



The Application of Legal and Beneficial Ownership in *Sukuk* Structure in Malaysia and Nigeria

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Abstract: *Sukuk* is a financial instrument in the Islamic capital market and it has been expanding to all international financial markets in both Muslim and non-Muslim nations. Various government and corporate entities have demanded and supplied *Sukuk* in the international market making *Sukuk* as a new alternative for global investors. Notwithstanding this expansion, *Sukuk* is facing some challenges in terms of application of legal ownership and beneficial ownership in *Sukuk* structures. The objective of the study is to explore the application of legal ownership and beneficial ownership in *Sukuk* structures. The study employs both primary and secondary sources of data. The interview technique as the primary data source for this study was gathered from Malaysian and Nigerian Shariah scholars, and interview data were thematically analysed using Nvivo 10. Malaysia and Nigeria were chosen as both countries are operating on the same legal system (common law). The secondary data sources for this study were conducted through relevant materials. Results indicated that the characterization of ownership into beneficial and legal arise in *Sukuk* structure in a country that applies the concept of common law. It is possible to separate legal ownership from beneficial ownership in these countries. The study demonstrated that the application of English law into *Sukuk* structures is based on the common law system that does not contradict the Shariah principles. However, the main issue is that the investors cannot gain benefits without taking liability. The findings further revealed that one of the factors that prevent investors from obtaining the legal title of *Sukuk* asset is the legal system and government policy of the country where *Sukuk* was issued. The result of this study will assist investors, issuers, and governments in dealing with the application of legal and beneficial ownership of *Sukuk* structures. Finally, the study recommended that during the tenure of *Sukuk* projects the investors should obtain underlying assets to prevent the issue of non-Shariah compliance.


Keywords: Legal and beneficial ownership, common and civil law, possession, legal system, *Sukuk* structure.

JEL Classification: G10, G28, G32, F65, K15

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Introduction

Globally, the Islamic Capital Market (ICM), particularly *Sukuk*, is gaining popularity due to its availability as an option to mobilize funds for long-term savings and investments from numerous investors. As at the end of the first quarter of 2020, the outstanding universal *Sukuk* has amounted to USD 1.42 trillion (IIFM, 2021), and this indicates the significant improvement of the modern *Sukuk* market. *Sukuk* (صكوك) is an Arabic word and its plural form is *sakk* (صك) which is 'legal instrument/check deed'. As an Arabic name for an Islamic financial certificate, *Sukuk* is used as an alternative financial instrument to conventional bonds, which has increasingly gained popularity in recent years (Onagun, 2016; Soylemez, 2016; Hasan et al., 2019). *Sukuk* is often alluded to as Islamic bonds which people commonly misconstrue the concept of *Sukuk* as bonds. Many forms of the *Sukuk* introduced in the market are categorized as Islamic bonds rather than *Sukuk* (Uddin et al., 2020). Even though *Sukuk* are considered as important products of Islamic finance (COMCEC, 2017; IFSB, 2018), *Sukuk* is confronted with challenges at the early stage of development. Many *Sukuk* offered in the market are still debatable among the authorities of the Islamic law which denote a negative propensity on the growth of *Sukuk* (Benaicha et al., 2019; Razak et al., 2019).

The most prominent challenge is the strong criticisms by some Islamic scholars on the level of *Sukuk* compliance with Islamic law regarding the structural formation of *Sukuk* (Hosen, 2016; Safian, 2017). Specifically, many questions have been raised on Shariah compliance with *Sukuk* mechanisms such as legal and beneficial ownership in the application of *Sukuk* structures. These challenging issues remain unresolved among Shariah scholars and industry players resulting in negative effects on the growth of *Sukuk* (Benaicha et al., 2019; Hasan et al., 2019). Citing from inconsistent interpretations of Islamic law and jurisprudence, many Shariah scholars argued that almost three-quarters of *Sukuk* worldwide do not comply with the principles of Shariah (Lee, 2016).

One of the major issues confronting *Sukuk* in which this study aims at investigating is the application of legal and beneficial ownership of underlying assets of the *Sukuk* structure. According to Shariah, the ownership of assets must be held by the *Sukuk* holders. This may be due to the increase or decrease in asset value to real estate price fluctuations which do not exist in almost all of the *Sukuk* structures in the market (Abdul Razak & Saupi, 2017). However, AAOIFI (2018) established that Special Purpose Vehicle (SPV) or originator of asset-based *Sukuk* mostly fails to transfer ownership of the asset to *Sukuk* holders. This failure is caused by the transfer of ownership which makes it impossible for the investors

to disregard the underlying asset to the third party when the originator defaults (Ghani, 2018; Radzi & Muhamed, 2019).

Benaicha, et al. (2019) and Tasniaa, et al. (2017) claimed that the inability to hold legal ownership by the *Sukuk* holders has restricted them from disposing assets of *Sukuk* during the tenure of *Sukuk* upon originator default. Mostly, in the practices, it is demonstrated that beneficial ownership of an asset-based *Sukuk* is not equivalent to complete ownership from the Islamic perspective. The ownership from Shariah perspective grants owners of the property the right to dispose of what they own. This is called complete ownership whereby owners have the privilege to dispose of and utilise their properties. As an unresolved issue among Shariah scholars, these deviations from Shariah have raised critical questions of how beneficial ownership will follow the stipulation of Shariah law of contract? Several studies have examined the issues of legal and beneficial ownership in the *Sukuk* structure. However, there is limited and inadequate literature that examines this issue in developed and developing countries since both countries are based on common law system jurisdiction. Therefore, this study proposes to investigate the application of legal ownership and beneficial ownership in the *Sukuk* structure in Malaysia and Nigeria based on the view of Shariah scholars. To the best knowledge of the authors, there are scarce or limited studies that attempt to explore the application of legal ownership and beneficial ownership in the *Sukuk* structure based on the view of Shariah scholars. This study enhances a novel feature to the literature in contributing to previous literature on investigating scholars' views on the application of legal ownership and beneficial ownership in *Sukuk* structures. Additionally, some of the obstacles for the *Sukuk* investors to obtain the legal ownership of the underlying asset of *Sukuk* are highlighted, especially in common law jurisdictions. These could also contribute towards progressing the overview image of Islamic finance products, particularly *Sukuk* structures and issuance in these jurisdictions. Likewise, it allows proper application of Shariah principles and rules through improving Shariah compliance quality essential for the Islamic finance and stakeholders.

Methodology

Related literature to the application of legal and beneficial ownership in the *Sukuk* structure is gained from the library search. The study is based on a qualitative method approach employing both primary and secondary sources of information. The primary source of information is the interview with the experts gaining their perspectives. These experts are those who incorporate Shariah scholars,

academicians, and practitioners of Islamic financial institutions both in Malaysia and Nigeria. The respondents were considered appropriate because of their experiences and participation in the topic under investigation. An in-depth interview approach in collecting information as suggested by Rosenthal (2016) helps to gain access to processes; structures and can eventually lead to the discovery of unexpected phenomena. While the secondary source of information employed by the study consists of reputable published articles, textbooks, policy documents, and others. The researcher conducted in-depth interviews with 12 participants. The interview protocol is attached in the appendix section. In accordance with the data analysis procedure as recommended by Kegler et al. (2019), to preserve confidentiality and anonymity, it is important not to mention the real names of interviewees. Instead, pseudonyms such as respondent SSM¹ 1, SSM 2, SSN² 1 and SSN 2 were formulated as indicated in Table 1.1 below.

Table 1.1

Background Information of the Interviewees

S/N	Respondents Code	Organization	Position	Country
1	Informant SSM 1	ISRA ³	<i>Shariah</i> scholar	Malaysia
2	Informant SSM 2	ISRA	<i>Shariah</i> scholar	Malaysia
3	Informant SSM 3	ISRA	<i>Shariah</i> scholar	Malaysia
4	Informant SSM 4	ISRA	<i>Shariah</i> scholar	Malaysia
5	Informant SSM 5	UUM ⁴	<i>Shariah</i> scholar	Malaysia
6	Informant SSM 6	ISRA	<i>Shariah</i> scholar	Malaysia
7	Informant SSM 7	ISRA	<i>Shariah</i> scholar	Malaysia
8	Informant SSN 1	University of Ilorin	<i>Shariah</i> scholar	Nigeria
9	Informant SSN 2	University of Gombe	<i>Shariah</i> scholar	Nigeria
10	Informant SSN 3	IIUM ⁵	<i>Shariah</i> scholar	Nigeria
11	Informant SSN 4	IIUM	<i>Shariah</i> scholar	Nigeria
12	Informant SSN 5	IILM ⁶	<i>Shariah</i> scholar/Practitioner	Nigeria

Source: Formulated from the data of the study.

- 1 *Shariah* Scholar Malaysia (SSM).
- 2 *Shariah* Scholar Nigeria (SSN).
- 3 International *Shariah* Research Academy (ISRA).
- 4 University Utara Malaysia (UUM).
- 5 International Islamic University Malaysia (IIUM).
- 6 International Islamic Liquidity Management (IILM).

Legal and Beneficial Ownership

Among the controversial issues in the *Sukuk* structure is the issue of ownership of the underlying assets of *Sukuk*. *Sukuk* represents its *Sukuk* holder ownership over certain assets and a controversial issue arises among Shariah scholars whether the *Sukuk* holder owns the underlying asset of *Sukuk* as required by Shariah. Thus, the study intends to clarify understanding of the legal and beneficial ownership concept based on the legal perspective before determining the perspective of Shariah on legal and beneficial ownership. Friedman et al. (2018) affirmed that legal ownership is recognized as an individual right to control and possess something. For instance, if someone purchases a vehicle or house in full payment, he/she is entitled to alter and use it however he/she wishes to (within legal boundaries). Similarly, the legal owner is the one known by the law as the owner of something, particularly who holds the legal title of the property for the other benefit (Nwapi et al., 2021).

On the other hand, Graziadei (2017) mentioned the beneficial ownership can be traced back to the history of the trust law in the 12th and 13th centuries, which appeared from the principle of equity. This term was employed as opposed to the term “legal ownership”. Additionally, other terms are commonly utilized to indicate the same meaning, such as beneficial title, equitable title, beneficial interest, and equitable ownership. Likewise, mostly the term “beneficial ownership” is applied in matters pertaining to the land. Investopedia (2020) describes beneficial ownership as:

“A beneficial owner is a person who enjoys the benefits of ownership even though title to some form of property is in another name. It also means any individual or group of individuals who, either directly or indirectly, has the power to vote or influence the transaction decisions regarding a specific security, such as shares in a company” (Para. 1).

Similarly, in Malaysia Securities Industry Act 1991 defined “Beneficial Owner in relation to Deposited Securities, means the ultimate owner of the Deposited Securities who is the person who is entitled to all rights, benefits, powers, and privileges and is subject to all liabilities, duties and obligations in respect of, or arising from, the Deposited Securities, and does not include a nominee of any description” (Sime Darby Property, 2018, p. 22). Beneficial ownership/possession is a legal term where particular asset rights belong to an individual even though the legal title of that asset belongs to another person (Dahlan et al., 2017). This frequently relates where the legitimate title owner has indicated trustee obligations to the beneficial owner. It is obvious that the beneficial owner is the genuine owner of the asset and has all ownership ascribes, except for the title. When the property

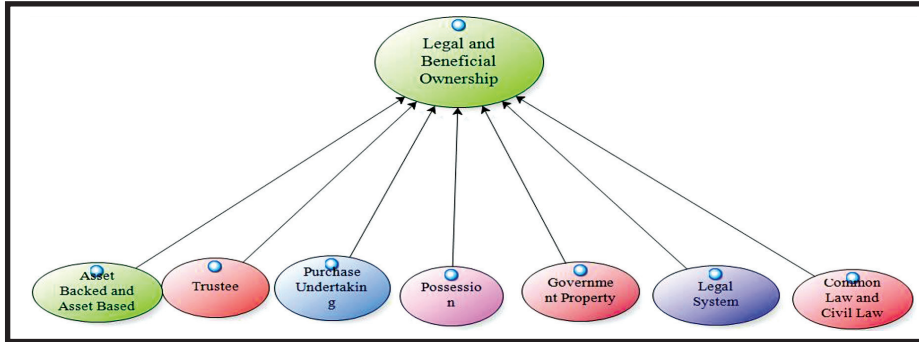
is liable to the trust, a difference must be drawn between beneficial ownership and legal ownership. Legal ownership is the opposite to the beneficial owner which holds the legal title of the property for another benefit as a trustee. The beneficial ownership has all the privileges, rights, and benefits to enjoy and use the property or asset although the legal owner is under another personal name.

From Shariah perspective, Al-Zuhayli (2003) in Abdul Razak & Saupi (2017) defined ownership as “an exclusive association of the owned item with its owner, which gives the owner the right to deal with what he owns in any way that is not legally forbidden” (p.149). Meanwhile, Alaro (2017) noted that there are two types of ownership in Shariah, namely (1) complete ownership and (2) incomplete ownership. Complete ownership provides the unlimited rights for the owner to discard legally owned assets and the enjoyment of that asset rights should not be restricted to any time frame. Henceforth, this kind of ownership gives the owner all legal rights to deal with the owned property and it is unlimited if the property keeps on existing. Additionally, the ownership right of the property cannot be eliminated. The incomplete ownership alludes to the ownership of property but not of its usufruct or property. In such a manner, the owner is unable to enjoy the full benefits or rights of the asset.

Furthermore, Ghani et al., (2021) proclaimed that in legal title, there is no obligation based on the Shariah point of view that every contract in Islam involves a transfer of ownership from the seller to the buyer. This view has received consensual agreement by the majority of Islamic scholars of all schools of thought as expressed by Al-Nawawi (2002). Ndumbaro (2018) described ownership as “a right indefinite in point of the user, unrestricted in point of disposition and unlimited in point of duration” (P. 140). Thus, various factors constitute the issues of legal and beneficial ownership in *Sukuk* structure among Shariah scholars derived from the interview with the experts. Figure 1 below illustrates the underlying factors behind the issues of beneficial ownership in *Sukuk* structure and some of the factors that prevent *Sukuk* investors to gain beneficial ownership instead of legal ownership of an underlying asset. These factors comprise common law and civil law, asset-backed and asset-based, government property, trustee, possession, legal system, and purchase undertaking.

Figure 1

Factors Constituting the Issues of Legal and Beneficial Ownership in Sukuk Structures



Common-Law and Civil law

The introduction of English law characterization of ownership into beneficial and legal has posed a challenge for Shariah scholars and practitioners of Islamic finance in *Sukuk* structures, especially in the area of underlying asset transfer as a condition for the legitimacy of certain products of ICM. For instance, in sovereign *Sukuk*, the underlying asset of *Sukuk* may be such that the legal system of the country where *Sukuk* are issued forbids the transfer of the asset to the foreign investors. The issuer authority may have an interest in international investors to invest in their *Sukuk* market. Usually what is being transferred to the *Sukuk* investors through *Sukuk* structures is the beneficial ownership of the underlying asset and not the legal ownership. This is particularly in the case of asset-based *Sukuk* structure (Tasniah, *et al.*, 2017). The issues of legal and beneficial ownership are issues of common and civil law in the country that practices Islamic finance, particularly *Sukuk* products. In common law jurisdiction, the law recognizes only beneficial ownership to be transferred to the investors of *Sukuk* while the legal ownership is still held by the issuer. Contrarily, the civil law jurisdiction does not have a separate ownership concept (Zolfaghari, 2017).

Similarly, this assertion was supported by informant SSN 1 whereby he attached the issue of legal and beneficial ownership originated from the common law system. He clarified that:

The concept of legal and beneficial ownership does not originate from Shariah. It came from the common law practice in England which was later introduced into Islamic finance particularly in the application of Sukuk. Let us forget about legal or beneficial ownership and go back to the concept of ownership in Shariah itself. Shariah does not know anything called legal differently from beneficial ownership. This concept is under the common law, but it should not be necessarily imposed on Shariah practice, hence, Shariah has a different concept of ownership. According to Shariah complete ownership (الملكية التامة) qualifies an investor in Sukuk to earn dividends or profit as an owner. We do not need to bother ourselves about the concept of legal and beneficial ownership in the common law, this is the concept from common law which is in line with the law of trust (SSN 1).

In addition, another informant agreed with SSN1 who emphasized that “Shariah does not differentiate between beneficial and legal ownership. From the Shariah perspective, ownership is ownership. If the contract (عقد) fulfils the conditions, then ownership is considered transferred from one party to another party. Also, this concept does not apply to all countries, especially in civil law jurisdiction. On that account, beneficial ownership is mostly recognized under common law jurisdiction” (SSM 7). This view was similarly established by an informant that:

The legal and beneficial ownership terminology is based on common law. Common law differentiates legal from beneficial ownership. Legal ownership is someone whose property is registered under his/her name for the benefit of the real owner. While beneficial ownership refers to someone who benefits from the property. For example, in a Unit Trust, the investors are registered under the manager of Unit Trust, while the real owner is the investors’ manager who holds the asset as a trust on behalf of the investors. The property does not register under investors names but under managers’ names on behalf of investors. Therefore, from a common-law perspective, beneficial ownership is stronger than legal ownership (Info. SSM 3).

The informant SSN 3 supported the view that Malaysia and Nigeria will not differentiate legal from beneficial ownership that “Common law is the UK and all the colonized countries. The legal and beneficial ownership for Sukuk in Malaysia and Nigeria will not be different from a legal perspective because both are common law countries and there is no controversy concerning this from the legal perspective” (SSN 3). To validate this, SSM1 similarly supported those efforts to address the issue of legal and beneficial in Sukuk structure by stating:

The issue of legal and beneficial ownership arises in the Sukuk structure in a country that uses common law. For instance, Malaysia and Nigeria operate a common law system. But, in French or Middle East countries with civil law jurisdiction, there is no issue of legal and beneficial ownership. According to common law, the beneficial owner is the real owner of an asset. Such a beneficial owner is the person with all the rights associated with such property and the privilege to dispose of the asset. While legal ownership is just like a trustee of the property registered under his name on behalf of the real owner (SSM 1).

More so, in the civil law jurisdiction, there is only one ownership which includes all ownership rights. Civil law permits joint ownership; the separation of ownership is not allowed in this jurisdiction (Ploeger et al., 2005). The idea of trust is recognized under common law which is not part of civil law (Adawiah et al., 2015). Furthermore, an informant supported that the issue of legal and beneficial ownership is the issues of the legal requirement, not Shariah issues by stating that:

In terms of legal and beneficial ownership, this is a legal requirement under common law. Take this as an example in Malaysia, if Mr. A has a piece of land and Mr. B like to buy it, Mr. B pays Mr. A then Mr. A gives everything that has to do with this asset to Mr. B. So, this is a valid sale and there is another requirement for Mr. B to claim that a piece of land. In terms of beneficial ownership, Mr. B is the beneficial owner of the land. So, from a Shariah perspective, there is no section requiring Mr. A to transfer the legal title. Thus, from Shariah perspective, when the contract is concluded, and the buyer has full التصرف (right to dispose of) on the asset the buyer can transfer the land to another party hence he is the legal owner. It is a legal requirement it is not Shariah matter (SSM 4).

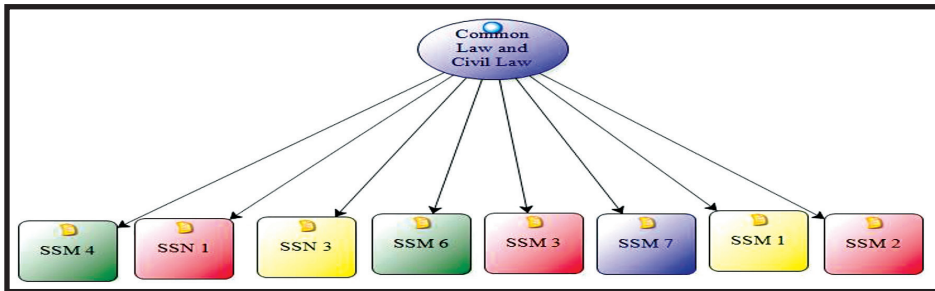
In addition, another informant claimed that the issues of legal and beneficial ownership in the *Sukuk* structure are not Shariah issues, but purely a legal issue. It claims that: “the issue of legal and beneficial ownership is purely legal because how the asset is going to be registered, be it under investors or trustees name is not a Shariah issue. The main issue is that the investors cannot take benefits without taking liability, but since *Sukuk* holders are the beneficial owners, they must take liability. There is no violation of any fundamental principle of Shariah it is allowed to have beneficial ownership” (SSM 6). Similarly, legal ownership and beneficial ownership of *Sukuk* structure is not an issue of Shariah as corroborated by an informant that:

Legal ownership is the legal title of the asset whose name is written on the asset while beneficial ownership is who is benefiting from the asset, but the legal title is registered under the SPV and all the benefits generated from the asset goes to the investors. In the Sukuk structure, the real owner is an investor why SPV is holding the ownership on behalf of investors (SSM 2).

Another informant posited that “The issue of the legal and beneficial owners is a common law issue, but when brought into Shariah it takes a different dimension. It is very important to look at the *Sukuk* structure to know if the *Sukuk* holders take responsibility for damages in addition to benefiting from the profit” (SSN 3). Thus, it is arguable from the discussion that the issues of legal and beneficial ownership in the *Sukuk* structure are not Shariah issues. It is a legal issue that is generated from the common law. Based on this information, the beneficial owner does not violate any Shariah requirement of contracts. The major concern about Shariah is that someone cannot take benefits without taking liabilities or responsibilities of the asset or property. Figure 2 below illustrates the responses rate of the interviewees regarding the issue of legal and beneficial ownership in the *Sukuk* structure based on the common law system.

Figure 2

Common Law and Civil Law



Asset-Backed and Asset-based

Hosen (2016) categorized *Sukuk* into asset-backed and asset-based structures. In the asset-based *Sukuk*, the underlying asset of the *Sukuk* structure remains on the originator’s balance sheet after the issuance of *Sukuk*. The ownership of the asset remains in the originator balance sheet and only beneficial ownership of the asset is passed to investors. Ahmed et al. (2019) and Hosen (2016) highlighted that the *Sukuk* holder does not have ownership of the underlying asset as there is no true sale in asset-based. Similarly, the legal right of the asset does not belong

to the investors which prevent them to have recourse to an asset other than the originator. While asset-backed structure legal ownership belongs to the investors and there is no obstacle for the investors to have recourse to the underlying asset.

To examine Shariah rulings on beneficial ownership of asset-based and asset-backed *Sukuk* structure, various researchers have discussed the issues from legal and Shariah perspectives. Ahmed et al. (2019) has affirmed that asset-backed *Sukuk* structure is in line with the Shariah principle of contract. In the event of default *Sukuk* holders being legal owners of the asset can recover their capital while asset-based *Sukuk* structure does not focus on the asset risk, rather than the credit value of the issuer. By citing Shariah view on asset-based and asset-backed structures, informant SSN 1 stressed that:

The asset-based Sukuk are not Shariah-compliant because the ownership of the asset is not transferred to the investors. The complete ownership that is required which will qualify an investor as an owner to earn dividends and to render investors liable in an event of a loss and this is different in the case of asset-based structure (SSN 1).

Tasnias, et al. (2017) observed that in asset-based *Sukuk*, investors had no interest in the underlying asset of *Sukuk* which indicates that asset-based structure is not a Shariah-compliant contract. Equally, Hosen (2016) highlighted from a Shariah perspective, there is no true sale of the asset in asset-based *Sukuk* because the investor does not have the absolute right to the asset. Furthermore, another informant has substantiated the argument by stating that:

The asset-based Sukuk are not Shariah-compliant hence it looks like a trick. This is the reason why a repurchase undertaking is brought into the scene. Thereby allowing the investors to benefit from the asset hence the complete ownership of the asset is not transferred to the investors. The investors do not have complete ownership which contradicts the spirit of Islam in terms of owning what one bought. The asset-based Sukuk are structured in a way that legal ownership is not transferred to the investors which are not allowed and is against Shariah provision (SSN 2).

In contrast to the above argument, Zolfaghari (2017) affirmed that asset-based *Sukuk* structure does not violate Shariah principles of the contract when contemplating asset-based from the perspective of common law in case of beneficial ownership. This is correspondingly supported by informant SSN 3 that:

What happens in asset-based is that the ownership of the asset does not belong to the Sukuk holders but the issuer. If Sukuk holders have the right associated with the asset, there is no issue hence the investors do not need the asset but only the profit or returns from the asset. There is no problem if the Sukuk holders do not have legal ownership according to common law, but in Shariah, the transaction is complete hence Shariah does not consider legal or beneficial ownership (SSN 3).

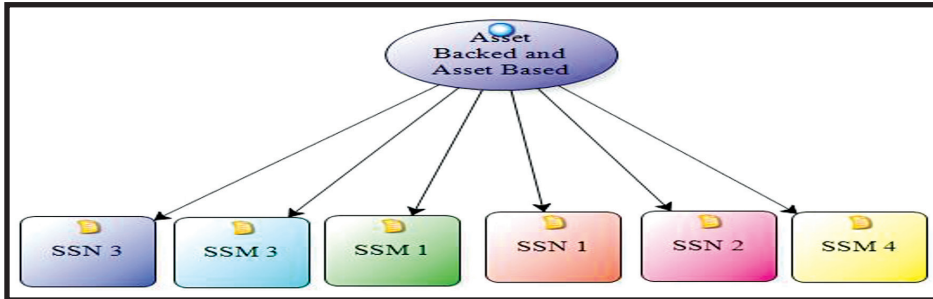
The informant additionally contended that there is no issue in having beneficial ownership in asset-based *Sukuk* “Beneficial ownership is allowed in asset-based *Sukuk* structure from my perspective. There is no harm if the issuer sold beneficial ownership to the investors” (SSM 4). This point of view was similarly corroborated by informant SSM 1 that “there are no issues in having only beneficial ownership in debt-based *Sukuk* structures but equity-based structure investors must have possession of the asset if the beneficial owner is sufficient to declare dividend and to take the liability of the asset there is no issue” (SSM 1). More so, the above statement was endorsed by informant SSM 3 whereby he claimed that:

There is no issue with beneficial ownership in asset-based Sukuk as long as the applied practice is correct. However, in recent times, the way beneficial ownership is practised in Sukuk is incorrect. Sukuk holders in asset-based Sukuk are not the owner of the asset but are just nominal owners who have no recourse to the underlying assets (SSM 3).

On this note, the majority of the informant opined that asset-backed *Sukuk* structures are in line with Shariah principles as there is no constraint for the investors to dispose of what they owned. Contrarily, in terms of asset-based structures, there is disagreement among the informants whether asset-based structures are in line with Shariah principle or not. Some agreed that beneficial ownership used in asset-based contracts does not violate any Shariah prerequisites of contracts based on the common law system. The investors do not come to the market to hold the asset but just to invest and get profit from the projects. While some informants view that asset-based is not Shariah-compliant because there is no freedom for the investors to dispose of assets as required. Figure 3 below shows the response rate among the informants regarding Shariah rulings on beneficial ownership of asset-based structure.

Figure 3

Shariah Rulings on Beneficial Ownership of Asset-based Sukuk Structure



Government Property

It has been the fact that the legal and beneficial ownership applied in Islamic finance particularly in *Sukuk* is originated from English law. Similarly, one of the factors that prevent *Sukuk* holders from having recourse to the underlying asset of *Sukuk* is the government policy whereby the government outlines some restrictions on the asset which prevents investors from disposing it to a third party. Usually, the underlying assets of *Sukuk* are government property and legal ownership of the asset and is still with the government who issued *Sukuk*. In this situation only beneficial ownership is transferred to the investors. For instance, the underlying asset of *Sukuk* is the airport or government house; in this case only beneficial ownership is transferred to the investors. To prevent the interest of *Sukuk* holders in the case of default, the purchase undertaking is applied from the government as issuer to repurchase assets back.

Balibek (2017) affirmed that the government commits to repurchase the asset back from the trustee who acts on behalf of investors, in accordance with terms and conditions of undertaking scheduled on the date of maturity or event of default. In another submission by Sa'ad (2019) the reason of the underlying asset that does not transfer to the *Sukuk* investors is due to public property. This is the reason why numerous *Sukuk* investors cannot dispose of the asset to the third party except the purchase undertaken by the government. Accordingly, informant SSM 4 added that:

Usually, this issue of beneficial ownership arises under sovereign Sukuk structure, for instance, this happens with Malaysia first sovereign Sukuk issued back in 2002. So, what happened was that when the government wanted to issue Sukuk, the underlying asset was a government asset. So, the government needs to sell the asset to the investors and then the investors lease the asset back to the government. After some years, the government will repurchase the asset back from the investors. So, this is where scholars find the issue of beneficial ownership, in which the contract has fulfilled Shariah requirement, but the government sold the beneficial ownership and does not give legal title to investors. This is what happens to the Sukuk structure involving government assets. There is no issue from a Shariah perspective in terms of debt-based structure. The investors still need a legal title to sell the asset, but the asset is public, hence, if the investors are allowed to do whatever they want, that would affect the public as a whole as the asset is public property (SSM 4).

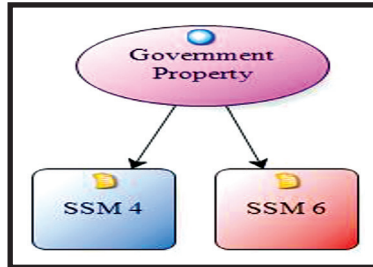
In attesting to the government property as one of the factors that prevent investors to obtain legal title of the asset, an informant observed that:

Normally this issue happens in sovereign Sukuk when the underlying assets of Sukuk are government property. For example, the airport or ministry building, all these assets are normally not allowed to go to the other parties but within the tenure of Sukuk, all the rights and liabilities of these assets belong to the investors. The investors do not have the right to sell these assets to a third party, only the government has the right to buy it back from the investors. The government will not allow an asset to be transferred to a third party hence this will affect the country's sovereignty. In this kind of Sukuk, if anything happens to the building or asset the investors will take responsibility. Also, any profit coming from the asset goes to the investors. Obviously, ownership belongs to the investors but to sell the assets to a third party becomes a shortcoming in terms of restrictions put by the government (SSM 6).

Consequently, restriction by the government is one of the obstacles for the Sukuk holders to have legal title of the asset especially in debt-based Sukuk. It is a strategy for the government as an issuer to impose some limitation that is in line with the actions of a leader who are driven by the interest of the community it is allowed. Figure 4 below shows a responses rate among the informants regarding government property as one of prevention for Sukuk holders to obtain legal title of the underlying asset.

Figure 4

Government Property as One of Preventions for the Sukuk Holders to Have Legal Title of the Asset



Legal System

Another factor that constitutes an obstacle for *Sukuk* owners to have legal ownership of the underlying asset is the legal system of the country where *Sukuk* is being issued. The legal system plays a significant role in the sense that *Sukuk* holders just obtained beneficial ownership through the trustee. Alaro (2016) contented that the classification of the English law of ownership into legal and beneficial ownership created a new challenge to Shariah scholars of Islam in the area of transfer of assets as a condition for the legitimacy of some products of Islamic finance. For example, in sovereign *Sukuk*, the underlying asset of a *Sukuk* project is prohibited by the legal system of the country to transfer assets to investors, especially foreigners. This has been explained by an informant that:

The issue of transfer of ownership of assets from the issuer to Sukuk holders is another area of concern in the Sukuk structure in the case of default. In some countries, the legal system of that country prohibits investors from having absolute ownership of Sukuk assets, especially in common law jurisdiction. AAOIFI standard opined that there must be transfer ownership of the asset unlike SAC of Malaysia do allow the transfer of beneficial ownership based on the legal system of the country. There is no problem as far as the legal system where Sukuk issued recognized beneficial ownership without having the legal ownership of the asset (SSN 4).

The informant added that “To have full ownership of the *Sukuk* asset, this depends on the law of the country where *Sukuk* was issued either common law or civil law. For instance, in Malaysia, legal ownership is not transferred in the case of government property. So, if the *Sukuk* is structured based on government property, the *Sukuk* investors are not entitled to have legal ownership. Sometimes the Shariah law is not enough for the contract in some assets, and the custom of the country can be applied if it does not contradict Shariah principle” (SSN 3). Equally, another informant added that “if *Sukuk* holders are legally recognized as the owner

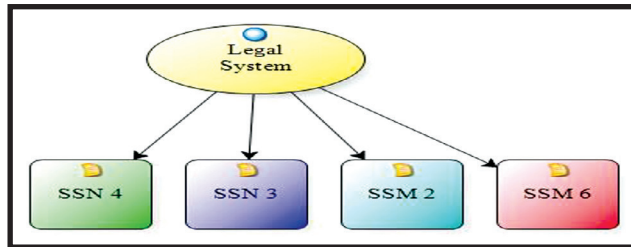
of the underlying asset and the court identifies the benefit of the asset even if the registration is under originator there is a problem (SSM 2). Furthermore, the argument was supported that the legal system is one of the factors that prevent *Sukuk* holders to obtain legal title of the asset:

The issue of Sukuk investors not having legal ownership of the underlying asset normally happens in sovereign Sukuk, where the underlying asset belongs to the country. For instance, in Malaysia, based on common law, the law of the country does not allow investors to have the legal right of the asset. This is the government policy and Maslahah of the country. All these need to be taken into consideration when the Sukuk structure is peculiar to the common law countries (SSM 6).

On that account, based on the assertion among informants, it demonstrates that the legal system of the country where *Sukuk* is issued played a vital role in terms of *Sukuk* owners not having legal ownership of the underlying asset. Figure 5 below indicates a response rate among the interviewees regarding the legal system as an obstacle for *Sukuk* investors to have legal title of the asset.

Figure 5

Legal System as an Obstacle for Sukuk Investors to Have Legal Title of the Asset



Role of Trustee

The function of trustee is to protect the interest of investors in situations where only beneficial ownership belongs to investors. Some of the scholars have established the position of the trustee who acts on behalf of the *Sukuk* holder and manages the project to generate profit from the investment for the investors (Zakaria et al., 2018). Suwadi (2016) indicated that the SPV/trustee in the domain of securitization is commonly recognized in law and serves as a trustee on behalf of investors which represents their interest. When there is a dispute, the legal system will determine legal ownership from beneficial ownership, in fact, the legal owner is considered as a trustee. This confirms further that the trustee is just holding the asset of *Sukuk* for the benefit of investors (Alaro, 2016; Ghani et al., 2021). The

transfer of legal ownership of the asset happens from the originator to the trustee who acts for the *Sukuk* holder. Similarly, to support the views that trustees act on behalf of investors since the legal title does not belong to investors, an informant pointed out that:

Under the sovereign Sukuk, the legal ownership is not transferred to the investors. The trustee/SPV acts on behalf of investors and holds the legal title of the underlying asset during the tenure of Sukuk. The legal owner of the project is the SPV, the beneficial owner is the Sukuk holder for the duration of the Sukuk, and hence the issuer has relinquished the title of the asset to the SPV as trustee on behalf of Sukuk holders (SSN 5).

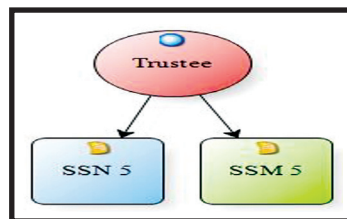
Another informant noted the role trustees play in *Sukuk* issuance to protect the interest of investors especially in sovereign *Sukuk* which prevent investors to have legal title of the asset. He stated that:

In Sukuk structure, trustees act on behalf of Sukuk holders. Sukuk holders are beneficial owners while the trustee is the legal owner on behalf of investors, all benefits and advantages derived from property belong to Sukuk holders. Sukuk holders have all rights, but legal ownership belongs to the trustee. Actually, in Islam ownership is when one enters into a contract and the contract ends, automatically ownership belongs to the purchaser (SSM 5).

This can be implied that trustee is very essential in every *Sukuk* structure as it serves to protect the interest of *Sukuk* holders since the underlying asset remains in the balance sheet of the issuer, especially in sovereign *Sukuk*. Figure 6 below demonstrates a responses rate among the interviewees regarding the trustee who acts as a protector for *Sukuk* holders.

Figure 6

Trustee Act to Protect Sukuk Holders in Beneficial Ownership



Possession

Possession of the underlying asset of *Sukuk* during the tenure of the *Sukuk* project is very important. Every transaction must comply with the rules and regulations of the contract as prescribed by Shariah. After the contract is concluded by offer and acceptance, the ownership must be immediately transferred to the new buyer. Next, the buyer should take possession of the object of contract. The *Sukuk* investors must have possession of the asset before it can be leased back to the issuer (Rahman, 2020). An informant corroborated that:

In every Sukuk, the investors must have possession of underlying assets during the tenure of the project. There must be a transfer of ownership that will give the Sukuk holders the right to lease the asset back to the issuer. The issuer will pay rent to SPV on behalf of the investors, which will be resold back to the issuer on maturity or any triggered event. When it comes to real ownership the investors must have to own something. The prophet (SAW) says (لا تبيع ما ليس عندك) you cannot sell what you do not own, the Sukuk holders must-own the asset before it can be sold back to the issuer (SSN 3).

In addition, Ghani et al. (2021) asserted that ownership is a fundamental concept in Islamic transaction regulation. It is suggested that the possession of asset/property gives the owners capability to utilise it. This was verified by an informant stating that:

Possession of assets is a requirement in Shariah. It firstly has to differentiate between possession and rights of the Sukuk holders. No matter what kind of Sukuk there must be a sale of underlying assets and a transfer of ownership. The question is, what kind of ownership is transferred, is it full or beneficial ownership? Majorly, the beneficial ownership is very much rights will be transferred to the investors. Shariah recognizes the transfer of ownership to the investors, in the market at the moment, the issuer put certain restrictions, that restriction should be removed to ensure that investors have possession of the asset whether it is registered under the investors' name or not (SSM 7).

Moreover, an informant buttressed the argument of other informants on the possession of underlying asset of *Sukuk* that:

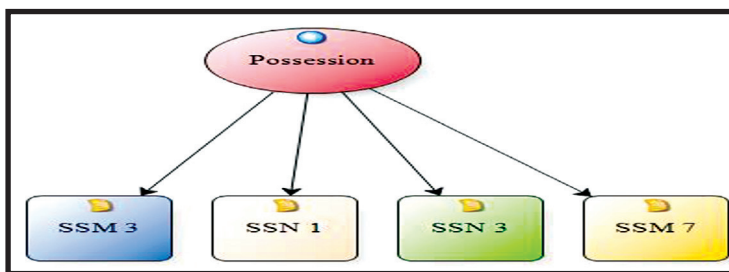
What concerns the Shariah practitioner is to extract whatever ownership has been claimed, be it complete or incomplete ownership. Complete ownership indicates that investors are qualified to receive the benefit of what they own, while in the case of incomplete ownership the investors do not have the right of ownership. According to Shariah, complete ownership is the best in terms of claiming profit or divided from what an investor owns. Ownership in Shariah qualifies investors to earn dividends or profit. Similarly, if beneficial ownership qualifies investors to earn profit or dividends there is no issue (SSN 1).

Additionally, another informant reviewed that “for *Sukuk* to be Shariah-compliant, the investors must have possession of the underlying asset if *Sukuk* owners do not have full possession of the underlying asset and there is no serious incur if the rights are preserved and maintained. It is not necessary to register the asset under investors name as the name can be registered under trustee” (SSM 3). This is in line with Islamic two legal maxims “*Al-Ghunm bi al Ghurm*” (reward is to be accompanied with risk) and “*Al-Kharaj bi al Daman*” (gain or benefit comes with liability). These legal maxims indicate that the owner of the property must accept all the costs and risks stipulated to the ownership of the asset since he is qualified to enjoy the benefit derived from the underlying asset. Correspondingly, if the *Sukuk* holder does not have possession of the asset therefore there is no privilege to partake in the benefit of the asset. If *Sukuk* holders are not taking risk of the asset, they are not entitled to any income generated from the asset as the Prophet disallowed the profit earned without bearing risk and liability (Ikram, 2018).

On that note, evidence has shown from different positions of argument from informants on this study that possession is very crucial in Shariah. In particular, they agreed that if *Sukuk* holders have taken risk and liability of the asset without taking possession there is no contradiction with Shariah. Figure 7 below elucidates a responses rate among the informants regarding possession as a requirement of any Shariah contract.

Figure 7

Possession is Shariah Requirement for any Contract before Taking Profits or Dividing from the Underlying Asset



Purchase Undertaking

In the case of default, the legal system and government policy where *Sukuk* was issued has prevented *Sukuk* holders to transact *Sukuk* assets to a third party. According to AbdulKareem and Mahmud (2019), purchase undertaking from the government is fundamental in case of default or insolvency because the underlying

asset is not transferred to the investors. In addition, the issuer has promised the investors that at any event of default, the underlying asset will be purchased back. In addition, Uddin et al. (2015) asserted that *Sukuk* holders under the asset-based system do not have absolute right to sell the underlying asset to the third party particularly when default transpires. Thus, only purchases undertaken by the issuer will be exercised. To support this view, an informant stated that:

In case of default or maturity date since Sukuk holders do not have recourse to the underlying asset so repurchase undertaking will apply. This condition does not contradict any Shariah principle (العقد شريعة المتعاقدين) which means whatever the two-party in the contract agreed is binding as long as it does not violate the Shariah principle. This is Malaysia's perspective on beneficial ownership in the case of sovereign Sukuk (SSM 1).

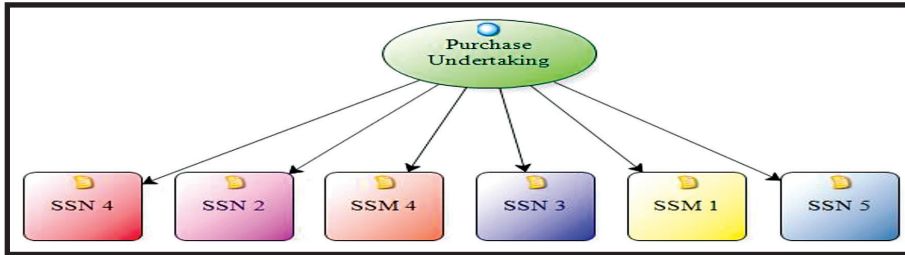
In a similar opinion, informant SSN 4 posited that “purchase undertaking in sovereign *Sukuk* implies that *Sukuk* holders do not have full recourse to the underlying assets and these underlying assets are not used as collateral. Since the legal system of the country and government policy prevent investors from disposing of the asset to a third party, hence, purchase undertaking will occur” (SSN 4). Equally, informant SSN 3 verified that “in the case of default or difficulties to make the payment from the government or the issuer, purchase undertaking will come in, one of the objectives of a purchase undertaking is to apply at any trigger event” (SSN 3). Additionally, an informant confirmed that “in the case of default or maturity date, if the *Sukuk* holder does not have recourse to the underlying asset, repurchase undertaking will come in that is why purchase undertaking is applied in every *Sukuk* structure” (SSN 2). Another informant equally emphasized more on the safe guide in terms of purchase undertaking in the event of default. She further added that:

There is a safe guide in terms of repurchase undertaking, so in the event of default, the purchase undertaking will kick off. I have not seen any government property without repurchase undertaking. This is because of the restriction that the investors cannot dispose of an asset to a third party (SSM 4).

Moreover, informant SSN 5 supported the argument of other informants that purchase undertaking is crucial under the asset-based structure that “In the case of insolvency or defaults by the issuer the *Sukuk* holders will recover their money through repurchase undertaking whether at market value or agreed price by the time of purchase” (SSN 5). Accordingly, the informants considered that repurchase undertaking is indispensable since the underlying asset does not belong to the *Sukuk* holders and this will give investors’ confidence to invest. Figure 8 below shows a reasons rate among the informant regarding purchase undertaking as an instrument to *Sukuk* holders in event of default or maturity date.

Figure 8

Purchase Undertaking as an Instrument to Sukuk Holders to Recover an Underlying Asset



Conclusion

The study explored the application of legal and beneficial ownership in the *Sukuk* structure in Malaysia and Nigeria based on the view of Shariah scholars. The findings of the study showed that the characterization of ownership into beneficial and legal arise in the *Sukuk* structure in a country that practises the concept of common law system which Malaysia and Nigeria fall under this system. This concept may not be found in countries that practice civil law systems. Someone who owns the property is both legal and beneficial in civil law jurisdiction. In these countries, it is possible to separate legal ownership from beneficial ownership. This corroborated the outcome of the study conducted by Zolfaghar (2017) and Tariqullah et al. (2014) which asserted that the common law system allows only beneficial ownership to be transferred to the investors when the underlying asset of *Sukuk* moves and the legal ownership is preserved by the issuer.

The findings further demonstrated that Shariah does not have a classification of ownership into legal and beneficial ownership. From a Shariah perspective, ownership is ownership. If the contract fulfils conditions of the contract automatically the ownership is considered transferred from seller to buyer. It is essential to know who takes the responsibility for damages of the projects in addition to benefiting from the dividends or profits. From the view of Shariah, profit comes with liability, at the same time it is essential to look at the principle of both legal and beneficial ownership, to easily identify who takes liability before dividends. On that account, the issues of legal and beneficial ownership are not Shariah issues, it is a legal requirement that is generated from the common law system. However, the main issue in Shariah is that the investors cannot take benefits without taking liability, but since *Sukuk* holders are the beneficial owners, they must take liability. Based on this, beneficial ownership applied in *Sukuk* structures in Malaysia and Nigeria does

not violate Shariah requirement of the contract unless *Sukuk* investors do not take the liability of the projects before taking dividends.

These findings correspond with the result of the study conducted by Oseni (2015) and Ikram (2018) which affirmed that the nature of legal and beneficial ownership in *Sukuk* issued is generated from the common law system. Therefore, there is no controversial issue to use it in Islamic transactions. It is found that the modern *Sukuk* structure only considers beneficial ownership to be transferred to the investors based on the legal system and government policy of the country where *Sukuk* was issued. The findings further showed that the legal system under which *Sukuk* are issued played a significant role in constraining *Sukuk* investors to terminate assets out. For instance, if *Sukuk* were issued based on government property, normally the governments do not allow this property to be cleared out to other parties, but within the tenure of *Sukuk*, all the rights and liabilities of these assets belong to the investors. The only obstacle is that investors do not have the right to dispose of these properties to the third party other than the government who has the right to repurchase it. Normally the ownership belongs to *Sukuk* investors but to sell properties to a third party becomes a limitation in terms of ownership which restricts investors from selling to the third party due to *Maslahah* of the country.

One of the issues and challenges faced by the existing *Sukuk* structures is the application of beneficial ownership which prevents *Sukuk* holders from having an absolute right to the underlying asset. On that note, it is essential to encourage the issuer of the *Sukuk* especially when *Sukuk* is related to the government property and legislators of the country to allow *Sukuk* holders to obtain full ownership of assets during the tenure of *Sukuk* to circumvent non-Shariah compliance. Nevertheless, the study has its limitations. Firstly, not all respective people in the field of Islamic finance are keen to participate and share their experiences with researchers due to time constraints. Secondly, only twelve Shariah scholars in both countries participated in the study. The small sample size can questionably restrict the depth of discussion on phenomenon under the study. Thirdly, the study is restricted to the application of legal and beneficial ownership in *Sukuk* structures. Future studies may expand the number of informants to another product of Islamic finance.

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Appendix: Interview Checklist

Theme: Application of legal ownership and beneficial ownership of Sukuk structures in Malaysia and Nigeria.

Questions asked:

- i. How can someone differentiate legal ownership from beneficial ownership of *Sukuk* structure?
- ii. What are the Shariah rulings on beneficial ownership of asset-based *Sukuk* structure?
- iii. What is your opinion about *Sukuk* owners not having full possession of underlying assets of *Sukuk*?
- iv. What is the Shariah perspective on *Sukuk* holders who have only beneficial ownership through trustees but not registered ownership of an asset?
- v. In the case of insolvency, what are the Shariah rulings if a *Sukuk* holder does not have recourse to the underlying asset of *Sukuk*?