

Examples of Icara Sukuk Used in Interest-Free Banking Liquidity Management, Problems and Solutions**

Fatih Kazancı ^{1*}

¹ Dr., Kuveyt Türk Participation Banking; fatih.kazanci@kuveytturk.com.tr and İstanbul Sabahattin Zaim University; fatih.kazanci@izu.edu.tr, ORCID No: 0000 0002 7865 4229

* Correspondence: fatih.kazanci@kuveytturk.com.tr; Tel.: +90 530 7618089

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Abstract: In some Muslim countries around the world, state institutions issue sukuk in order to contribute to the liquidity management of interest-free banks. Most of these sukuk issued by state institutions are in the form of icara sukuk. One of the most important reasons for this is that this sukuk structure is suitable for trading in the secondary market. The aim of the study is to examine these sukuk structures, to identify the problems experienced in the fiqh sense and to produce solutions to these problems. In this way, it will be ensured that the discussions in the issuance of sukuk are minimized. In the article, icara sukuk structures issued by the Treasury or central banks in Malaysia, Bahrain, Pakistan, Sudan and Turkey were examined and the problems in icara sukuk issuances in Turkey were listed in six items. Solution suggestions are presented in the conclusion part. The importance of the study is because it scrutinizes the problems in the issuance of icara sukuk and offers solutions to these problems. In this way, the study will contribute to the elimination of the fiqh problems experienced in the issuance of icara sukuk. In the article, the compilation research method was preferred. The reason for this is that it is possible to compare different world examples.

Keywords: Islamic Finance, Participation Banking, Icara Sukuk, Liquidity Management

1. Introduction

Sukuk issuance plays an important role in today's interest-free banking, especially in the field of liquidity management. The reason for this is that interest-free banks manage their excess liquidity with sukuk investments during periods of excess liquidity, and they need to reach liquidity by selling their sukuk during periods of lack of liquidity. In addition, sukuk plays an important role in the relations of interest-free banks with central banks. Because some central banks accept these sukuk as collateral and even buy sukuk from interest-free banks in the repo/reverse repo market, providing them with short-term liquidity.

When we look at the world in general, it is seen that the icara sukuk structure is used especially in Islamic countries such as Turkey, Malaysia, Bahrain, Pakistan and Sudan. This sukuk structures are issued by Treasuries in some countries and central banks in others.

The aim of our study is to investigate the icara sukuk structures issued in countries where interest-free banking is developed around the world, and to identify the problematic issues in the fiqh area in issuance and to offer solutions to these problems.

In this way, this type of sukuk, which is issued both in Turkey and around the world, will contribute to the smoothening of fiqh.

2. Methods

In the article, the compilation research method was preferred. The reason for this is that it is possible to compare different world examples.

3. Liquidity Management in Interest Free Banking

All banks need liquidity to fulfill their payment obligations. The risk of banks failing to fulfill their payment obligations is called liquidity risk (Hassan and Mollah, 2018).

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The cost of liquidity affects the entire banking sector today. Excess liquidity reduces profitability, while lack of liquidity causes banks to have difficulty in paying, thus increasing the liquidity risk. In order to minimize the liquidity risk, banks must remain liquid, that is, keep a certain amount of liquidity in their safes. This definition of liquidity includes both cash and securities. Conventional banks invest in fixed income bonds and bills for this purpose. Since interest-free banks cannot use these interest-bearing instruments, they have to invest in sukuk and similar certificates.

Other advantages of such securities, apart from liquidity management, are that these securities can be kept at the central bank as collateral in the transactions of banks with central banks and even used for borrowing purposes in the repo/reverse repo market. However, central banks do not accept bonds or sukuk issued by the private sector as collateral. Central banks accept government bonds or sukuk issued by the Treasury or on behalf of the Treasury. For this reason, the Treasury or central banks of many Islamic countries issue sukuk.

In our article, the examples of Malaysia, Bahrain, Pakistan, Sudan and Turkey were examined. The official institutions of these countries generally use the icara sukuk structure in their sukuk issuances. The most important reason for the preference of icara sukuk is the ease of selling and renting back the lands, facilities or buildings belonging to the state in this sukuk structure and the fact that this type of sukuk is legally suitable for buying and selling in the secondary market.

In order for interest-free banks to use sukuk certificates in their liquidity management, first of all, sukuk markets should be established and these markets should not be shallow markets in order to be able to trade at any time. Otherwise, interest-free banks may be exposed to the risk of not meeting their payment obligations when they have difficulty in finding buyers for their urgent liquidity needs.

3.1. What is Sukuk?

The word sukuk is called financial certificate in the dictionary. As a term, "the right of use is the equal value shares produced in relation to the ownership of goods, services or an investment." Assets used in sukuk issuance may be goods, right to use goods or right of service (benefit), or a mixture of goods, interests, money and debt. The assets mentioned here must either exist in person or be created with the income obtained from the issuance of sukuk (Cebeci, 2019).

3.1.1. Types of Sukuk

Sukuk is issued in accordance with the contracts that comply with the fiqh and take the effect of these contracts. Although the types of sukuk are based on the same thought and purpose, there are significant differences between them in terms of the structure and condition of the contracts and whether they are suitable for trading in secondary markets.

The types of sukuk are listed below:

1. Icara Sukuk
2. Mudarabah Sukuk
3. Musharakah Sukuk
4. Murabahah Sukuk
5. Salam Sukuk
6. Istisna Sukuk
7. Muzaraa Sukuk
8. Musakat Sukuk
9. Mugarese Sukuk
10. Hybrid Sukuk (Cebeci, 2019).

3.2. Icara Sukuk

This type of sukuk is a type of sukuk created by converting the goods and interests subject to the icara contract into securities suitable for trading (Cebeci, 2019). The word icara means rent paid to the owner. Icara sukuk holders have the right to own the asset subject to the issuance of the sukuk, as well as the right to receive the rental income of the related asset. The rental income of the asset subject to icara sukuk can be fixed or variable depending on the agreement (Büyükcakın and Önyılmaz, 2012).

For the issuance of icara sukuk as a security, the following conditions must be met:

- a. A lease agreement should be made on an asset that can be rented and rental income should be obtained on certain dates.
- b. The underlying asset of the contract should be clearly identified.

- c. All institutions and persons who are parties to the contract should know the leased property and the rental amount.
- d. The contract should clearly state the rate at which the rental amount is calculated.
- e. Expenses related to the asset should be the responsibility of the landlord, and expenses incurred in use by the tenants.
- f. The lease ends when the leased asset ceases to function (Bayram & Ulaş, 2021).

3.3. Institutional Icara Sukuk Examples

In our article, corporate icara sukuk issuances in Malaysia, Bahrain, Pakistan, Sudan and Turkey were investigated, respectively. The issuance of these sukuk by which state institution, the underlying assets used in the issuance, the issuance processes and the different characteristics of the issuance were investigated.

3.3.1. Bank Negara Malaysia Icara Sukuk

The Central Bank of Malaysia (Bank Negara Malaysia-BNM) has established an institution called BNM Sukuk Berhad to issue icara sukuk and issues sukuk through this institution. Some of BNM's real estates are purchased with the income obtained through the issuance of sukuk. These real estates are leased to BNM to generate rental income and payments are made to sukuk investors every six months. On the maturity date of the sukuk, that is, on the redemption date, the properties are sold back to BNM at a predetermined price.

BNM issued its first icara sukuk in 2006, amounting to MYR 400 million. Today, BNM issuing regular sukuk in the amount of MYR 100 to 200 million (Alam and Rizvi, 2016: 96).

The icara sukuk structure issued by BNM is schematized in the figure below.

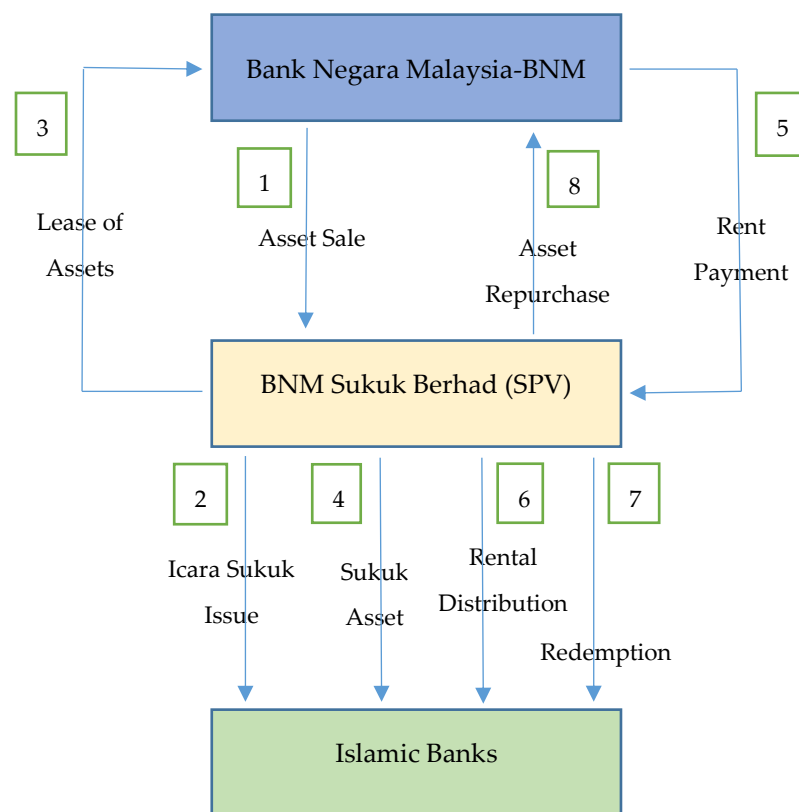


Figure 1. BNM icara sukuk process (IFSB, 2008).

3.3.2. Bahrain Icara Sukuk

The Central Bank of Bahrain carries out sukuk issuance operations and provides guarantor services for these issuances. The Central Bank of Bahrain performs this service on behalf of the State and does not collect service fees from issuances.

The Central Bank of Bahrain issues two different types of icara sukuk. One of them is in Bahraini Dinar (BHD) with a short term of 182 days and the other is a long term issuance of 3 to 10 years in USD or BHD.

Short-term issuances are made once a month and there is no secondary market. Long-term issuances are made for special purposes and are traded in the secondary market on the Bahrain Stock Exchange. This type of sukuk can have fixed or fluctuating returns. Yields are paid to investors semi-annually. The amount of return to be paid to the sukuk is determined in advance by the monetary policy board (IFSB, 2008).

In the figure below, the structure of the icara sukuk issued by the Central Bank of Bahrain is schematized.

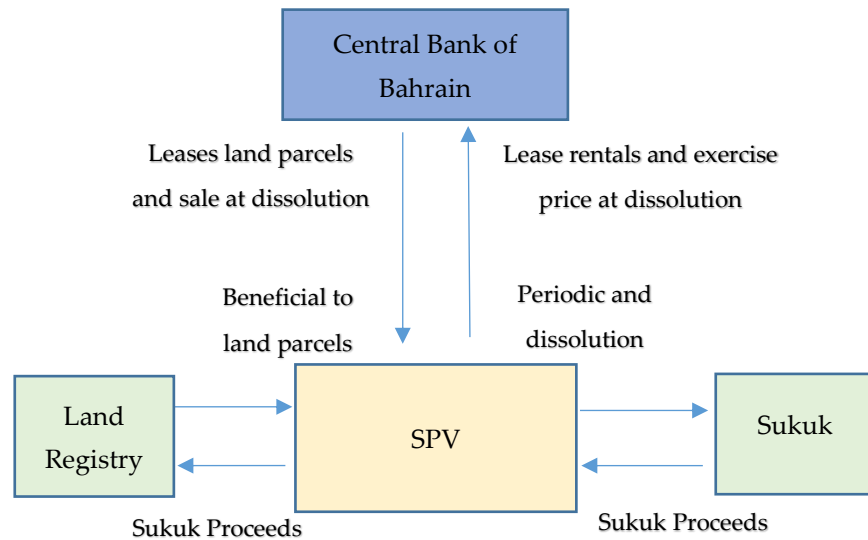


Figure 2. Bahrain icara sukuk process (IFSB, 2008).

3.3.3. Government of Pakistan Icara Sukuk-GIS

Some government institutions issue sukuk in the Pakistan interest-free instruments market. These organizations issue different types of sukuk. These consist of icara sukuk, as well as in the hybrid structure of icara-murabaha or icara-musharakah. Issues are usually made on a nightly or monthly basis. The maturities of these sukuk are 3 months, 6 months and 12 months (IFSB, 2008).

The following figure shows the process of the Pakistan state icara sukuk structure.

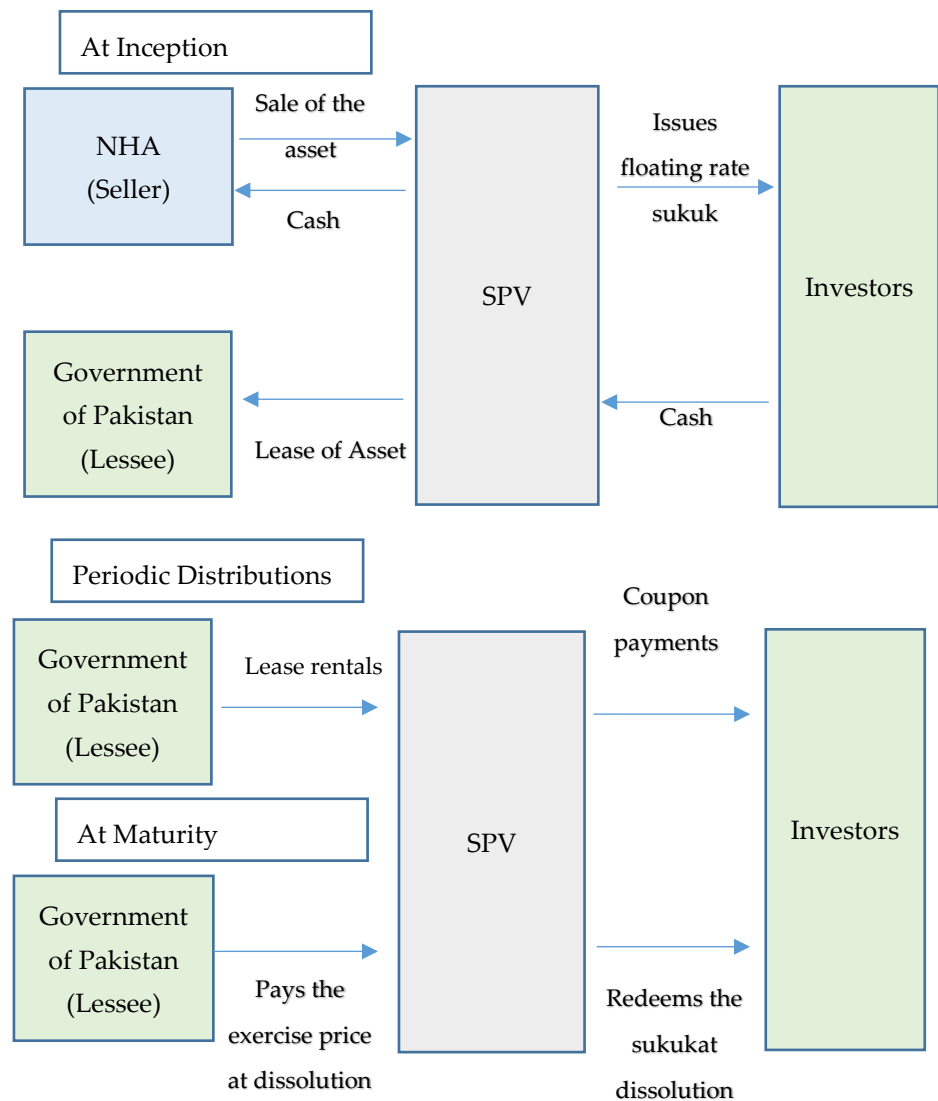


Figure 3. Government of Pakistan icara sukuk proceeds (IFSB, 2008).

3.3.4. Central Bank of Sudan Icara Certificates

The Central Bank of Sudan has been issuing icara sukuk since 2005. The central bank issues these sukuk only for the purpose of liquidity management in money markets. The Central Bank of Sudan uses its own buildings as an underlying asset for issuance. These buildings are sold by the central bank to the Sudan Financial Services Institution and then rented with a monthly rental fee of 1%. Revenues are used for coupon payments for icara sukuk.

The Central Bank of Sudan sells icara sukuk to demanding banks, asset management companies and public institutions by auction method. The Central Bank of Sudan repurchases these sukuk by putting the accrued return on the purchase price so that they cannot be bought or sold in the secondary market. The reason for this is to prevent the sale of sukuk below their par value in the market (IFSB, 2008).

The following figure shows the stages of issuance of the Central Bank of Sudan icara certificates.

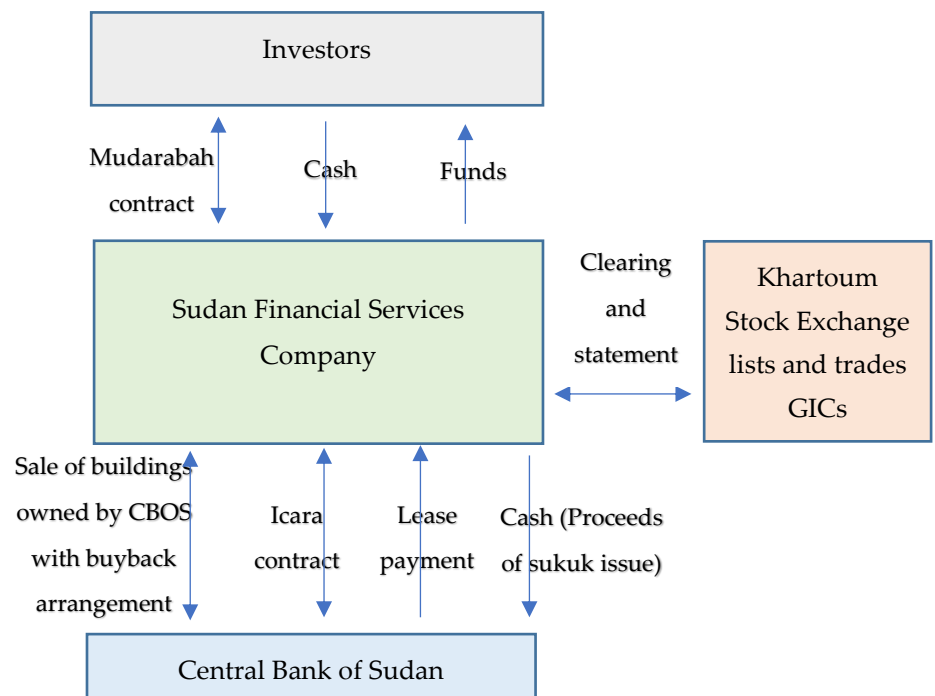


Figure 4. Central Bank of Sudan icara certificates proceeds (IFSB, 2008).

3.3.5. Türkiye Treasury (Lease Certificate) Sukuk

The Treasury established a company called Undersecretariat of Treasury Asset Lease Company (HMKVŞ) to issue lease certificates (icara sukuk). Treasury lease certificates are issued to finance the real estates taken over by HMKVŞ. Treasury lease certificates are a type of guaranteed and risk-free security that is issued using public assets as the underlying, with the rental income of the underlying asset.

Treasury lease certificates are issued on behalf of HMKVŞ on behalf of and for the benefit of certificate holders, and these certificates enable holders to earn rental income in proportion to their shares (HM Lease Certificate Investor Guide, 2021).

The following figure shows the issuance process of Treasury lease certificates.

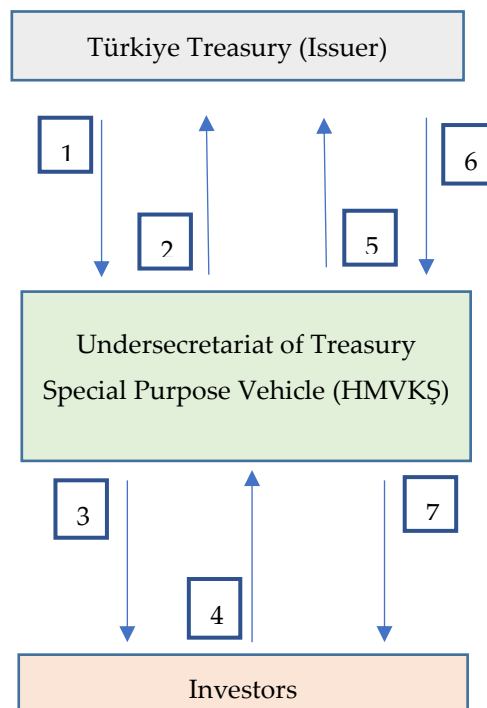


Figure 5. Operation method of Treasury Asset Lease Company (Tekin, 2017).

The workflow is detailed below.

1. The Treasury transfers some of its own real estate to HMKVŞ.
2. HMKVŞ leases these real estates.
3. HMKVŞ issues lease certificates to investors.
4. Investors pay the fees of the lease certificate to HMKVŞ.
5. HMKVŞ transfers the issuance revenues to the Treasury.
6. In the interim periods, the Treasury pays the rental fees and the sales price on the redemption date to HMKVŞ.
7. HMKVŞ pays the rental fees in the interim periods and the lease certificate fee on the redemption date to the investors.

Treasury lease certificates are under the guarantee of the Treasury. In addition, the fact that the Treasury lease certificates can be bought and sold on the Borsa Istanbul (BIST) ensures that their prices are always determined and that it is easy to convert them into cash when desired. Since Treasury lease certificates are interest-free, they help participation banks to create a security portfolio in liquidity management (Tekin, 2017).

3.4. Issuance Details of Some State Icara Sukuk

In the table below, the issuance of the icara sukuk issued by government institutions and the underlying assets used in the issuance are summarized.

Table 1. Issuance details of state icara sukuk

Country of Issue	Issuance Party	Underlying Assets
Malaysia	Bank Negara Malaysia	Real Estates belonging to the Central Bank
Bahrain	Central Bank of Bahrain on behalf of the Treasury	State Lands
Pakistan	Pakistan Government Institutions	Unknown
Sudan	Central Bank of Sudan	Central Bank Buildings
Türkiye	Treasury	State-owned Properties

According to the table above, it is seen that in some countries issuances are made by the treasury, while in others, issuances are made by central banks on behalf of the treasury. On the other hand, it is striking that the buildings and lands belonging to the state are generally used as the underlying assets.

3.5. Fiqh Status of Icara Sukuk According to Islamic Fiqh Academy and AAOIFI

Both the International Islamic Fiqh Academy (IIFA) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have determined the fiqh rules to be applied in icara sukuk issuances.

The most important of these rules are summarized below.

- According to the International Islamic Fiqh Academy; Sukuk transactions in which the ownership is not fully transferred to the investors, namely the sukuk holders, and the issuance of sukuk, which include the condition of repurchase at the same price as sold or at a price determined at the beginning, are not legally appropriate (Adıgüzel, 2016).
- According to AAOIFI; Sukuk issuances with a buyback guarantee or a profit (return) guarantee at the same price as the sold (nominal) price are not legally appropriate.

However, an independent third party may voluntarily and gratuitously give these sukuk a guarantee of principal and return. In addition, profit fluctuations can be mitigated by establishing a takaful insurance fund with the partnership of sukuk investors or with deductions to be made from the sukuk income of the investors in order to reduce the effect of profit fluctuations (AAOIFI, 2012).

4. Conclusions

There are some legal problems in the structure of icara sukuk issued by the Treasury in Türkiye. These problems and suggested solutions are listed below:

Problem 1: Not transferring the ownership to the investors (transfer with real estate pledge).

By purchasing icara sukuk, investors actually become partners in the relevant real estate. Investors can only benefit from the rental income of the property that is the subject of the partnership in this way. Since the partners will be responsible for the damages that may occur to this property they are a partner in, they must also cover the insurance of these goods.

In icara sukuk issuances, ownership of a building or land, whether owned by the central bank or the treasury, is usually not entirely transferred to investors. The transfer is made with real estate pledge, in this case, the investors cannot fully own the property. If the investors were the full owners of the building or land, they should have been responsible for insuring the relevant real estate. However, the responsibility is always with the Treasuries or the central banks.

According to the Capital Markets Board of Türkiye (CMB) Lease Certificates Declaration; If the Treasury is unable to return the investors' money, the sole disposal authority of the investors is to sell the real estate and pay the investors a price in accordance with their rights, in accordance with the obligation of the SPV to pay the investor's principal and the initially determined return by selling the real estate.

In order to solve the problem created by the real estate pledge, the real estate should not be transferred to SPV through a pledge agreement, but should be sold through a sales agreement.

Problem 2: The existence of the obligation to lease the real estate purchased by SPV to the issuer, not to third parties, and to annotate in the land registry that the issuer has the right to repurchase. (CMB Lease Certificates Declaration, article 5).

In this case, the process turns into a structure called *bey'ul-istiğlal*. In the *bey'ul-istiğlal* method, real estate is taken as pledge and benefit is obtained from the money received in return. In the *bey'ul istiğlal* method, the house of a person in need of financing is bought to be sold to him when the payments are completed, and the sale price of the house is paid to him. The person rents and uses the house and buys it back when the debt is paid. The rent paid by the person is the return of the benefit obtained from the debt. The treasury icara sukuk structure is a modern version of this method, and this method was legally allowed to be applied in accordance with the public interest during the Ottoman period. Today, many jurists believe that this method is a fraudulent interest application (Bayındır, 2015).

Solving this problem can only be achieved by leasing the real estate purchased by SPV to third parties to generate income, or by renouncing the right to repurchase from annotation in the land registry.

Problem 3: The issuer does not benefit economically from the transferred land while it is idle, but it pays rent.

If the issuer which owns an idle land, sells this land to SPV and leases it back, rent is paid to the investors without any gain from the Treasury. In order to prevent this situation, the buildings, facilities or lands that are actively used by the issuer should be the subject of sukuk issuance. Otherwise, the process becomes artificial and causes various discussions in the public.

Problem 4: The total rent to be paid is equal to the rate of return determined by the issuer at the market interest rate.

The rent paid by the issuer is calculated by dividing the rate determined by the issuer according to the market interest rates into six-month periods, not a rental amount determined over the market value of the relevant real estate. Therefore, this amount is different from the rental price to be determined in the normal market conditions of the relevant building or land.

In order to solve this problem, payments can be made according to the market rental rates, not according to the interest rates on the coupon payment dates to be determined.

Problem 5: Repurchase of the sold property or land at the original price.

In practice, the real estate sold to SPV by the issuer is repurchased at the price determined at the beginning on the redemption date of the sukuk. This makes the transaction collusive and therefore the principal and return are guaranteed. However, in practice, the buy-back price of the real estate should not be determined from the beginning. On the maturity date, the related real estate should be resold according to the market prices. In addition, Adıgüzel (2016) proposes the method of mutual agreement, that is, bargaining, in buybacks.

Problem 6: Giving principal and return guarantees to investors in sukuk issuances (Bayındır, 2021).

There should be no guarantee of principal and return in any contract in Islamic financial transactions. Otherwise, the transactions turn into interest-bearing debt exchanges. No guarantee of principal and return should be given in any sukuk transaction, whether issued by the Treasury or by a private institution. Therefore, the Treasury can do the transaction correctly in terms of fiqh, by not giving a guarantee of principal and return in these transactions.

SPV must repurchase the sukuk at market value or at the price agreed with the investor on or before the redemption date. In addition, a Sukuk Guarantee Fund, proposed by AAOIFI, for an independent third party to guarantee the principal and return, can be established and the difference to be made against the investors can be covered from this fund.

In addition to all these problems, the icara sukuk structure also has the following advantages:

1. Treasury sukuk is a solid investment tool by investors, as it is a guarantee of principal and return.
2. The icara sukuk type is suitable for trading in the secondary market.
3. In the event that the Treasury cannot return the investors' money, Special Purpose Vehicle (SPV) has an obligation to sell the real estate and pay the investor's principal and the initially determined return (Bayındır, 2015).
4. It is possible for participation banks to use Treasury sukuk in liquidity management.
5. Participation banks were given the opportunity to accept Treasury sukuk as collateral by central banks.
6. Treasury sukuk are purchased from participation banks by central banks, and these banks are provided with the opportunity to repo/reverse repo (purchase with promise to resell/sell with promise to buy back).

In the table below, the fiqh problems encountered in the icara sukuk issued by the Treasury are examined and various solution suggestions are presented. If these suggestions are implemented, the procedures will be made more convenient in terms of fiqh.

Table 2. Problems and suggested solutions in Treasury icara sukuk issues.

Problems in Treasury Icara Sukuk Issues	Suggested Solutions
The property is not transferred to the investors completely due to the transfer with real estate pledge.	The real estate should not be transferred to SPV through a pledge agreement, but should be sold through a sales agreement.
Existence of the obligation to lease the real estate purchased by SPV to the issuer, not to third parties, and to annotate the right of repurchase to the land registry.	Income can also be obtained by leasing the real estate purchased by SPV to third parties. For this reason, annotation in the land registry that the right of redemption is given only to the issuer should be abandoned.
The issuer does not benefit economically from the transferred land while it is idle, but pays the rent.	The issuer must subject its buildings, facilities or lands that are in active use to the issuance of sukuk.
The total rent to be paid is equal to the rate of return determined by the issuer at the market interest rate.	On the coupon payment dates to be determined, payments can be made according to market rental rates, not interest rates.
Repurchase of the sold property or land at the originally determined price.	The resale of the relevant real estate should be realized at the market prices on the maturity date or by mutual agreement.

Giving investors principal and return guarantees in sukuk issuances.	The Treasury should not provide principal and return guarantees in these transactions. SPV must repurchase the sukuk at market value or at the price agreed with the investor on or before the redemption date. In order to guarantee the principal and return, the Sukuk Guarantee Fund can be established and the difference that will arise against the investors can be covered from this fund.
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Some of our solutions may cause problems in practice. One of these; It is our recommendation that “payments should be made according to market rental rates, not interest rates on the coupon payment dates to be determined”. If this is implemented, since the Treasury will make payments below or above the market interest rates, it will have used credit (raised funds) at a higher or lower rate than the market conditions. In addition, when the yield is given below the market interest rate, there will be no demand for an instrument with a yield below the market price, and in case of high yield, the Treasury will make a loss. If the Treasury wants to reflect the current policy interest on the market, it has to adjust the rental prices accordingly. Another is our suggestion that “the relevant real estate should be resold according to the market prices on the maturity date”. Since the current real estate prices generally increase every year, the Treasury will lose from this situation, as the price of the real estate will increase in long-term issuances. Therefore, the offered product will move away from a financial product and become a commercial transaction.

Although these two solutions are not suitable especially for Türkiye, which has an inflation problem, they are applicable in Islamic countries that do not feel inflationary pressures.

All other suggestions can be easily applied in Türkiye, and as a result, this product, which is offered to investors and banks, can be made far from discussion in terms of fiqh.

Finally, it can be said that the current icara sukuk structures issued by the Treasury are inconsistent with the law. In order to fix this, the solution proposals mentioned should be taken into account and the expulsions should be arranged accordingly. For this reason, various arrangements should be made in the Lease Certificates Declaration issued by the CMB.

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