

**Research Article**

**SUKUK IN IRAN'S BANKING, CHALLENGES AND OPPORTUNITIES  
A STUDY OF FOUR DECADES OF SUKUK IN IRAN**

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**ABSTRACT**

This article examines the role of sukuk as an instrument of Islamic financing in Iran. Sukuk as an Islamic financing tool has been known in the world economy for more than two decades, especially in the banking system of Islamic and non-Islamic countries, but it is still unknown in the completely Islamic banking system of Iran. In the Iranian banking system, corporate bonds are still used as an alternative to sukuk, which contains many problems. Therefore, the purpose of this article is to investigate the effects of sukuk vacuum on the banking system of Iran and for this purpose its situation in the last four decades (the period after the victory of the Islamic Revolution in Iran) is followed and the advantages and problems of its entry in the banking system will be studied. The results show that the creation of sukuk in the Iranian banking system can help to improve the level of banking and ultimately promote production growth, expand public welfare, attract foreign capital and etc.

**Keywords:** "Corporate bonds", "Iranian banking system", "Sukuk"

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**INTRODUCTION**

One of the most significant discussions in financial science is financing and the most prominent feature of a system Islamic finance is the complete interest boycott. In the Islamic countries, using debt instruments, the most important of which is bonds, is considered usury for religious reasons. For a financial or banking product to be placed in Islamic financial and banking products category, it must meet two basic conditions: firstly, it must not include receiving or paying usury, and secondly, it the capitals collected through it must not be used in haram (forbidden) activities like trading alcohol, pork or gambling (Khan et al., 2020). The types of Islamic financing methods are four: a) debt-based financing, b) trade-based financing, c) investment-based financing and d) financing through the issuance of Islamic securities (Sukuk). Here, the issuance of Sukuk as a replacement for bonds is one of the suitable tools for financing governments, companies and banks. Sukuk are a type of securities to be issued based on the backing of real assets (Tamimi et al., 2017).

With its predominantly Muslim population, Iran has long considered the issue of Islamic finance, and after the victory of the Islamic Revolution, it has been emphasis more. On the other hand, one of the most important concerns in the Iranian economy in the past decades has been liquidity management problems, budget deficits and government financing methods. Moreover, as the Islamic banking system is being implemented in Iran, the existence of a dynamic Islamic capital market is essential for the provision of Islamic financing tools. Given the characteristics of Sukuk, accepted by both Islamic law, and as they bring about the ability to access primary and secondary capital market capacities for financing, the paper will examine the existing obstacles and provide appropriate solutions through a short review of Sukuk and their latest status in the world and Iran, as well as its comparison with corporate bonds.

**A REVIEW OF CORPORATE BONDS IN IRAN**

Corporate bonds are the same bonds issued in accordance with Islamic banking law. Additionally, there are three major differences between the corporate bonds issued in Iran and the common bonds. Firstly, corporate bonds are issued according to the Islamic principles and are

based on investment in economic projects with a positive rate of return, and their profits are divided between investors and those responsible for completing the project (issuer of bonds). Secondly, the issuer has to guarantee a minimum of profit from the project in question, and ultimately that the securities have to be for financing a particular project and cannot be consumed elsewhere. Table 1 shows the status of issuance in Iran after the victory of the Islamic Revolution.

**Table 1: The status of issuance and sales of corporate bonds in 1974-2017 (billion riyals)**

Unsold	Sales	Issuance	Year
0	75	75	1994
0	225	225	1995
0	401	401	1996
76	2,472	2,548	1997
0	3,130	3,130	1998
73	2,377	2,450	1999
0	2,380	2,380	2000
1	6099	6100	2001
723	5,377	6,100	2002
89	11,796	11,885	2003
1,110	18,590	19,700	2004
0	17,000	17,000	2005
3,425	15,775	19,200	2006
9,540	23,510	33,050	2007
501	11,299	11,800	2008
3	17,697	17,700	2009
22,615	156,805	179,420	2010
39,678	52,489	92,167	2011
77,095	143,354	220,449	2012
14,020	34,480	48,500	2013
30,239	2,261	32,500	2014

54,527	33,473	88,000	2015
4,073	16,166	*20,239	
67,724	12,776	80,500	2016
31,140	33,957	*65,097	
44,996	4	45,000	2017
5,867	50,633	*56,500	
407,515	67,601	1,082,116	

\* Reissuance of unsold bonds of the previous year

### Disadvantages of corporate bonds

Although corporate bonds have managed to perform some functions of the bonds, there are some significant disadvantages. Firstly, the issuer obligation is to guarantee the payment of main and interest before the due date, whereas bonds can only be redeemed at maturity. Secondly, in the definition of corporate bonds it is stated that these bonds must be for financing a specific project and cannot be used in other issues, whereas many of the problems of economic enterprises are connected to working capital and current liquidity. Thirdly, the interest paid on corporate bonds is exactly the same as initially announced, and will never be more or less than that value, which could raise the suspicion that these bonds are usurious.

Given the problems stated, the best Islamic financing is through Sukuk. Indeed, using the technique of converting assets into securities, thinkers have introduced a new financial instrument called Sukuk, which is an alternative to the type of securities challenged by religion.

### Definition and history of Sukuk

The word Sukuk, derived from the word check, means a security sheet called "suk" in Arabic and its plural is Sukuk. Using the word Sukuk for Islamic financial instruments was first proposed in 2002 at a jurisprudential meeting of the Islamic Development Bank. Indeed, using the technique of converting assets into securities, scholars have introduced a new financial instrument called Sukuk, which is an alternative to the type of securities challenged by religion (Danila, 2020). Overall, instead of being a debt-based bond, Sukuk is a bond based on an asset issued in real financial transfers (Tamimi et al., 2019).

The definition of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) states that Sukuk is a paper with the same nominal value which, after the end of the underwriting, shows the payment of the nominal amount stated by the buyer to the issuer and its holder owns one or a set of assets, the benefits of the assets or benefits of a project, or a specific investment activity (Standard 17 of AAOIFI).

The idea of converting assets into securities became prevalent in conventional financing in the 1980s and used by Islamic investment banks in different financial transaction structures in the 1990s. In this year, Malaysia issued its first domestic Sukuk worth \$ 125 million with the issuance of Berhard Bank Sukuk, and took the first step towards establishing an Islamic capital market. However, the issue of issuing Sukuk was first raised by Monzer Kahf in 1997, and the first international Sukuk was established in 1999 with the issuance of the Malaysian and Bahrain international Sukuk. In 1994, Iran issued regulations governing the issuance of corporate bonds, and the municipality of Tehran, issued the first corporate bonds as the issuer (Ghasemi Armaki, 2011).

### The need for Sukuk securities in Iran and the world

As in most cases, the current methods and tools of the money and capital market in the world are contrary to Islamic principles, an alternative solution must be provided for it so that countries with Islamic financial system can pave the grounds for economic growth and development by expanding their money and capital market. Furthermore, the countries with a Muslim minority can take full advantage of these solutions to attract the financial resources of Muslims living in those countries. On the other hand, about two billion

people in the world are Muslims, whose capital can have a significant role in the global economy.

The banking system in Iran after the passage of the law on interest-free banking operations in 1983 is managed totally in a Islamic way and the vacuum of such financial instruments in this system (given the use of most Islamic countries and even non-Islamic countries) is clearly felt that is very thought-provoking. Additionally, due to the financial and economic sanctions and the restrictions of Iranian institutions and companies to evaluate the international capital market, the creation and development of this tool should be one of the main priorities of the government and decision-making institutions, and planning and creating platforms for using Sukuk as the innovation in the field of Islamic financing is essential.

### Sukuk gap in Iran banking system

Using the executive approaches in the world's banks and adapting them to the Islamic rules, the law on interest-free banking operations was approved in 1983 and implemented the following year. In other words, Iran's current banking operations and all its banking transactions are in line with the Islamic contracts, and Qardh al-hasan (benevolent lending) contract, with certain characteristics, is separated from the commercial banking industry and operates independently (Najafi, 2006, p. 111). Thus, the current laws of our banking system are the product of many years of experience, updating and Islamizing the country's banking operations law, which have provided the most appropriate situation in practice by coordinating and cooperating with Western banks and accepting Islamic monetary instruments like Sukuk and their partnership agreement. Hence, given the law on usury-free banking, using Sukuk financial tools along with current corporate bonds in the capital market can be a factor for greater diversification and prosperity of the capital market and a suitable tool for financing, liquidity control and risk management for the government, companies and banks. These bonds are a means to a fair distribution of wealth and income, allowing the investors to profitably benefit from the real benefits of economic plans and activities.

On the other hand, Iran economy is mostly bank-oriented, and the government borrows more than the bank, and if it is stronger it borrows from the central bank in the form of a budget deficit. Iran has not developed enough in the capital market that governments and companies can borrow money from the people. Moreover, as the financial system is bank-based, financing of various sectors of the economy is highly dependent on this sector, whereas the country's banking system covers a small share of financial needs due to the lack of proper financial instruments. Thus, it is necessary to move towards financing through appropriate financial instruments (Mousavian, Kavand, and Radadi, 2010).

Another disadvantage of Iran's being bank-based is that there is no proper distribution in the financing sector. This means that at the moment there is no distinction between what kind of financing we want to direct to the bank and what part to the capital market, and there is no indication of how optimal this is. In Iran, large firms go to the bank to finance, which is not the case in developed countries. In these countries, large firms usually turn to the capital market. However, in Iran, it is impossible for large companies to come to the capital market, and this has created many problems in the banking sector. These banking problems have prevented the capital market from being used again. In other words, a cycle has developed that the banking system itself is an obstacle to financing the capital market. Thus, there is no proper distribution in the financing sector for small, medium and large enterprises.

On the other hand, Iran economy currently faces a dual situation concerning liquidity. There is a surplus of liquidity in the demand and household sectors, and this creates demand and artificially raises prices. At the same time, the economy grapples with a shortage of liquidity in the manufacturing sector and in the manufacturing and supply sectors. Businesses also face deficits and a lack of liquidity for turnover, production, and working capital. Using new financial

instruments can be a solution to this problem. Moreover, in Iran's economy status quo, in spite of the two characteristics of increasing liquidity and high unemployment rate, it seems necessary to use financial instruments to direct stray liquidity to production and service sectors (Soroosh 2007).

Thus, given the points stated, using new and widely accepted financial instruments seems inevitable. Thus, the establishment and operation of the jurisprudential committee in the capital market in the second half months of 2007 was of the measures to take advantage of the opinions of jurists and experts in the field of Islamic finance and create a platform for innovation and growth of Islamic financial instruments. Introducing new Islamic financial instruments in the capital market (which so far includes the presentation of seven models of rental Sukuk, futures contract, mortgage corporate bonds, model in line with the law of equity loan sale, parallel forward securities model and future stock trading model) are considered of the outcomes of this measure. Thomson Reuters Zawya (2015) stressed that Sukuk is becoming a very important Islamic financial instrument both in Islamic and non-Islamic countries. Additionally, Sukuk has become a significant tool for raising effective and efficient finance during the transformation, allocation and equipping of resources in international capital markets.

As Table 2 shows, the share of Sukuk in the total resources of all banks of Iran is almost zero, showing that the banks have failed in the field of Sukuk.

**Table 2: Total balance of Riyal and foreign exchange facilities and deposits of banks and credit institutions until December 20, 2016 (billion Riyals)**

Facilities (current and non-current)	Percentage of Sukuk to total resources	Sukuk issued	Deposits before deducting legal deposits	Deposits before deducting legal deposits
17,409,196	Almost zero	0.004	22,163,966	24,716,853

Source: Central Bank of the Islamic Republic of Iran

The development of financial markets regarding tools and structure is of the issues to be considered in the form of interest-free banking system and convergent with the world's advanced financial instruments to advance the country's economic development goals. Given the developments in the financial system in the world and Islamic countries, it is necessary to diversify the new financial instruments to equip resources, to increase the efficiency in the field of equipping resources, which calls for providing and creating the necessary institutions and infrastructure to operate this tool for development of Islamic financial system and thus economic development of the country. Hence, the significance and necessity of such studies in this field and identifying and examining its unknown aspects is felt more than ever considering the necessity of launching new financial instruments to reach goals like deepening the country's financial system, dynamism of financial innovation process, sustainability and health of financial institutions and increasing their efficiency and effectiveness.

Now that the gap of Sukuk is obvious in the banking system, its benefits can be listed as follows by considering all aspects:

Providing liquidity to the applicant unit, development and diversification of financial and capital markets, production growth, expansion of public welfare, collection of small and stray capitals, a suitable tool for applying monetary policy of the central bank, and liquidity management have less risk as they are issued with the support of assets, reduction of the financing of foreign resources and so on.

#### Sukuk status in Iran and the world

Iran established the first Sukuk in 1994 and before all Islamic countries as corporate bonds, but unfortunately this tool has been

overlooked by banks and only some companies use it in a limited way. Now, according to Table 3, the volume of Sukuk issuances from 2001 and 2018 has been examined.

**Table 3: TOTAL GLOBAL SUKUK ISSUANCES (JAN 2001 - DEC 2018) ALL TENORS, ALL CURRENCIES, IN USD MILLIONS**

Amount USD	Year
66,830	<b>2006-2001</b>
50,184	<b>2007</b>
24,337	<b>2008</b>
37,927	<b>2009</b>
53,125	<b>2010</b>
93,173	<b>2011</b>
137,599	<b>2012</b>
135,557	<b>2013</b>
107,300	<b>2014</b>
67,818	<b>2015</b>
87,784	<b>2016</b>
116,717	<b>2017</b>
123,150	<b>2018</b>
1,101,502	<b>Total</b>

Source: IIFM Sukuk database

As is seen, the total volume of global Sukuk issued in the first two decades of the twentieth century is so high, which shows that this important tool has found its status in the world economy and cannot be overlooked easily. Even in the second half of the table (second decade), the upward trend in the issuance of these bonds is quite evident, except in some years. However, Iran's status is very low and the volume of Sukuk issued is very small compared to other countries, and given the Islamic nature of the entire banking system in Iran and all banks, it is very disappointing. Table 4 shows the statistics of Sukuk issued separately by countries for further clarification of the issue.

**Table 4: Global Sukuk Issuances By Country 2001-2018**

Name	USD	Percent
<b>Malaysia</b>	649,313.399	58.948
<b>Kuwait</b>	6,675.102	0.606
<b>Jordan</b>	341.466	0.031
<b>Japan</b>	286.391	0.026
<b>Iran</b>	561.766	0.051
<b>Indonesia</b>	38,100.954	3.459
<b>Germany</b>	561.766	0.051
<b>Gambia</b>	143.195	0.013
<b>Brunei</b>	8,404.460	0.763
<b>Yemen</b>	55.075	0.005
<b>Bahrain</b>	32,450.249	2.946
<b>UAE</b>	138,756.207	12.597
<b>UK</b>	771.051	0.07
<b>USA</b>	5,573.600	0.506
<b>Turkey</b>	11,477.651	1.042
<b>Sudan</b>	37,803.549	3.432
<b>Qatar</b>	48,818.569	4.432
<b>Singapore</b>	539.736	0.049
<b>Saudi Arabia</b>	98,397.174	8.933
<b>Pakistan</b>	19,210.194	1.744
<b>Nigeria</b>	429.586	0.039
<b>Hong Kong</b>	2,830.860	0.257

Total	1,101,502	100
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Based on Table 4, Malaysia is the pioneer of Sukuk in the world, followed by the countries bordering the Persian Gulf with Saudi Arabia at the top but with a great distance behind and Iran has a very small share in this issue as a member of the GCC. Interestingly, non-Muslim countries, and even countries that do not have Islamic banking, have been much more successful in issuing Sukuk bonds and have increased their market share.

#### Review of Sukuk instructions in Iran

There have been no written instructions on the issuance of Sukuk bonds by banks to the banking network until recently, meaning that not only there was no serious determination on the part of the Central Bank of the Islamic Republic of Iran, but also no desires on the part of banks. Four years after the formation of the Jurisprudential Committee of the Capital Market and in March 2011, the instructions for issuing rental Sukuk (Riyals and foreign exchange) in the banking system were finally approved by the Monetary and Credit Council and communicated to the banking network with 23 articles and 5 notes. It has to be noted that this instruction is only for rental Sukuk and other types of Sukuk still do not have a license for publication. Moreover, after this instruction, only two banks, Maskan and Saman, started issuing Sukuk with very limited amounts as described in Table 4. Thus, one can state that in spite of the existence of instructions from the Central Bank, there are still problems with the issuance of Sukuk securities, some of which are to be stated in the next section.

#### Disadvantages and limitations of Sukuk financing in Iran

1. Lack of enough communication between universities and Iran economic sector
2. The existence of economic sanctions: the rules governing the issuance of corporate bonds was first adopted in 1994, but the first ideas on the use of capital instruments were formed three years later in 1997 given the lack of knowledge of Iranian academics (Ghasemi Armaki, 2012)
3. Lack of proper evaluation criteria for investment portfolio consisting of Islamic financial instruments
4. Weakness in expertise and improper analysis of project profitability
5. Lack of enough knowledge of investment literacy as well as the concept of risk in Iran
6. Improper regulations and structures for attracting foreign investment
7. Market maker limitations
8. Lack of ranking mechanisms
9. Lack of strong companies in terms of rankings
10. None-use of international expert consultants

#### CONCLUSION

Sukuk is a very powerful financing tool that able to help banks to advance their goals and ultimately lead to increased welfare and economic growth, job creation and so on. Sukuk issuance has been very popular among Islamic countries and has even become a way to attract Muslim capital in many non-Islamic countries, but unfortunately it has been overlooked in Iran, where the banking system is 100% Islamic. Additionally, by stating some advantages of issuing Sukuk and some of the problems of its issuance in Iran, the paper has done an implicit study on global statistics and its position among Iran's banking resources. The paper indicates that the banks approach towards attracting resources has to change and the government and especially the Central Bank of the Islamic Republic of Iran should pay special attention to attracting stray capital and foreign investment with special support for the issuance of Sukuk even as a new financial policy.

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