ISLAMIC SECURITIES AND BONDS (SUKUK) FOR INFRASTRUCTURAL DEVELOPMENT IN NIGERIA: A COMPARATIVE STUDY OF LEGAL AND INSTITUTIONAL FRAMEWORKS

By

Ali Abdulkadir Waziri Ph.D* and Halima Doma Ph.D**

ABSTRACT

Many emerging economies like Nigeria urgently require huge investment in infrastructure for increased capital expenditure. Developing countries generally have difficulty in raising financial infrastructure, yet short falls in infrastructure development reduce the quality of life for citizens and inhibit productive capacity of economies. Economic growth, quality of life and support services essential to the need of citizens depend on robust infrastructure, industrial growth, and infrastructure to produce goods at competitive prices. The fact that infrastructure projects typically have a large scale upfront capital requirement, a long initial period without returns, and extended payback period calls for innovative financial models. Thus, conventional bonds and Sukuk, attempt to mobilise the funds from surplus spending units to shortage spending units. However, under Islamic Law, there are fundamental risk/return differences between them- money (debt) is the underlying asset in conventional bonds while the underlying asset in Sukuk is the exact asset. This paper concludes that Sukuk provides for greater return and financial security than conventional bonds. Although, the CBN Act and BOFIA regulate both the conventional and Islamic finance. Therefore, the paper recommends that much has to be done for legislation in Sukuk within the Nigerian Islamic finance industry in order to compete in the global industry.

Keywords: Infrastructure, Conventional Bonds, *Sukuk*, Islamic Finance and Shariah

* Lecturer, Nasarawa State University, Keffi. He can be contacted on **08036908109; and aliabdulkadir160@ymail.com**

** Lecturer, Nasarawa State University, Keffi. She can be contacted at **halimsi@yahoo.com**

1. INTRODUCTION

Islamic finance has witnessed extraordinary growth over the past few years. At the same time, African states have embarked on gargantuan projects which have resulted in creating deficits in infrastructure. In order to address the infrastructure needs in African countries including Nigeria, about USD 93 billion is required for investment annually until 2020. Taking into account the resources currently available to African governments, an infrastructure gap of USD 31 billion a year thus exist which much be bridged if the continents infrastructure needs are to be met. New avenue of financing should be explored by government to meet the need. Investment provides an important opportunities to deepen and broaden the sources of funds required and Sukuk is an alternative for raising capital in financing public infrastructure projects. The Sukuk issuance was part of a funding diversification strategy. This expansion has been, in part, fuelled by the issuance of Sukuk, which are often referred to as Islamic Bonds[1] or Islamic securities.

The emergence of Sukuk is one of the most significant developments in Islamic capital markets in recent years, Sukuk are financial products which terms and structures comply with Shariah, with the intention of creating returns similar to those of conventional fixed-income instruments. Unlike conventional bonds (secured or unsecured), which represent the debt obligation of the issuer, Sukuk technically represents an interest in an underlying funding arrangement structured according to Shariah, entitling the holder to a proportionate share of the returns generated by such arrangement and, at a defined future date, the return of the capital.[2] The way Sukuk are structured make it comparable to conventional bonds, but there exist many differences. The differences exist due to Sukuk not being typical debt instruments and having the asset directly attached to them. The objectives of the paper are:

- To find out whether the application of bonds under conventional finance and Sukuk under Islamic finance regulations are the same and achieve the same purpose of infrastructural development.
- To examine the two regimes with a view of establishing smooth infrastructural development in Nigeria.

[1] Ibechukwu, C and Fondufe, C., 'Islamic Finance Sector Features' <*https://www.ly.com/thoughtleadershipmeeting-africa's-infrastracture-need*> accessed 7 December 2017.

[2] Arunma Oteh, 'Capital Market as a Long Term option for Financing Infrastructure Development' (Being a paper delivered at CBN Conference , held in Sheraton Hotel Towers Abuja, on 6th December 2010); see also Al-Noor B., 'Islamic Finance in Africa in its Infancy: Important Initiatives Underway', *Islamic Finance News Special Report* (9 September 2013).

2. RESEARCH METHODOLOGY

The research employed doctrinal method in order to depict the differences and similarities between bonds and Sukuk in terms of their structure and risk and to decipher if there exist any differences in their regulations. Thus, the research made use of textbooks, journals, internet materials, and statutory law in developing the paper. The work in achieving its objectives explores the following:

(a) Conceptual analysis of bonds and Sukuk.
(b) Examine the nature of floating of bonds and Sukuk structures for infrastructure development.
(c) Ascertain the legal frame work issuance of Sukuk structure in Nigeria.
(d) Comparative analysis of bonds and Sukuk.
(e) Proper suggestions for challenges of infrastructure development through Sukuk.

3. DEVELOPMENT OF SUKUK MARKET

Sukuk is a relatively infant financial instrument, designed to be a Shariah compliant alternative to conventional bonds. However, much debate has been raised on the nature of the instrument, particularly in cases of default[3]. Sukuk shares characteristics with bonds and stock which are issued to finance trade or the production of tangible assets. Similar to a bonds, Sukuk has a maturity date and in some of them the holder will receive a regular income over the period and a final payment at the maturity date. While the conventional bonds price is determined only by the creditworthiness of the issuer, Sukuk price is determined by the creditworthiness of the issuer and the value of the asset[4].

Benefits of Sukuk include being a tradable capital market product providing medium to long-term fixed or variable rates of return. It is assessed and rated by international rating agencies, which investors use as a guideline to assess risk/return parameters of a Sukuk issue. It has regular periodic income streams during the investment period with easy and efficient settlement and a possibility of capital appreciation.

The Persian Gulf Corporation (GCC) Countries and South East Asia (SEA) countries are the main players in the global Sukuk market. Among the GCC countries UAE, Saudi Arabia,

[3] Sukuk: Equity or Bonds? < http://www.idealratings.com/Sukuk-equity-or-bonds.html> *accessed 5 February 2018.*

[4] *IIFM Newsletter* (March 2017) Issue 1, p.7.

Bahrain, Qatar, Kuwait are important countries in issuing Sukuk. Meanwhile the Malaysia is playing a main role in the region of SEA. Others like Malaysia, Indonesia, and Singapore are also contributing to the global Sukuk market in the region. Today it has transcended to other regions and countries as well; such as Pakistan and Japan from other parts of Asia, while USA, UK, Germany, Turkey, Egypt, and Gambia from other regions are also contributing to the market. According to International Islamic Financial Market (IIOFM) report in 2016, a positive development in Sukuk market is the appeal of Sukuk as an alternative source of financing from new jurisdictions ranging from Europe, Asia, CIS and Africa and emerging sign of possible direct entry from North America[5]. In 2000, the total size of the Sukuk was only US$1,172 million with no sovereign Sukuk in the market. According to IIFM report, in the subsequent 16 years, the total size of Sukuk has crossed US$68,742 million.

4. CONCEPTUAL DEFINITIONS

i. Bond

A bond is a loan in form of debt security. The authorized issuer (Borrower) loans the bonds holder (Lender) a debt obligation to pay the principal and interest at maturity of the loan.[6]

Bonds are further defined as:

> Long-term debt instruments that are issued by corporations and government. Bonds generate two cash flows for investors: a) face value which is a fixed amount of funds that bonds issuer is obligated to pay to bonds holders when the bonds matured; b) Coupon (interest) which is a fixed amount of funds that bonds issuer is obligated to pay to the bonds holders periodically (annually and/or semi-annually) until the bonds is matured. These cash flows are independent of the amount of profit or loss that bonds issuer has earned from utilizing the funds that was raised through issuing bonds.[7]

Bonds enables the issuer to finance long term investment with external loans. The aim of bonds trading is usually to make capital gains from the raising price of the fixed interest bonds when variable market interest rate fall. The major risk for holders of conventional bonds is of

[5] 'A Comprehensive Study of the Global Sukuk Market', *IIFM Sukuk Report* (5th Edition).

[6] Ofemum E., 'Exploring Bonds & Sukuk for Infrastructure Development' (Being a paper presented on NIQS Workshop Abuja, in July 2017), Offshore Capital and Asset Investment PLC<*www.offshorecapitallc.com*> accessed 6 August 2017.

[7] Shaukat M., (2009) 'Human Structure on Sukuk' <http//www.ifir.com/article2444719> accessed 21 June 2017.

payment default, but this risk is usually assessed solely based on credit rating by the rating agencies rather than the buyers and purchases estimating the actual risk involved.[8]

There are two different types of bonds. General Obligation Bonds are backed by the full faith credit and taxing power of the issuing authority usually Government Agency such as state. It is used for projects that benefit the public, mainly infrastructure, the other type is Revenue Bonds which are issued for specific project and are payable from revenue generated by the project. This is hardly explored in Nigeria as issuing houses has little faith on stable income streams from projects. It however remains part of the solution to viable projects finance. The second type being Revenue Bonds, are Industrial Revenue issued by Government Agencies with the bonds proceeds loaned to local industries to finance various schemes. Others are economic development bonds, public housing bonds, agricultural bonds, toll road revenue bonds and specific tax bonds etc.

ii. Sukuk (Islamic Securities)

Sukuk 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.[9]

Sukuk (plural of sakk) are referred to as 'Islamic bonds.' The Arabic translation of the word Sakk, 'Islamic Investment Certificate'. Under Sukuk structure, the Sukuk holders (investors) hold an individual beneficial ownership in the "Sukuk assets'.[10]

The Rules and Regulations of the Securities and Exchange Commission define Sukuk as:

> Investment certificates or notes of equal value which evidences undivided interest/ownership of tangible assets, usufructs and services or investment in the assets of particular project or special investment using Shariah principles and concept and approved by the SEC[11].

The requirements under Shariah for Sukuk is very strict; it must fulfil the following obligations: firstly, the certificate must represent ownership in tangible assets, usufructs or services from

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[8] Jobs A., 'The Economic of Islamic Finance and Securitization', *Journal of Structural Finance* [2007] (13) (1).
[9] AAOIFI (2008) 'Statement of Sukuk and its Implications' <aaoifi.com>accessed 22 February 2019.
[10] *Ibid*.
[11] Rule 569, Securities and Exchange Commission Rules and Regulations,2013<www.sec.gov.ng > accessed 22 August 2018.

revenue-generating firms. Secondly, payments to the investor come from after-tax profits and third, the value repaid at maturity date should follow the current market price of the underlying asset and not the original investment amount.

Sukuk is also referred to as tradable capital market product providing medium to long-term fixed or variable rates of return. It is assessed and rated by international rating agencies, which investors use as a guideline to assess risk/return parameters of a Sukuk issue. It has regular periodic income streams during the investment period with easy and efficient settlement, and a possibility of capital appreciation of the Sukuk. Finally Sukuk are liquid instruments and tradable in secondary market.[12]

Asset based and asset backed Sukuk: There are two types of Sukuk, asset based and asset backed. Under the asset based Sukuk, the Sukuk holders have beneficial ownership is the asset. The Sukuk holders have recourse to the originator if there is a shortfall in payments. The beneficial ownership is a legal term where specific property rights, such as its use and title belongs to a person even though legal title of the property belongs to another person. A common example of beneficial owner is the funds held by a nominee bank or for stocks held in the name of brokerage firm. Under asset backed Sukuk, the Sukuk holders owned the asset and a result do not have recourse to the asset but to the originator if a shortfall in payment.[13]

iii. Infrastructure

Infrastructure is referred to as:

> Economic physical assets to support private business development. Under this definition, infrastructure consists of economic infrastructure, which comprises roads, bridge, tunnels, airports, transit, ports, railways, energy production facilities and distribution networks, telecommunication systems, water and sewage systems, and waste management.[14]

Another broad definition of infrastructure is:

> A wide array of physical assets required to support both private economic activity and social services. According to this definition, infrastructure does not only contain economic infrastructure but also encompasses social infrastructure that is essential for a society to

[12] Shawanrah C., 'The Legal Frame Work of Islamic Finance', in *Contemporary Islamic Finance, Innovation, Application and the Best Practice* (John Wiley and Sons Publishers, London, 2013) 44-47.
[13] Igbal and Mirakfor, 'Recent Developments in Conventional Finance: Financial Globalisation', in *Globalisation and Islamic Finance* (John Wiley and Sons (Asia), 2010) 94.
[14] (n 2) .

function. Social infrastructure includes schools, universities, hospitals, courts, prisons, parks and recreational facilities, libraries, community housing, public safety building and facilities, city halls and facilities.[15]

iv. Securitisation

Cotter defined securitisation as, 'a method of raising funds and creating liquidity through the sale of tradable securities that represent an asset or an interest in the asset'.[16]

Securitisation in Islamic finance relies on the transfer of title (securities backed by asset) to facilitate access to financing and it is thus passing of ownership instead of borrowing money (i.e. title finance) that makes securitisation a viable financial structure more especially in Islamic Law. Securitisation of receivables is the most common type of securitisation. It ensures continuous flow of income to cover the periodic payments on the securitise assets and usually entered the purchasing of a leased assets, a mortgated property, unsecured commercial loans or credit card payment system which are the securitised.

5. FLOATING CONVENTIONAL BONDS INFRASTRUCTURE

The infrastructure project starts with the floating of a Special Purpose Corporation/Vehicle popularly called SPV with Corporate Affairs Commission. Upon the registration of the SPV, the following project contract will be put in place:

Agreement of Shareholders or Sponsors Agent: This is usually an Agreement between sponsors spelling out their shares representation in management decision making process, etc[17]. Contract is reached between the SPV and the Engineering Procurement and Construction (EPC) Contractor spelling out the designs, construction, commissioning etc. The contract documents and form of contract is contained in this Agreement. Project Loan Agreement Usually signed with the investment banking Group approached to raise the bonds. The size of the loan, the security for the credit, remedies in event of default, sponsors remedy in full recourse/limited recourse are spelt out.[18]

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[15] Suleiman Bichi, 'Alternative Modes of Infrastructure Financing: A Review of Issues and Challenges' (Being a paper presented at a workshop on *Finance and Development of Capital Projects- Emerging Solutions*, held in West Town Hotel, Lagos, on 5th-6th July 2017).

[16] Cotter A., *Banking and Corporate Financial Law* (Canvendish Publishing Australia, 2003) 51.

[17] Balala M., *Islamic Finance and Law: Theory and Practice in Globalized World* (I.B Tauris Co. Ltd., London, 2011) 94.

[18] Zolfaghari, P., *An Introduction to Islamic Securities (Sukuk)* (Being a Working Paper, Uppsala University, Iran, 2017) 8.

Operations and Management Contract: This is an Agreement between the SPV and Post Construction Manager of the project who must have a track record in similar transactions. It is a key requirement in trapping the project receivables for bonds principal and interest redemption. The operations and management contract will establish the role of the management contractor, the maintenance obligations, and bonus payments to them.[19]

Capital Market and Infrastructure Development: The Nigerian capital market is being positioned to play more significant role in the area of infrastructural development. The purpose of financial market is to bring together investors seeking to provide funds and economic actors seeking to use them matching them in ways that maximize the benefit to both and achieve broader economic and public growth in primary market. While trading in secondary market for example in companies, the term of the bonds is fixed. But investor who buy and issue can sell the bonds which are marketable security, in the market if they need rapid access to money. Standardised documents issued with high level of transparency and regulation will contribute to an effective and efficient bonds market in which the participant will have confidence with high standard.

To effectively raise and mobilize funds for infrastructural development through fixed income securities, some basic conditions have to be satisfied[20]. They include: (i) Existence of contractual savings institutions to create a pool of long-term investible funds; (ii) Stable macroeconomic environment; (iii) Establishment of credit rating agencies and development of rating culture by issuers. The development of rating culture cloud be fostered by the market demanding rating of fixed income instruments. (iv) Strong issuer base. (v)Development of a reference bonds and yield curve for appropriate pricing of other fixed income instruments. (vi) Efficient trading and settlement infrastructure. (vii) Good legal regulatory and institutional framework. (viii) Market liquidity (ix) Low trading cost (x)Tax policies which encourage issuance and participation in bonds. (xi) Fixed income pricing capacity by intermediaries.

[19] *Ibid.*
[20] (n 2).

6. SUKUK FLOATING FOR INFRASTRUCTURAL DEVELOPMENT

The fundamentals of having a stable source of income stream remain the same as with conventional bonds. However, Sukuk bond is a method of finance based on the principles of Islamic law (Shariah), thus, conventional bonds are not allowed in Shariah compliant transactions due to the interest charge which is prohibited in Islamic law.

Shariah Compliant Structure

Islamic finance operates on structures that must be free of the following:

(a) The payment or acceptance of interest (Riba) for a loan is absolutely forbidden. The word "Riba" means excess or addition and implies excess compensation without due consideration.[21] Under Islamic law, money is not an asset; it is merely a medium of exchange and a measuring unit of value. An individual or an institution should not be able to generate income from money. This self generation of money from money is "Riba", is absolutely prohibited in Islam. Accordingly, the trading/selling of debts or receivables (without the underlying asset) for anything other than its par is not permissible.[22]

(b) Trading under excessive uncertainty or where the outcome is unknown (Gharar) in financial transactions must be forbidden. The Shariah defines Gharar as a situation whose consequences are hidden or are unknown. Some scholars have defined Gharar as a "Zero sum game with unequal payoffs". Accordingly, Undertaking transactions with insufficient knowledge of the market or product and thereby incurring an excessive risk is forbidden.[23]

(c) Financial transactions in Islamic law must not involve selling and distribution of pork, alcoholic beverages, illicit drugs, gambling, pornography and weapons as they are all clearly forbidden.[24]

(d) Islamic law distinguishes between the time value of money as a measure of investment efficiency and means of determining yield. Therefore, yield is either based on profit or loss sharing in the enterprise or negotiated price for sale or lease transactions, in other

[21] Zaharaddin Abdulrahman, *Contracts and the Products of Islamic Banking* (CERT Publications Sdn Bhd, Kuala Lumpur Malaysia , 2010) 37.
[22] (n 17) ; See also Quran 2:275-279, Quran 4:161, and Quran 3:130.
[23] (n 21) 72; See also Quran 5:90-91.
[24] Obaidullah M., *Islamic Financial Services* (IERC King Abdulaziz University, Jedda Saudi Arabia, 2005) 103-109; See also Quran 17:34-35; 4:58; 16:91; and 7:31-72.

words, a return of capital is justified only when the capital has taken the form of real (non-monetary) assets.[25]

Financial Structure of Sukuk

Sukuk can be issued under different structures to accommodate the dynamics of different transactions. Some of these include:

(a)***Salam*** (prepayment, deferred delivery): The buyer pays the seller the full negotiated price of a product that the seller promises to deliver at a future date.[26]

(b)***Ijarah*** (Lease, lease purchase): A party leases a particular product for a specific sum and a specific time period. In the case of a lease purchase, each payment includes a portion that goes towards the final purchase and transfer of ownership of the product.[27]

(c)***Mudarabah*** (Trustee finance contract): An investment which represents the ownership of units of equal value in the equity of the *Mudarabah*. The provider of capital supplies the funds needed to finance a project while the entrepreneur offers labour and expertise. Profits are shared between them at a certain fixed ratio whereas financial losses are exclusively borne by the capital owner. The liability of the entrepreneur is limited only to his time and effort.[28]

(d)***Musharaka*** (Equity participation): An investment that represents ownership of partnership equity. The bank enters into an equity partnership agreement (joint venture) with one or more partners to jointly finance an investment project. Profits are distributed according to predetermined ratios, and losses are shared strictly in relation to the respective capital contributions.[29]

(e)***Murabahah*** (Mark-up financing): A widely-used sale transaction between customers and banks. The buyer approaches the bank to acquire goods. In turn, the bank purchases them from a third party (a supplier) and then resells them to the borrower at an agreed mark-up for immediate or deferred payment. The seller informs the buyer of the cost of acquiring the specified product and the profit margin is negotiated between them. The total cost is usually paid in instalments.[30]

(f) ***Takaful*** (Insurance): This provides Mutual protection of assets and property and offers joint risk sharing in the event of a loss by one of the participants. In the case of loss to any one group, the loss is met from the collected funds.[31]

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[25] (n 22) 99.
[26] ISRA , *Islamic Financial System Principles and Operations* (ISRA, Kuala Lumpur Malaysia 2012) 20.
[27] *Ibid* 232; See also (n 21) 142.
[28] (n 21) 169; See also (n 24) 57.
[29] *Ibid* 197.
[30] (n 24*)* 68
[31] (n 21) 207.

(g)***Wakalah*** (Agency): One party (either the bank or client) acts as an agent to the other party to undertake transactions on his behalf. For example, the bank invests funds on behalf of a client or bank appoints the client as an agent to buy the needed merchandise in a *Murabahah* Transaction.[32]

Accordingly, the Nigerian Securities and Exchange Commission (SEC) recognizes the following structure Sukuk *Ijarah*-lease contract, Sukuk *musharakah* – sharing contract, Sukuk *Istishnah* – exchange contract and Sukuk *Murabahah* – financing contract[33].

7. LEGAL FRAMEWORK FOR ISSUANCE OF SUKUK

There is a legal structure in place that regulates the issuance of Sukuk in Nigeria; this includes: the Investments and Securities Act (ISA) 2007, the Securities and Exchange Commission Rules and Regulations, 2013[34], and the state law authorizing the Sukuk issuance.

Any public company (including special purpose vehicles), state government, local government, and government agency is eligible to issue, offer or make an invitation for Sukuk with the approval of the SEC[35]. However, any issuance of Sukuk must comply with the same registration requirements in the SEC Rules and Regulations that are applicable to other conventional securities issued or offered for sale in Nigeria. If the issuer is a public company and the Sukuk is capable of being converted or exchanged into equity with the intention of being listed, the issuer must also comply with the listing requirements of the relevant securities exchange in Nigeria.

The Shariah principles that must be observed for all Sukuk are the same general principles that underline other Islamic finance structures. Accordingly, in relation to the assets that will support a Sukuk, such assets must comply with the requirements of Shariah (which, for example, prohibits dealings or business involving alcohol, pork or pornography), and must be established and certain. In terms of the consideration to be paid by an issuer to acquire the underlying assets from the originator, the Sukuk Rules go on to specify that the purchase price must not exceed 1.51 times the market value of the assets.

Issuers must appoint a Shariah adviser that is registered and recognized by the SEC. The Shariah adviser will be responsible for (i) advising on all aspects of the Sukuk issuance (including documentation and structuring); (ii) issuing a Shariah certification that outlines the

[32] (n 24)113.
[33] Rule 571, SEC Rules 2013.
[34] The Commission in recognition of the development of Islamic finance introduced new rules on February 8, 2013 to regulate the issuance of Sukuk in Nigeria.
[35] Rule 572, SEC Rules 2013.

basis and rationale of the structure and the Shariah principles used, and; (iii) ensuring that all aspects relating to the Sukuk issuance comply with Shariah principles[36].

Therefore, in this regard, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has introduced a governance standard on Shariah supervision[37]. The standard, in paragraph 2, describes a Shariah board as:

> .. an independent body of specialised jurists in fiqh al-mua'malat (Islamic commercial jurisprudence). However, the Sharia supervisory board may include a member other than those specialised in fiqh almua'malat, but who should be an expert in the field of Islamic financial Institutions and with knowledge of fiqh al-mu'amalat. The Sharia supervisory board is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Islamic Sharia Rules and Principles. The fatawa, and rulings of the Sharia supervisory board shall be binding on the Islamic financial institution.

The fact that the AAOIFI has a separate governance standard for Shariah supervision of Islamic financial institutions underscores the obvious importance of Shariah in the sphere of Islamic finance.

The Islamic Financial Services Board (IFSB) has an exposure draft, which, among other things, deals with Shariah compliance. The guiding principle in this regard, is that Islamic financial institutions should "have in place an appropriate mechanism for obtaining Shariah rulings, application of fatawa and monitoring of Shariah compliance in all aspects of their products, operations and activities". The exposure draft recognizes that there will always be diversity in the interpretation of the Shariah and opinions therefore will vary among scholars. This diversity reflects the inherent beauty of the Shariah, which has universal relevance both from a geographic perspective and from a historical perspective. It is this diversity coupled with flexibility in the application of the Shariah that has led to the exponential growth of Islamic finance. It must be stated, however, that diversity and flexibility are subject to stringent rules and require a thorough understanding of the Shariah[38].

[36] Rule 574, SEC Rules 2013.
[37] Governance Standard for Islamic Financial Institutions No.1, Shariah Supervisory Board: Appointment, Composition and Report.
[38] Governance Standard for Islamic Financial Institutions No.2, Shariah Supervisory Board: Appointment, Composition and Report.

Regulating the process of Shariah interpretation is not, for the reasons mentioned above, desirable. However, the Shariah review process should be regulated to ensure that certain minimum standards are adhered to. In the current Islamic finance landscape, both Islamic finance as well as non-Islamic institutions offer services related to Islamic finance. Most Islamic institutions presumably have rules and regulations in relation to Shariah review in place in line with AAOIFI standards and the proposals by the IFSB.

The SEC recognizes, as a Shariah adviser, any Islamic development bank, a bank licensed by the CBN to operate as a non-interest bank, or a fund manager licensed by the SEC to manage a Shariah compliant fund.

From the wordings of the rules, Sukuk issued by private companies appear not to fall within the regulatory purview of the SEC[39]. In a similar vein, a strict interpretation of some rules[40] suggests that the bonds issued by private companies will not be regulated by SEC.[41] As specifically mentioned, only bonds issued by public companies, foreign public companies and transnational bodies will be regulated. However, the SEC will exercise its supervisory powers over any instrument issued to the public by private or public companies.

For example, the Osun State Government through a wholly owned special purpose company, Osun Sukuk Company Plc issued on the 8th of October, 2013 the first Sukuk in sub-Saharan Africa worth N11.4 billion ($70.6 million) under the Osun State N60 Billion Debt Issuance Programme to fund the development of 20 High Schools, 2 Middle Schools and 2 Elementary Schools in Osun State. Certain delays were faced during the course of the transaction particularly whilst awaiting the SEC's approval of the Sukuk Rules.

Similarly, the Federal Government of Nigeria issued Ijarah Sukuk on 14th September, 2017 pursuant to a local loan[42] worth N100 billion which amounts to 16.47% to be due in 2024, under Federal Government of Nigeria Road Sukuk Company Plc, to fund the construction of 12 federal roads in six geopolitical zones in the country.

8. COMPARISON BETWEEN SUKUK AND BONDS

The similarities and differences between bonds and Sukuk may be considered as their liquidity in secondary market, their credit being rated by rating agencies and variety in their design and

[39] Rule 572, SEC Rules 2013.
[40] Rule 567, SEC Rules 2013.
[41] *Ibid.*
[42] Registered Stock and Securities Act, CAP L17, LFN 2004.

supply. However Sukuk differs from common bonds of finance markets in structure and risk aspect as follows:-

a) *Asset-based or asset-backed*: Sukuk can be asset-based or asset-backed. Asset-backed Sukuk are such where a true sale has taken place and the SPV controls the underlying asset; whereas an asset-based Sukuk is a securitization of the assets which is closer in form to conventional bonds. Conventional bonds do not have any underlying assets and are rather debt instruments whereby investors will get a coupon (interest) payment and at maturity the face value. This can be compared to the rental and proceeds received from the sale of the underlying asset in a Sukuk.[43] The rental that a Sukuk holder receives is based on the profit or loss that the obligator makes from the use of the asset. This is different from bondss where the return or interest is predetermined[44].

b) *Defaults:* In the event that the issuer of conventional bonds defaults on a payment the bonds holders can bring a lawsuit against it and collect as much as possible. This differs in the case of a Sukuk where the underlying asset can be sold and the proceeds from the sale will be distributed amongst the certificate holders. Bonds and Sukuk are different in structure. Conventional bonds have money as the underlying asset and in the case of Sukuk a tangible asset. This difference is for religious purpose, but it makes virtually no financial difference. However, even though bonds have cash as the underlying asset, the payments can be made from any source of income and if there is default, the bonds holders are able to seize any assets of the company; whereas in the case of Sukuk, the only asset the Sukuk holder has rights to is the underlying asset.[45]

c) *Effect on stock market:* Although Sukuk and conventional bonds are the same financially, they have different effects on stock markets. It is found that in the Malaysian stock market, a Sukuk announcement leads to a negative market reaction that adversely affects the firm's value. The same reaction was observed in Indonesia, Singapore, Pakistan, UAE, Bahrain and Qatar. Turk Ariss and Weill; and Alam, Hassan and Haque discuss reasons for this negative reaction, and establish that mainly financially unhealthy companies issue Sukuk as opposed to conventional bonds. This can be attributed to profit sharing being more beneficial to a low profit while set interest payments are more beneficial to high profits.[46]

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[43] (n 26) 401; See also (n 17) 32.

[44] *Ibid*.

[45] (n 17) 50.

[46] Godlewski C., *et al.,* 'Sukuk v. Conventional Bonds: A stock Market Perspectives', *Journal of Comparative Economics* (2013) 41.

The comparison process between conventional bonds and Sukuk will not be completed unless we examine the risk element as well. The risk that Sukuk encounter varies according to their structure as follows:

d) *Legal risks:* The risk that there is a conflict between the provisions of Shariah with the regulations of the country in which the Sukuk were initiated. As far as Sukuk is concerned, the major risk is the violation of the six standards set by the AAIOFI in 2008. One of the credit rating agencies has recommended that Shariah scholars should take into account both a *priori* and *posteriori* compliance process carefully in order to avoid invalidation of the Sukuk over its life time. Therefore the overall risk results from the violation of Shariah provisions in the Sukuk case.[47]

e) Liquidity and Risk: It is opined that Sukuk in a portfolio significantly reduces value at risk of the portfolio. It was found that Sukuk reduces value at risk in portfolios of bonds in Malaysian, Pakistan, Qatar and Bahrain respectively. Cakir and Raei warn that the gains of diversification by including Sukuk in the bonds need to be evaluated against the lower return and liquidity risk of Sukuk. The secondary market for Sukuk is found to have a lack of activity and this can show that Sukuk are illiquid. The illiquidity can pose a risk on the portfolio in times of volatility, as investors may not be able to buy or sell any Sukuk in the secondary market. This low volatility may be a false sense as Sukuk are only priced in a similar fashion to property, where pricing only happens once a year, but the price could have changed many times within the period. Hence, a potentially false sense of low volatility could be observed.[48]

f) *Business/financial risk:* There is a situation whereby the bonds issuer will default on interest and/or face value or both. In the conventional bonds, bonds holders have no choice but to recourse to the issuer for unpaid amount.[49]

This often is done by a lawsuit against the bonds issuer and it is not clear how much of the unpaid cash flow can be collected and for how long. In the Sukuk case, the Sukuk holders have recourse to the asset, not to a bankrupted individual. As a result, more comfort is offered to the Sukuk holders than bonds holders. Connected with this, there is a problem of call risk that a bonds holder is obligated to sell the outstanding bonds back to the bonds issuer. The conventional bonds are usually subject to this risk when a big market interest rate occurs. This creates a big problem for bonds holders since they will be deprived from the higher original

[47] El-Gamal M., *Islamic Finance, Law, Economics and Practice* (Cambridge University Press UK, 2006) 26.

[48] Hawary Graise and Igbal , *Regulating Islamic Finance Institutions: The Nature of Regulated* (Being a World Bank Research Paper, 2008) 23-48.

[49] (n 17) 29; See also (n 8)18.

interest rate. This type of risk is only applicable to conventional bonds, as Sukuk are not susceptive to the fluctuation in market interest rates.[50]

g) *Foreign exchange risk*: risk arises when there is a substantial change in exchange rate among different currencies. This risk is the same for both conventional bonds and Sukuk. However, Sukuk which are liquid or which are relatively short term in nature will be less exposed. Another issue is price risk, in that the value of an asset at maturity date in Sukuk al Ijara is different from the market price due to fast depreciation, over use of the asset, and/or damage. This risk is applied only to Sukuk.[51]

9. CONCLUSION

This paper finds that the two bonds (conventional and Sukuk) can successfully solve the same common financial problem; raising capital for infrastructural development to needed entities, whether corporations or government. However, there are various solutions to the same financial problem. The conventional bonds are structured on the basis of debt, while Sukuk are equity based instruments. There are some advantages of Sukuk issuance for corporate or sovereign market; which include potential marketing benefit for issuers acting in Islamic market, should they seek investment in those markets. Since the investor base represented by Islamic compliant investors is still largely untapped, there is potential cross over into other financial markets such as broaden ethical investment market, that may provide a reputational benefit. The use of Sukuk along with conventional bonds creates a business opportunity for bonds issuers. Nevertheless, one can foresee that the Sukuk issuance provides a far greater return and financial security than the convention bonds. Bonds issuers may also enjoy from a broader market place for their bonds products. Sukuk issuance is available to all financial institutions and investors regardless of their religious background, beliefs, and faith.

[50] (n 17) 50.
[51] Tariqullah K., *Legal And Regulatory Issues in Issuing Sukuk in Muslims-Minority Countries: Lessons From Developing Countries Experience*< http://www.sukuk.com/articles/sukuk/taxation-legal-structure>accessed 21 February 2018.

Recommendations

1. There is the need to legislate on Sukuk as the current law (Securities and Investment Act) regulates the conventional regime.
2. There is the need for capacity building of stakeholders on securitization through SEC reforms in order to reposition the market through issuance of Sukuk to compete in the global market.
3. The Nigerian Securities and Exchange Commission needs to adopt NAICOM Rules of Islamic Insurance (takaful) companies in issuance of Sukuk.
4. Tax waivers signed by government requires some specific regulations, such as tax-related regulations in terms of securities, so that, these securities could be transacted at lower cost.
5. There should be awareness for State Governments and corporate organizations to take advantage of issuance of Sukuk through Nigerian capital market to facilitate more infrastructural projects in the country.

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