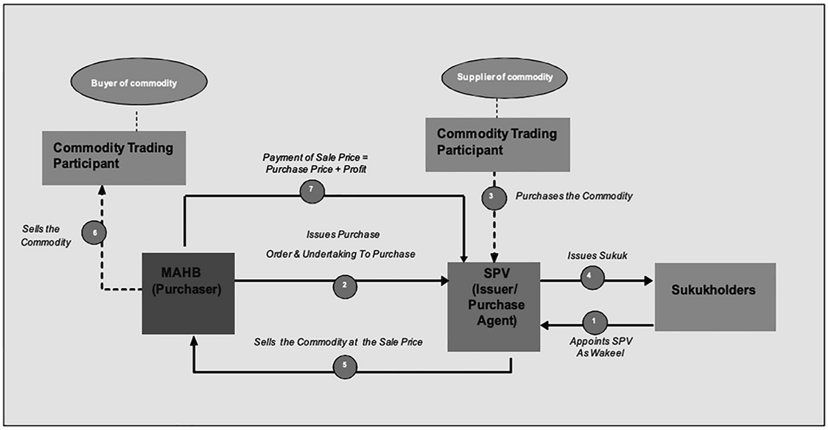
3. The issuer shall lease the Asset to MAHB under an *ijārah* agreement for a specific lease term in return for periodic one-off *ijārah* payments. There shall be purchase undertaking executed by MAHB for the benefit of the issuer (acting on behalf of the *ṣukūk* holder.

4. MAHB shall pay periodic/one-off *ijārah* rentals due to under the *ijārah* Agreement to the Issuer, and
5. The issuer shall make periodic/one-off distributions to *ṣukūk* holders equivalent to the periodic/one-off *ijārah* rentals received from MAHB. On maturity date, Event of Default ("EOD") Dissolution Event or Mandatory Redemption Event, MAHB, as the Obligor, shall purchase the Asset and the issuer shall sell the Assets at the exercise price, pursuant to the purchase undertaking executed by MAHB for the benefit of the issuer (acting on behalf of the *ṣukūk* holders)

Source(s): MAHB Term sheet (2010)

Figure 3.
Ṣukūk Ijārah of MAHB

in MENA (Middle Eastern and North African) countries, 18% to investors in Europe, while Asian investors were allocated 21%. Orderbook was opened with the release of the initial price thoughts on Wednesday, March 07, 2018. The *ṣukūk* was priced on Thursday, March 08, 2018 at Mid Swap (MS) plus 33 basis points (bps), 4 bps below the IDB's September 2017 issuance, which was priced at MS + 37 bps with profit rate of 3.10%; the *ṣukūk* will mature in 2023. Below is the structure overview of the IsDB's Trust Certificate (*ṣukūk*) structure (Figure 6).



Note(s):

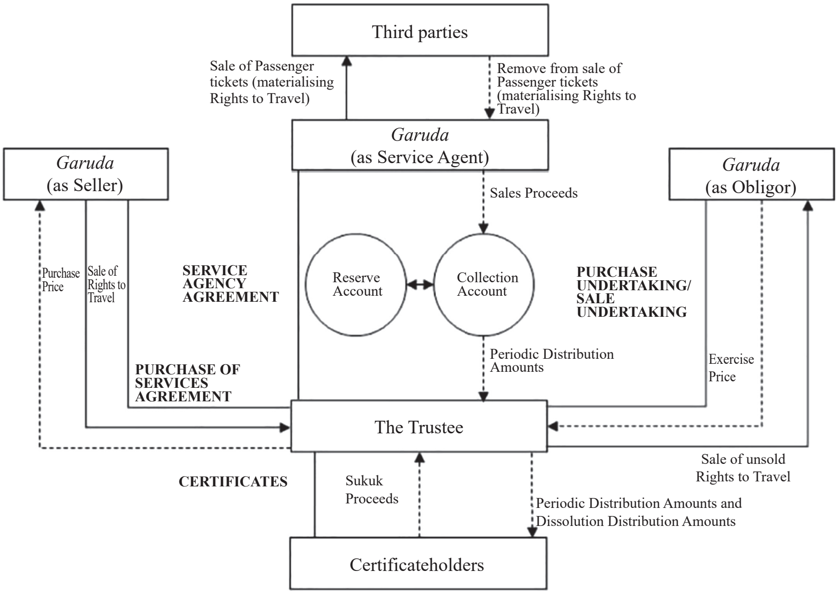
1. Issuer will be appointed as agent (*wakeel*) of the *ṣukūk* holders to buy Sharīʿah-compliant (the Commodity) (in such capacity, the Purchase Agent).
2. MAHB will issue a purchase order (The Purchase order) to the Purchase Agent (acting on behalf of *ṣukūk* holders) at a deferred sale price (the Sale Price)
3. Based on the Purchase Order, the Purchase Agent, on behalf of the *ṣukūk* holders shall purchase, on a spot basis, the commodity from commodity vendor(s) in the Bursa Suq Al-Sila' to the *ṣukūk* proceeds.
4. The Issuer shall then issue the *ṣukūk* to evidence the ṣukūk holders' ownership of the commodity and the rights of the *ṣukūk* holders via the issuer (acting in its capacity as the Purchase agent) under the contract for the purchase of the commodity from the CTP and, upon onward sale of the commodity to MAHB, the Sale Price and the rights of the *ṣukūk* holders via the issuer (acting in its capacity as the Purchase Agent) under the contract for the sale of the commodity to MAHB (the *murābahaḥ* Sale Agreement). The proceeds received from the *ṣukūk* holders shall be used by the issuer to pay the Purchase Price.
5. Pursuant to the undertaking to Purchase, MAHB shall buy the commodity from the Purchase Agent at a sale price (which shall be the Purchase Price plus a profit margin) payable on an instalment payment basis.
6. MAHB shall then sell the commodity to commodity buyer(s) in the Bursa Suq Al-Sila' commodity market (through the CTP) on a spot basis for an amount equal to the purchase price.

On-going cash flows and maturity

7. At maturity, Event of Default/Dissolution Event or Mandatory Redemption Event, MAHB (as part of its obligation to pay the sale price) will pay the Purchase Agent who in turn will pay the *ṣukūk* holders all amounts outstanding on the sale price as final settlement (subject to the redemption rebate where applicable) upon which the *ṣukūk* will be cancelled.

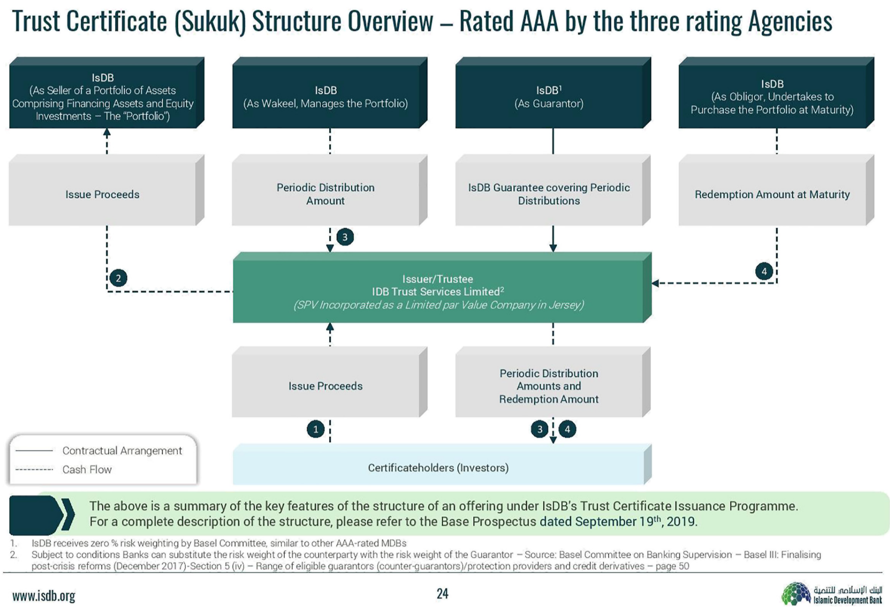
Source(s): MAHB Term sheet (2010)

Figure 4.
Ṣukūk commodity *Murābahaḥ* of MAHB



Source(s): Garuda Indonesia (2015)

Figure 5.
Garuda Indonesia *Ṣukūk* structure



Source(s): IDB Trust Certificates (www.isdb.org)

Figure 6.
IsDB trust certificate (*Ṣukūk*) structure

3.2.1 Implications. First, despite using *wakālah* structure for this *ṣukūk* in particular, the financial stability of the issuer proves the *ṣukūk* as highly rated even during the pandemic. Another tranche of the IsDB trust certificate rated AAA/AAA/AAA by Moody's, S&P and Fitch shows all stable outlooks. The bank has successfully priced a US$1.5 billion, five-year trust certificates (*Ṣukūk*) under its US$25 billion trust certificate issuance program. The *ṣukūk* was priced at par at 2.843%, to be payable on semi-annual basis, marking IsDB's first public issuance in 2019.

Second, the financial stability of IsDB appeared during the COVID-19 pandemic. The rating exercise of the bank which was rated AAA by three renowned rating agencies. Pitch rating agency affirms that the firm's rating indicates IsDB stable and assured support for all the member countries during the pandemic. Assessment by Fitch rating indicates that the AAA rating of the IsDB is an affirmation that the bank will not be affected by the global distress related to the COVID-19 pandemic, likewise the *ṣukūk* issued by the bank.

Third, besides, the 'AAA' rating is an assurance of the bank's general strength, sustainable financial capability and competitiveness. Apart from IsDB current rating by the three renowned international rating agencies; Standard and Poor's Global Ratings, Fitch Ratings and Moody's Ratings, IsDB is further rated by the Malaysia Rating Corporation (MARC). All four international agencies have rated the Bank at 'AAA' with a "stable outlook", recognizing the very strong financial and business profile, underpinned by robust financial and non-financial metrics (Fitch Ratings London, 2020).

3.3 The new ṣukūk *issuances during COVID-19 pandemic*

The pandemic has created turmoil in corporations as well as many governments corporations and governments are struggling to manage their cash flows. Many corporations and government agencies have lain off many of their employees as they could not find an immediate suitable source of funding to deal with the financial crisis caused by the pandemic. In this complex and worrying situation, some have forecasted that; the coronavirus crisis will also provide a window of opportunity for sovereigns to raise funds to finance aid packages, and for corporates to lock in more attractive funding rates while taking stock of their financing maturity profiles; and in such highly uncertain times, investors will seek safer havens by moving into bonds and *ṣukūk*, thereby benefiting some key economies in the *ṣukūk* market (RAM Rating Services Bhd, 2020a, b).

The reality which COVID-19 has forced on the whole world is to find alternative financing mechanisms apart from the financing facilities or loans provided by the banks. The failure of having a debtor-creditor based relationship without linking the return payment to a performance of a real asset or a real economic activity has been evident due to this pandemic proving the risk sharing nature of *ṣukūk*. As such, the corporations and governments may consider going for the *ṣukūk* option more than the conventional bond option.

Furthermore, multilateral financial institutions, such as IsDB is working with governments of different countries to provide financing options including grants and raising funds through *ṣukūk* structuring. As such, there is a possibility that the number of *ṣukūk* issuances by sovereigns might increase exponentially in the upcoming months. The objective of such issuances would be to assist governments to come out of the financial crisis caused by the pandemic by having enough liquidity to pump money into the private sector to ease the lack of liquidity issues they face. This way unemployment rate could go down and the social harmony with economic stimulation could be achieved.

What is predicted from the reactions of the corporations and governments is that there is definitely a need for an alternative source of financing. Since *ṣukūk* has the potential to meet this need and since IsDB is also closely working with different governments towards it; there is a hope that the prospects for *ṣukūk* market are bright. In this regard, the rating agency Moody's anticipates worldwide sovereign long-term *ṣukūk* issuance to grow at a modest rate in 2020, continuing the expansionary trend of the past few years and it is projected that the global long-term gross sovereign *ṣukūk* issuance will attain approximately US$75 billion, from US$71 billion in 2019, which takes into account wider fiscal deficits and a drive-in market development the by major sovereign issuers (Gulf News, 2020).

However, some researchers predicted that there would be a decline in *ṣukūk* issuances in 2020 due to the COVID-19 pandemic. Haroon (2020) observed that as per S&P Global Rating, there would be a 40% slump in global *ṣukūk* issuances volume due to liquidity issues resulting from the pandemic faced by the banks and the complex process involved in *ṣukūk* structuring compared to that of conventional bonds. It was projected that *ṣukūk* issuance will drop to US$100 billion in 2020 from US$162 billion in 2019 (Haroon, 2020).

Despite the forecasts of the *ṣukūk* market slowing down in 2020 as a result of the pandemic, the world has witnessed issuances of some new *ṣukūk* in the middle of the pandemic; one by a company and other two by sovereigns. It was reported that Top Glove of Malaysia, ranked the world's leading glove manufacturer with a 26% global market share has issued a perpetual *ṣukūk* of MYR1.3 billion (approximately US$300 million) based on the concept of *wakālah* in February 2020 from its MYR3.0 billion (approximately US$720 million) via its wholly-owned SPV, TG Excellence Berhad and it is callable on 27 February 2025 with a profit rate of 3.95% and rated AA-(IS) by MARC where the proceeds were utilized to refinance existing obligations and to partly finance their capex requirements (Ghazali, 2020). It is expected that the demand for medical gloves will increase very substantially due to pandemic and this opportunity has been taken advantage of by the company to issue *ṣukūk* to raise financing.

In the middle of COVID-19, the Federal Government of Nigeria (FGN) Road *Ṣukūk* was issued whereby the *ṣukūk* proceeds were used to construct roads mentioned in the prospectus and ownership of the roads was given to the various investors based on amount they have put in the *ṣukūk*. Upon completion of the roads, FGN would pay a levy to the investors twice a year at the rate of 11.2% p.a. and at the end of seven years FGN would buy back the project from the investors at the actual money invested (Jaiz Bank Plc, 2020). This is a *ṣukūk ijārah,* whereby the intended amount to raise was NI 50 billion (approximately US$ 129,350,400) and it is to be due in 2027 (Jaiz Bank Plc, 2020). The opening date for subscription was on 21st May 2020 and as per the offer for subscription, the *ṣukūk* proceeds would be solely utilized to construct rehabilitate key roads across the six geopolitical zones of the country. It is an *ijārah ṣukūk* issued by FGN Roads *Ṣukūk* Company Plc. on behalf of the FGN; and redemption will be made via a bullet payment on the date of maturity while the levy is payable half yearly (Debt Management Office Nigeria, 2020).

Another *ṣukūk* issuance has also been announced by the government of United Arab Emirates (UAE) which raised two billion Dirham via *ṣukūk*. However, this *ṣukūk* was issued purposely to support the Sharīʿah banking system during the pandemic. It was also issued to rescue the economy, with the government using the *ṣukūk* to support its corporates, SMEs, the banking sector and even individuals affected by the pandemic. The *ṣukūk* issued was based on the targeted economic support program initiated by the Central Bank of the UAE, which issued it under liquidity support mechanism which appointed the Sharjah Islamic Bank as the sole arranger for the *ṣukūk*, and the certificates would be paying a profit rate of 1.5% to mature in May, 2021. Furthermore, the Government of UAE has also in March 2020, listed its US$200 million *ṣukūk* on Nasdaq Dubai, a brave step that showcased a broad potentiality of *ṣukūk* markets evolution during the COVID-19 crisis and amidst this unprecedented global financial distress.

It was not a surprise to many stakeholders and researchers when the Moody's investment services issued a projection on March 25, that sovereign *ṣukūk* issuances would reach USD75 billion in the year 2020 despite the COVID-19 pandemic. This projection was actually in the anticipation of a 6% increment compared to USD71 billion of the 2019 market share of the sovereign *ṣukūk* issuances. The projection indicates that the sovereigns will be in need of more funds via *ṣukūk* markets due to oil prices decline and the fall of government revenues due to the COVID-19 pandemic and the economic sanctions involved. Christian de Guzman, the Moody's Senior Vice President indicated that Moody anticipated larger fiscal deficits, greater schedule repayments and local Islamic financial markets could lead to bigger *ṣukūk* issuances in the coming few years. Furthermore, the impact of the pandemic may trigger higher deficits and heavy financing needs for hydrocarbon exporting issuers, this involving the players in South Asia and those in the GCC. Another good opportunity for the *ṣukūk* market is the integration of environmental social and governance interests which indicates the move to project a massive green *ṣukūk* offerings with the *ṣukūk* market players and beyond.

4. Recommendations

This paper suggests that there is definitely an opportunity for the *ṣukūk* market during the COVID-19 financial distress. While the existing *ṣukūk* issued might face some challenges in fulfilling their obligations, this pandemic will create a "new normal" for the *ṣukūk* market to grow. The traditional way of *ṣukūk* issuing might experience some changes to facilitate deficit financing models for many jurisdictions and cooperation and even financial institutions. Below are some recommendations in light of the discussions in this paper.

First, there is a need to incorporate some clauses in *ṣukūk* documentation to allow a *ṣukūk* return payment moratorium clause instead of declaring it to be an outright default if there is an unprecedented pandemic situation like the COVID-19. This could be implemented in specifically *ṣukūk* structures that are structured on debt-based instruments, contracts where non-payment to *ṣukūk* holders may be tantamount to a default situation. The experience of Garuda Indonesia *ṣukūk* in this pandemic shows that *ṣukūk* holders' meeting needs to be conducted using modern technology since physical meetings are almost impossible or inadvisable to be held. Instead of sending notices to *ṣukūk* holders as done in this case, it is best to have a *ṣukūk* holders' virtual meeting to sort out the issue of postponing payment.

Second, when a default does occur, the *ṣukūk* moratorium clause shall also be Sharīʿah-compliant and it should be arranged according to the Sharīʿah contracts used to structure the *ṣukūk*. In the *ṣukūk* structuring process, using equity-based *ṣukūk* shall be favored rather than debt-based arrangements. This is because the risk-sharing nature of equity-based contracts considers the circumstances and the situation the *ṣukūk* holders are in that is tied to the performance of the underlying *ṣukūk* assets. Therefore, facing any unprecedented situation will not immediately trigger default.

Third, *ijārah ṣukūk* could also be a favorable option in the *ṣukūk* market during the pandemic, especially when it is used by sovereign governments, since most governments can be seen as issuers with strong liquidity capabilities to pay the *ijārah* during the pandemic, as in the case of the Federal Government of Nigeria's Road *Ṣukūk*. However, the similar *ijārah ṣukūk* option might not be favorable in other countries such as Malaysia, especially in road financing, where the *ijārah* receivables are actually paid via toll-gates receivables which is technically stopped during the pandemic and because of the imposed movements control and travels restrictions laws during the pandemic.

Fourth, *wakālah ṣukūk* could also be favorable during the pandemic situation, as the *wakeel* has the right to invest the funds generated in various businesses which could be channeled to the food industry and health care industry as they offer higher profitability potential than many other industries badly affected by the pandemic.

5. Conclusion

There is no doubt that every crisis has a way out and offers possible opportunities. As such, COVID-19 has also created a "new normal" for *ṣukūk* markets. The market players need to embrace this new normal to strengthen the *ṣukūk* market capabilities in financing deficit in this time of crisis. The lessons taught by the pandemic need to be understood and one should know that such situation should be seen as merely a hiccup to the existing *ṣukūk* issued in the market. There is also an opportunity for the *ṣukūk* market to grow new structures that are relevant to any difficult situation. This is especially true for *ṣukūk* structured on debt-based contracts where non-payment of a fixed amount may be tantamount to a default. It is understood from this research that non-performance of all types of *ṣukūk* would not automatically trigger default in all types of *ṣukūk*. It is only the *ṣukūk* which is based purely on debt contracts that is most likely to face this issue. This simply indicates that having a non-debt-based structure to issue *ṣukūk* reflects the true risk-sharing nature of Islamic finance and COVID-19 has provided an opportunity to truly take the advantage of integrating such contracts in the *ṣukūk* structure. It is anticipated in future *ṣukūk* structuring processes that the issuer may consider using equity-based contracts for the betterment of the *ṣukūk* market, and there will be practical differences between the new *ṣukūk* issued and the conventional bonds in this respect. It is anticipated that during this pandemic, the stakeholders in the *ṣukūk* market would have learned beneficial lessons and now understand that many opportunities can be created to adapt to and exploit unprecedented situations and the opportunities are truly reflected in the *ṣukūk* market today and will be more visible in future *ṣukūk* issuances especially in the year 2021 and beyond.

Further research in the *ṣukūk* and COVID-19 should evaluate the *ṣukūk* market trend as well as subscriptions and secondary market responses to the current financial distress caused by the pandemic crisis. It is obvious that the pandemic has caused a lot of economic difficulties to many individuals and corporations, hence investing in *ṣukūk* could be a favorable or not favorable to investors, this should be further explored.

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