


EVALUATION OF REGULATORY AND PRACTICES ON DISCLOSURE FOR SUKUK IN SAUDI ARABIA



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ABSTRACT

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Financial market authorities demand participants in the market to disclose relevant information to the public. So that to prevent the utilization of individuals, less informed, and minority investors by exporting companies, in the ground of Islamic capital markets, particularly in sukuk markets, in order to achieve the bargain by applying the principle of avoiding excessive uncertainty and reducing asymmetry information between different parties in the sukuk contract, where disclosure of specific information is required by Islamic law authorities. Certainly this disclosure is the first layer to protect investor and consumer. Information relating to Sukuk investment is disclosed not only at the time of issue but also thereafter. This is a special trend of the sukuk market. The main objective of this paper is to assess the disclosure regulations within the presentation process and the secondary market activities of sukuk in Saudi Arabia.

Contribution/ Originality: The paper's primary contribution is to assess disclosure rules of sukuk within the offers process and the secondary market activities for provides basic legal information necessary to protect the investors. The results can be used to improve a comprehensive legal framework for sukuk regulations in Saudi Arabia.

1. INTRODUCTION

Sukuk is the Islamic version of conventional debt securities. In Islamic finance, there must be basic rules that qualify as "Islamic compliance", such as profit and loss sharing (PLS), prohibited goods / goods, interest bans (riba), prohibition of speculative or gambling Gharar) and the social welfare of Zakat and Takaful (Daryanani, 2008). Sukuk investors need sufficient information to ensure that their investments avoid usury, money and prohibited goods. Therefore, comprehensive information disclosure before, within, and after presentation of instruments is important to reduce uncertainty and manage risk (Kamso, 2013). Saudi Arabia, is one of the leading Islamic finance companies and has ongoing efforts to develop its governance and management system. Recently, in December 2017, an important development was achieved in the Sukuk regulations in Saudi Arabia. This study will focus on the disclosure of Sukuk in Saudi Arabia based on the latest update of 2017.

The purpose of the forgoing requirements is to "give investors appropriate information about securities to evaluate the present value of securities and to assess whether the secondary market is well organized or otherwise. One of the key documents in the issuance and presenting of Sukuk in conventional financing is the prospectus, an

advertisement or brochure for the marketing of the instruments offered to the target customers, and the contents of the bulletin would be in line with the authority's efforts to encourage the disclosure of animated information about investment decisions. In fact the prospectus should include all reasonable information requested and expected by investors and their consultants to be found in a prospectus due to the rationale of making investment decisions (Zimmer, 2009).

In the prospectus issued by local authority in an Islamic financial market, the guidelines specify the less amount of information that would be disclosed as primary market evidence. Common disclosures are required under these guidelines including information on the issuer, terms and conditions of financing, risk analysis, financial information, estimates and recourse in case of default, intended as use of proceeds and details on relevant party of transactions (Ariff *et al.*, 2013).

Various scholars and references have stated that Malaysia has best practices with comprehensive instruments management regulations (Oseni, 2014; Safari *et al.*, 2014; Zulkhibri, 2015). Malaysian regulations are therefore the North Star of best practice. For example, the Malaysian Securities Commission adopted a disclosure-based approach to the problem, offer, or call for the issuance of conventional bonds or sukuk for local exporters. The Securities Commission agrees to meet the following requirements (SC Guidelines book, 2011):

- Provide a complete set of the relevant documents and information, as precisely defined in the special debt security guidelines, asset-backed securities guidelines, or Islamic securities guidelines, which allow investors to make solemn decisions.
- Compliance with a set of transparent standards required for the source and lead consultant by the virtue of these guidelines.
- Compliance with additional requirements that the Securities Commission may impose to protect some interests of private debt holders or bondholders.

Shari'a Board members have a key role in supervising and overseeing transactions related to Islamic Sukuk, guiding the implementation of Islamic financial products, paying more attention to their development, and ensuring that these investments and development products comply with Shariah requirements (Qureshi, 2011). Thus, as stated by Nabil *et al.* (2012) the Shari'ah Committee reviews its own services and products (such as sukuk) to ensure that all transactions under its supervision are largely in accordance with the terms and conditions of Shariah.

2. SUKUK DISCLOSURE INFORMATION

To reduce uncertainty and investor confidence, disclosure of adequate information is important. This information should include compliance with the Shariah, profile, customer source, and risk.

2.1. Shari'ah Related Disclosures

It is clear that the demand for Sharia is an important demand for potential investors or investors. To evaluate the claim, in most cases it is necessary to know the Shariah which is owned by only a few of the investors themselves, and the unified approach throughout Islamic finance is to demand approval in the fatwa (ruling) submitted by a committee of Sharīah` scholars ah. Depending partly on jurisdiction, this committee (often called the Shari'ah Supervisory Board) may be established by the originator, one of its advisers or by the regulator. Members are usually named in the presentation document. Even if this is not a regulatory requirement, it will usually be done as a matter of market practice, because the use of a reliable group of scientists confers credibility on this issue (Na'im *et al.*, 2016).

In Malaysia and the United Arab Emirates, the role of Shariah is clear and members must be qualified individuals. Sharia scholars who preside over religious councils bear great responsibility (Kuen, 2007). Therefore, it is important that Muslim scholars with high qualifications and reputations be selected to be members of religious

councils. In addition, Islamic sukuk requires that the Islamic Shari'ah body be composed of highly knowledgeable Islamic scholars.

In the several sukuk issuance according to majority, the fatwa will be issued by the Shari'ah Supervisory Committee of some banks, since the entity report may not have its own Shariah board. Consequently, the entity may not be able to monitor changes in the composition of the Shari'ah Supervisory Board on an ongoing basis. In such cases, the reporting entity may apply to the DFSA for an exemption from this rule (Hassan, 2012). The listing rules also include a technical requirement for the reporting entity to submit an annual certificate from the relevant Shariah Board certifying that the instruments still meet the criteria. This is an additional coat of supervision that makes sukuk issuances subject to continuous scrutiny (Al-Elsheikh and Tanega, 2011).

3. DISCLOSURE OF THE RELEVANT SUKUK INSTRUMENTS

In the initial presentation stage, the main features of distinguishing Sukuk disclosures that relate to the nature of the securities offered and the rights attached to it. The regulatory body is likely to see that this requires full disclosure of the structure of the instruments, including at least the substantive provisions of each of the relevant contracts. Regulators are likely to pay more attention to these disclosures in the future, as there have been many defaults or renegotiations of instruments. Some aspects of these failures or failures are discussed below (Safari *et al.*, 2014).

The composition of Sukuk is directly linked to Shariah and is mainly confirmed by the Sharia Committee. When the market regulator accepts some responsibility for legitimate issues, some form of disclosure will generally be required on the basis for requiring Shariah compliance. This usually involves disclosing the details of SSB or any other body that issued an advisory opinion. This is necessary even when there is a comprehensive legal counsel, at least when there is an international market, because the investors represented by the commitment are important and want to continue to assess the quality of the legitimate approval. The same view is often included in the general documentation, although it is usually only briefly (Hassan, 2012).

There was some discussion as to whether sukuk issuers should be obliged to move forward and to disseminate the logic leading to the fatwa for each case. There are two arguments for this. The most obvious argument is that disclosure is the means by which a potential investor can satisfy himself on relevant legal issues, thereby reducing the risk of finding an unacceptable new structure that already contains good legal grounds. But if so, one might expect some exporters to voluntarily disclose such information, because it will help market them. Moreover, large institutional investors will be able to practically request this information, both public and private (Hassan, 2012).

The second, implies often undisclosed, as argument for disclosure will force scientists to think carefully before approving a structure and introduce some of the supposedly weaker structures in the market to external criticism. In principle, this approach should be possible. It will have some impact on the cost, but this will be restricted to other costs related to the marketing and structuring of sukuk issuance. It will add to the length of the prospectus and will not be relevant to some readers, however the effect will be limited as well. Of course the regulators do not wish to impose disclosures that appear not to be required by investors (Hasan, 2012).

4. RISK DISCLOSURE

This type of disclosure is related to periodic reporting on the financial position of the instruments. Risk management is important in all financial activities. The "Integrated Reporting Excellence" survey refers to risks that "will affect the ability of companies to create value" instead of being divided into financial and non-financial risks, much like the disclosure of non-financial key performance indicators, non-financial risks and often increased disclosure without being sufficiently linked to strategy or performance. While companies have shown an improved level of disclosure of items such as the amount of money spent on staff training or subsidies to build future capacity,

the lack of links to goals and strategies has been disappointing for accounting firms. Most of the companies surveyed improved their risk-balanced vision.

The periodic report, most of the time is annual, is the main disclosure that facilitates liquidity risk management in the sukuk market. Liquidity management is important for Islamic securities as it is for conventional securities. However, compared with conventional counterparty, liquidity management is unique and even more challenging as most of the current instruments used to manage liquidity are interest-based and therefore do not comply with Shariah.

5. DISCLOSURE OF FUTURE INFORMATION

Two of the fundamentals of Islamic finance are the social well-being of zakat, takaful and uncertainty on the subject (al-Gharar). Therefore, it is preferable if companies are able to disclose a lot of forward-looking information. This was particularly true when it came to environmental, social and governance concerns. Some reports stated that the reasons cited for non-disclosure are the fear of organizational retaliation and the creation of expectations that can be used against future management, as well as the simple fact that corporate reports traditionally focus on past performance. In its 2011 evaluation, KPMG proposed a fundamental cultural change that was necessary to achieve a truly forward-looking perspective supported by past performance against strategy and strategic perspectives.

The disclosure of future information may include information about periodic payment plans, customer information, financial and credit status, and several additional transparency reports that enhance trust by reducing uncertainty.

5.1. Findings of the Saudi Arabia Sukuk Regulation

As previously discussed, the disclosure of sukuk issuances in the sukuk market process is linked to compliance, issuance and issuance of Islamic Shariah.

5.2. Shariah Compliance

In Saudi Arabia the role of the Advisory Committee or its role in the life cycle of instruments is not vital. Under the CMA Securities Act, CMA is entitled to require the issuer to appoint an advisory committee or a Shariah committee or even to allocate it by the CMA.

5.3. Regulations of Offering (Type)

Prior to the last update in 2017, the offering of securities was two types, a general presentation (presentation for the purpose of listing in the parallel market) or special placement. However, the recent decision of the Capital Market Authority (3-123-2017) published in December 2017 classifies it into three types:

- 1) Exempt offer: The Exempt Offer shall regulate exemptions from meeting the CMA requirements for the presentation of securities which include, for example, securities issued by the Government of the Kingdom. The securities are contracted along with some other cases (Article 8).
- 2) Special placement offer: This is offering with limited subscription to sophisticated investors. In other word, private placement offer is the offer with restricted subscription to sophisticated investors; or the offer is a limited offer. Article 9 regulates the conditions of sophisticated investors, while Article 10 regulates the limited supply requirement to less than 100 offers of 10 million investments.
- 3) General offer or parallel market offer: This type of offer is offered with unrestricted investors or a number of offers. As stated in Article 18, the exporter must be included in the exchange market and must have approvals from the internal regulations of the issuer, the corporate law and its executive regulations. The final decision contains comprehensive material for the appointment of source representatives, source advisers, general presentation requirements, and the application for registration and presentation.

5.4. Regulations of Offering and Issuance

As in Article 28 of the 2017 Decision on the Offering of Securities, the issuer seeking to register and submit its securities shall submit a request to the Commission containing the information required under these rules and, at the same time request the Stock Exchange to request the listing of such securities in accordance with Provisions of the Listing Rules. The registration / insertion (approval) steps as an updated solution include the following issues:

- The source or guarantor, if the exporter is an entity for special purposes, shall submit to the Commission its registration application and provide electronic copies of the required documents (Article 29 a)
- After the application for registration has been approved and submitted by the Authority and prior to listing, the issuer or guarantor, if the issuer is an entity for special purposes, must submit an electronic copy of the additional documents relating to the securities and financial model. State of origin (Article 29b)

The Prospectus shall contain all information necessary to enable the Investor to conduct an assessment of the activities, assets, liabilities, financial position, management and expectations of the Issuer, its profits and losses and shall include information relating to the number and price of securities and any related obligations, rights, powers or privileges. If the Issuer is a Special Purpose Entity, the Prospectus shall include all information necessary to enable the Investor to assess the activity, assets and liabilities of the Special Purpose Entity, as well as the Trustee's assets, liabilities, financial position, management and expected opportunities, profits and losses. It shall include information on the number and price of securities and any obligations of rights, powers and privileges associated with them. The decision footers contain a full set of minimum information required for inclusion in the prospectus.

- Following the approval of the application for registration and offer by the Authority and prior to the listing, the issuer, or the sponsor if the issuer is a special purposes entity, must submit an electronic copy of the additional documents related to securities model and financial status of the issuer (Article 29-b)

The prospectus (offering information) should contain all necessary information to enable an investor to make an assessment of the activities. Similarly assets and liabilities, financial position, management and prospects of the issuer and of its profits and losses must include information in relation to the number and price of the securities and any obligations, rights, powers and privileges attaching to them. If the Issuer is a Special Purpose Entity, the Prospectus shall include all information necessary to enable the Investor to evaluate the activity, assets and liabilities of the special purposes entity, in addition to the sponsor's assets, liabilities, financial position, management, expected opportunities, profits and losses, which should include information on the number and price of securities and any obligations rights, powers and privileges associated with them. In fact, appendices of the resolution have a complete set of the minimum required information to be included in the prospectus.

6. DISCUSSION AND CONCLUSIONS

The role of the Shariah Committee in some leading countries such as Malaysia is vital and there is no list without the Committee's acceptance report. However, in Saudi Arabia the role is optional, and the law is not vital, but the decision is based on the CMA's view. It is thus recommended that Saudi Arabia to have CMA to place the regulations pertaining the role of the Sharia Committee, the structure and drafting of the Sharia Committee in the issuers or granted, and the role of the CMA in the Sharia Committee. For Sukuk types, the 2017 updates in Saudi Arabia contain clear and comprehensive articles describing three different offerings. Therefore, the organization of Saudi Arabia is the best in describing the different types of offers and the latter update greatly enhances the regulations. Although the 2017 regulations have tremendous improvements in terms of registration, requirements and disclosure information, it is recommended that issues which are not found in the laws of Saudi Arabia to be the next focus of future studies. At the moment, the Saudi market is very much internal and allows trading in non-local currency. Therefore, the Saudi organization must be developed and lessons learned from the success of other sukuk markets.

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