



FINANCIAL SERVICES AND THE TREASURY BUREAU

Further Consultation

Proposed specific features of Wakalah and floating-rate commodity Murabahah sukuk structures

SUBMISSIONS

The Law Society's Revenue Law Committee has reviewed the Further Consultation "*Proposed specific features of Wakalah and floating-rate commodity Murabahah sukuk structures*" (Consultation) and makes the following submissions:

Proposed specific features of the agency arrangement

Question 1

Do you agree that the description in paragraph 2.1 can accurately reflect the key features of the underlying structure of Wakalah sukuk in the market? Please explain the reasons for your views.

Law Society's response

We agree that the specific features contained in paragraphs 2.1.1 to 2.1.3 reflect the underlying structure of a wakalah sukuk as it follows the Shariah principles for the appointment of an agent (Wakil).

It must be accepted that the agency is an immediate agency for these purposes.

We suggest either the legislation or the DIPN address the issue of the acceptability of appointing more than one agent (Wakil).

Additional comments

Paragraph 2.1.4

We suggest clarification that the management activity is at the cost of the bond issuer. It is noted that the list of management activities is not exhaustive but you may consider adding "replacement" and "maintenance" for greater certainty at first sight.

Paragraph 2.1.5

This seems to limit the wakalah to a specified form of agency fee. The drafting should allow agency fees in general and as an alternative permit an incentive fee basis if agreed by the parties under the agency agreement. This can be dealt with under the DIPN.

We note there is a possible disadvantage that the incentive fee could end up being non compliant as it involves a debt due and possible delay in payment. It also has to satisfy the test under an Ijarah. The liquidity provided would also have to be tested to exclude interest (riba).

We suggested the following draft for consideration:

“The bond-issuer is entitled to the profits from the management of the specified asset and the originator is entitled to a fee based on a fixed agency fee or a specified fee on an incentive fee.”

Paragraph 2.1.6

The proposal is acceptable. However as to the inclusion of a commodity Murabahah there must be sufficient detail to show such structures because of restrictions on the use of Murabahah for deferred payment when dealing with gold or silver, or the other categories of commodities that come with the principles of interest (riba). It may also end up as a hybrid sukuk which may not come within the legislation which is limited to certain identified alternative bonds (sukuk).

Proposed specific features of the floating-rate purchase and sale arrangement

Question 2

Do you agree that the description in paragraph 3.2 (read together with paragraph 3.1) can accurately reflect the key features of the underlying structure of floating-rate commodity Murabahah sukuk in the market? Please explain the reasons for your views.

Law Society's response

Paragraphs 3.1.1 to 3.1.3

We consider paragraphs 3.1.1 to 3.1.3 correctly set out the features of a sale and purchase under a Murabahah structure.

Paragraphs 3.2.1 to 3.2.3 also address the repeated nature of the multiple sequential sale and purchase transactions leading to the last transaction by the end of the specified term.

We have already dealt with the disadvantages of dealing with commodity Murabahah structures but these will not affect the proposed legislation as it follows the Shariah principles. Our only concern is that the underlying structure may run the risk of falling into a hybrid sukuk not envisaged within the present proposed legislation, but this would be a risk for the issuers to address to ensure they do not fall foul of the legislation.

**The Law Society of Hong Kong
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