

RESEARCH ARTICLE	Sukuk Industry; Challenges, Issues and Prospects for better Future (With reference to the challenges of Sukuk industry in Algeria)	
Ramdani Hamida	Doctor	
	Faculty of Economics, Business and Management Sciences, University of Ouargla	
	Algeria	
	E-mail: hamidaramdani87@gmail.com	
Benzid Rabia	Doctor	
	Faculty of Economics, Business and Management Sciences, University of Ouargla	
	Algeria	
	Email Id- benzid.rabia@univ-ouargla.dz	
Nacer Slimane	Professor	
	Faculty of Economics, Business and Management Sciences, University of Ouargla	
	Algeria	
	E-mail Id: nacer.slimane@univ-ouargla.dz	
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Abstract This study aims to investigate the most important challenges and issues that face the Sukuk industry in the world, after it has become an important financial tool for financing in several environments, whether Islamic or Western, and these challenges and issues related to Sukuks require solutions in order not to turn with time, into a copy of the traditional bonds. The main finding of the study revealed that the problem of asset ownership and its consequences are the most important challenges, and the gradual tendency of Sukuk to shift towards fixed debt instruments is the most important issue. Moreover, the researcher presents some proposals for a better future for the Sukuk industry with high performance for these instruments. Concerning Algeria, the current legal texts and regulations are the most important challenge to the establishment of a real Sukuk industry, and this requires its adjustment, in addition to the absence of a law for Sukuk, unlike what exists in other Arab and Islamic countries, accordingly the Algerian legislator have to adjust the current laws and put new ones aligned with the Sukuk nature.		
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Introduction

Sukuk represent a versatile financial instrument for financing economic activities, having gained widespread use and popularity in recent decades across diverse environments and countries due to their advantages. This is not limited to Islamic nations but extends even to Western countries.

Given this broad adoption, Sukuk, along with their market as a specialized industry, face significant challenges and issues at both global and local levels. These challenges must be addressed to ensure their continued development in the future and to devise solutions and methodologies that allow this industry to respond effectively. Notably, there is the risk of Sukuk becoming a mere replication of conventional bonds in financial markets in the future.

It is also known that Algeria aspires to establish a comprehensive Islamic financial industry with its various components (Islamic banking, Takaful insurance, and Sukuk). After the country's authorities made significant efforts between 2018-2020 to create a suitable legal framework for Islamic banking and for Takaful insurance in 2021, they are now working to complete the system by establishing a legal framework for Sukuk.

Accordingly, this paper seeks to answer the following key questions:

- What are the major challenges and issues facing the Sukuk industry and market?
- What are the future prospects of this industry in light of these challenges and issues to ensure a better future?
- What are the main challenges confronting the Sukuk industry in Algeria?

We will attempt to address these questions through the following sections:

I. Challenges of the Sukuk Industry.

II. Issues in the Sukuk Market.

III. Optimal Future Prospects for the Sukuk Industry.

IV. Challenges Facing the Sukuk Industry in Algeria and Proposed Solutions.

I- Challenges of the Sukuk Industry:

There is no doubt that the progress of the Sukuk industry has achieved significant successes. However, like other products in the Islamic financial industry, it faces numerous intertwined and closely related practical challenges that may limit its economic efficiency and hinder its development and growth in the future. The most significant of these challenges can be summarized as follows:

I-1- Challenges of Divergent Fatwas in the Sukuk Industry:

One of the most significant challenges facing Sukuk is the divergence of Sharia opinions at various levels, particularly at the local, regional, and international levels. This divergence primarily arises from conflicting fatwas on Islamic financial matters. The consequences of these challenges, stemming from conflicting fatwas and differing juristic interpretations, include discrepancies in the Sharia standards governing Islamic financial products, particularly Sukuk. This has resulted in contemporary issues for the Sukuk market, such as legal disputes in courts, difficulties in marketing Sukuk, challenges in compliance and increased risks, as well as additional costs.¹

II-2- Ownership Issues in Sukuk:

This issue becomes more evident when examining the practical application of Sukuk structures based on the criterion of asset ownership, which includes asset-backed Sukuk and asset-based Sukuk. Asset-backed Sukuk entail the full legal transfer of asset ownership under the contract to the Sukuk holders. In contrast, asset-based Sukuk involve transferring the usufruct ownership to Sukuk holders, with recourse to the issuer or originator through a payment guarantee rather than relying on the assets themselves. This has raised questions about the true ownership of asset-based Sukuk holders. Under British law, beneficial ownership although not legal ownership grants the holder advantages of real ownership, even when

the assets are registered in another party's name. However, in practice, the issue lies not in beneficial ownership as defined by British law but in the restriction placed on the beneficial owner's ability to dispose of the assets. Such restrictions conflict with the principles of public and private law governing this type of ownership.²

I-3- Legal and Regulatory Challenges:

Legal challenges in the Sukuk industry often relate to the conflict between legal ownership and beneficial ownership, as well as the difficulty of applying the principle of beneficial ownership in certain legal systems. This has led to the non-recognition of beneficial ownership in the civil laws of some jurisdictions, such as Quebec in Canada. Regulatory and oversight challenges, on the other hand, stem from the lack of recognition of Sukuk and their investment nature in some legal frameworks. Even in jurisdictions with regulatory systems that include Islamic capital markets, there is often an absence of comprehensive incorporation of Sharia requirements into their regulatory and legal frameworks. Instead, the focus is limited to Sharia approval without adequately addressing the nature and characteristics of Sharia-compliant contracts, whether related to debt-based contracts or partnership-based contracts.³

It is also evident that some regulatory and oversight environments in certain countries do not contribute to the development of their Sukuk issuance markets. For instance, in Indonesia, the legal framework governing securities is only suitable for debt-based Sukuk issuances. Meanwhile, in Kuwait, Sukuk are issued by offshore financial institutions due to the absence of a legal framework to support domestic Sukuk issuance. Even after amendments to the system, it did not permit the establishment of a Special Purpose Vehicle (SPV).

Therefore, among the most significant impacts of the legal, regulatory, and oversight challenges facing Sukuk, the following can be noted:⁴

- The absence of a legislative and regulatory framework for the issuance and management of Sukuk constitutes a major obstacle and challenge to the development and growth of the Sukuk industry.
- Courts in some Arab and Western countries treat Sukuk holders as creditors rather than asset owners, based on the precedent of conventional bonds. This deprives Sukuk holders of their ownership rights over the assets. Furthermore, conflicts in laws regarding legal and beneficial ownership, along with the difficulty of applying the principle of beneficial ownership in some legal systems and its subsequent judicial rejection in certain countries, undermine the credibility of Sukuk.

I-4- Challenges of Marketing and Competitive Requirements:

This type of challenge lies in issuing Sukuk based on marketing and competitive requirements while reconciling these with Sharia requirements. Sukuk are ownership instruments and a legitimate alternative to conventional bonds. Therefore, they face competitive challenges in the processes of marketing and sale, as investors typically seek financial instruments with guaranteed principal and returns two features that are not available in Sukuk.⁵

I-5- Challenges of Prevailing Economic Conditions:

Sukuk are influenced by the prevailing economic conditions in the concerned country. During periods of recession, investment projects, including those funded by Sukuk, tend to decline, leading to reduced profits or even losses. This negatively affects the demand for Sukuk. Additionally, the size of a country's natural resources and the nature of its economy inversely correlate with the growth of Sukuk issuance. The greater the natural resources and the dependency of the economy on these resources, the lesser the need for financial resources, resulting in a decline in the volume of issued Sukuk.⁶

II-Issues in the Sukuk Market:

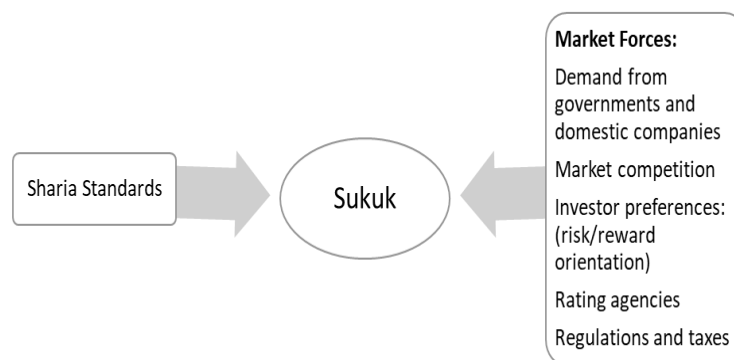
In addition to the challenges of divergent fatwas in the Sukuk industry, as well as legal and regulatory challenges and ownership issues, the Sukuk market faces technical issues related to its development and infrastructure. These issues are reflected in the following key technical concerns:

II-1- Sukuk: Equity or Debt (Bonds)?

Despite the classification of Sukuk as instruments of ownership participation according to Sharia Standard No. (17) on investment Sukuk issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) ⁷, reality shows a convergence between Sukuk and both equities and conventional bonds. Sukuk essentially become bonds if they deviate from Sharia standards and resemble equities if they comply with Sharia requirements. This observation resonates with the actual state of Sukuk, which differs from its theoretical framework based on Sharia rules established by the resolutions of fiqh academies and international Sharia standards. ⁸

While acknowledging the importance of Sharia requirements, commercial transactions and market considerations have influenced the trajectory of Sukuk to make them closer to debt instruments than equity participation. Many institutions operating in Islamic financial markets, under competitive pressures, have moved closer to conventional global financing practices, making Sukuk resemble traditional bonds. This shift has only been possible by overlooking several adopted Sharia standards. Figure (1) below illustrates the tension between Sharia standards and market forces shaping the structure of Sukuk.

Figure (1): The Structure of Sukuk Between Sharia Standards and Market Forces



Source: Mohammed bin Ibrahim Al-Suhaibani (2016), The Role of Sovereign and Quasi-Sovereign Sukuk in Financing Income-Generating Infrastructure Projects, Working Paper Presented at: "The Tunis International Forum on Sukuk (The International Symposium on Sukuk in Service of Employment)", Tunisia, 25-30 November 2016 (adapted).

Governments and companies often seek financing not through equities, but rather through Sharia-compliant financial structures that resemble debt instruments. This is primarily to address deficits in public budgets or to enhance the efficiency of corporate capital structures⁹. Conversely, there are various segments of investors who seek low-risk, quasi-fixed income securities as alternatives to conventional bonds. This demand has likely driven the Sukuk market toward structures resembling bonds. However, these investors still welcome the idea of having assets as collateral to secure the debts owed by the issuer ¹⁰.

This trend has been further reinforced by the entry of credit rating agencies into the Sukuk market, offering ratings to enhance their appeal to investors. However, these agencies rely on conventional credit rating models, and given their influence and role in shaping investor decisions, they indirectly impose restrictions on Sukuk structuring. These restrictions often conflict with the core Sharia standards upon which Sukuk are based ¹¹.

Additionally, the regulatory environment, particularly tax-related regulations, poses challenges. Both issuers and investors bear additional costs for issuing Sukuk when regulators do not implement initiatives to support the Sukuk market.

For instance, how should the returns earned by Sukuk holders be treated for tax purposes? Will they be treated as returns on debt instruments or taxed like equity dividends? Given the tax advantages that debt instruments enjoy in most countries, this has provided an additional incentive to structure Sukuk in a way that persuades tax authorities to treat them similarly

to conventional bonds for tax purposes. This approach has led to marketing Sukuk as debt instruments, even though from a Sharia perspective, they are closer to equity¹².

Furthermore, countries that aim to develop their Sukuk markets often find themselves constrained by tax issues that do not align with Islamic finance requirements. In this regard, the United Kingdom issued a legislative framework for Sukuk financing, treating them as debt instruments for tax purposes. Meanwhile, Malaysia amended its tax laws and implemented tax neutrality, enabling it to develop its Sukuk market effectively.

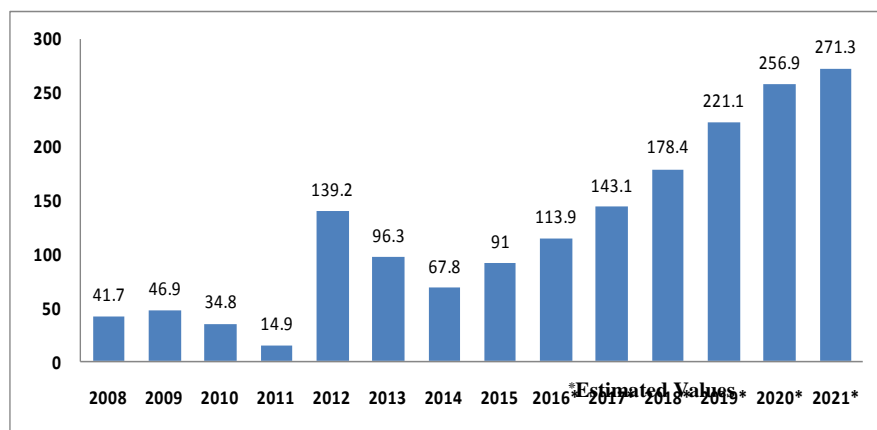
From the above, it is evident that what shapes Sukuk as debt instruments, equity, or more accurately, participation tools, is not the Sharia standards but rather the legal and tax framework and the investment environment of the issuing country¹³.

As a result, Sukuk structures have deviated from the adopted Sharia standards. During the 2008 global financial crisis, Sukuk faced several criticisms, with some scholars questioning their compliance with Sharia principles. In response to these criticisms, the Board of Directors of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) convened and issued additional resolutions that issuers must adhere to, aiming to prevent Sukuk structures from conflicting with Sharia principles. AAOIFI has also worked diligently in collaboration with other Sharia boards and fiqh academies to rewrite the Sharia standard for Sukuk in light of the significant developments that have occurred in this market¹⁴.

II-2- The Issue of Sukuk Trading:

Another technical issue facing Sukuk is the limited trading activity in the Sukuk market from its inception to the present day. This is primarily due to most investors preferring to purchase Sukuk and hold them until maturity. Although Sharia standards are the main factor determining the tradability of Sukuk in the secondary market, other factors also influence this issue. One of the most frequently cited reasons is the insufficient supply compared to demand.

Figure (2): The Gap Between Supply and Demand in the Sukuk Market for the Period (2008–2021) (in Billion USD)



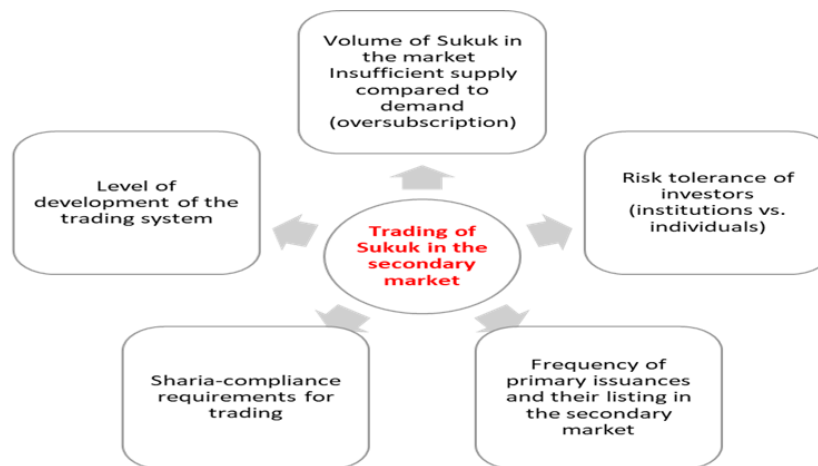
Source: Benzid Rabia (2020), Behavior and Determinants of Returns and Risks of Sukuk: A Theoretical and Applied Comparative Study on a Selected Sample from the Sukuk, Stock, and Bond Markets During the Period 2008–2017, Doctoral Dissertation in Economics, Faculty of Economic, Commercial, and Management Sciences, University of Ouargla, p. 86

The above Figure (2) illustrates the continuous widening of the gap between supply and demand for Sukuk during the period (2014–2021). In many cases, there is a high demand for subscription compared to the supply of issuances. Given the limited supply, investors prefer to hold onto their Sukuk, as they may not find comparable alternatives if they sell their holdings.

Another factor influencing the trading volume of Sukuk listed on financial markets is the frequency and continuity of issuances. Some researchers¹⁵ have pointed out that the availability of sovereign Sukuk plays a significant role in stimulating the trading of other types of Sukuk, as it provides a benchmark for pricing these other instruments¹⁶.

The trading mechanism itself is also a factor that can impact the trading volume of Sukuk. Unlike equities, many Sukuk are not listed on organized markets but are traded in parallel markets, similar to bonds. In practice, Sukuk are often listed on organized markets solely for initial offerings. Additionally, there is an increasing trend toward reliance on electronic trading of Sukuk. However, without sufficient supply, there will not be active trading¹⁷.

Figure (3): Factors Influencing Sukuk Trading



Source Benzid Rabia (2020), Previously Cited Reference, p. 87.

II-3- Issues of Sukuk Credit Rating:

Credit rating and its application represent one of the most prominent contemporary issues related to Sukuk issuance. Given investors' current perception of Sukuk particularly international ones as fixed-income instruments, they tend to avoid investing in fixed-income tools that lack credit ratings. However, theoretically, Sukuk ratings should not only focus on credit risks, as is the case with conventional bonds, but also consider several other elements, most notably the contract structure between the issuer and Sukuk holders. The risks faced by Sukuk holders are inherently tied to the nature of that contract.

Credit rating is also significant for issuers as it facilitates the marketing of their Sukuk, enables them to secure better pricing, extends the investment horizon, and attracts more investors. These investors typically demand that Sukuk be rated by global agencies such as S&P, Fitch, or Moody's. However, these agencies do not take into account the Sharia compliance of Sukuk, as determining this is the responsibility of Sharia boards. Additionally, they overlook Sharia-specific risks (e.g., ownership risks) when assigning ratings. These agencies tend to rely on debt-rating standards for Sukuk, emphasizing the creditworthiness of the Sukuk issuer and guarantees for capital and returns¹⁸. Such characteristics are theoretically not applicable to all Sukuk structures.

For example, Sukuk structured as ijara (leasing with ownership transfer) can be credit-rated due to their structural nature. However, Sukuk based on partnership models, such as mudaraba Sukuk, cannot be credit-rated since the mudaraba contract prohibits guaranteeing capital by the mudarib (fund manager). Thus, there is no credit element to rate, leading most issuers and investors to avoid such Sukuk¹⁹.

As a result, the current practice of credit rating for Sukuk does not reflect Sharia-related risks or the unique risks associated with each Sukuk structure, including their types, nature, and risk weights. This is because credit rating agencies and external audit firms approach Sukuk ratings in a manner very similar to that of conventional bonds. This highlights the need for Islamic credit rating agencies that combine technical (credit) and Sharia-compliant Sukuk ratings, such as the Islamic International Rating Agency (IIRA)²⁰. However, despite IIRA's focus on rating Islamic financial industry sectors, its current practice remains centered on Sharia compliance ratings for institutions, without extending to credit and Sharia ratings for Islamic financial products like Sukuk²¹. This limitation may stem from the lack of consensus on a clear methodology for Sukuk rating.

In this context, numerous seminars, conferences, workshops, and collaborative research efforts have been conducted, involving Sharia scholars, Islamic finance experts, legal professionals, and credit rating agency specialists. These efforts aim to study the risks associated with each Sharia-compliant contract underlying Sukuk, explore hedging methods and necessary guarantees, and establish a suitable rating methodology²². It is also crucial to consider the Sharia disputes regarding Sukuk structures during the rating process until unified Sharia standards for Sukuk are achieved.

II-4- The Issue of Sukuk Pricing:

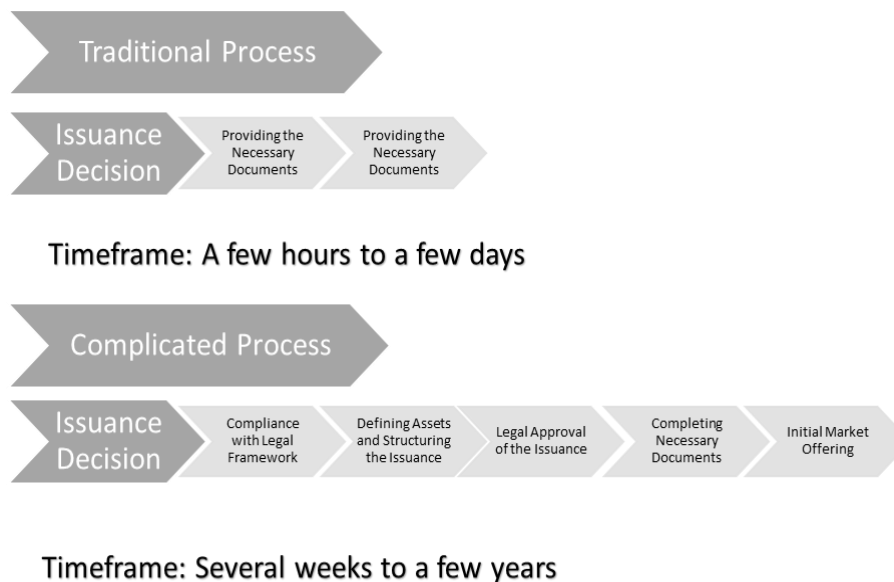
Although Sukuk were introduced as a Sharia-compliant alternative to conventional bonds, which are based on the concept of interest (riba), by generating returns derived from the performance of investment assets supporting their issuance and based on the principle of profit and loss sharing, their pricing in practice remains closely tied to interest rate levels. Specifically, the London Interbank Offered Rate (LIBOR) or its equivalents are commonly used as a reference rate for determining the returns of most Sukuk issuances, particularly international ones.

Despite the call made during the Symposium on Problems of Islamic Banks, organized by the Islamic Fiqh Academy and the Islamic Research and Training Institute from April 10-14, 1993, in Jeddah, which recommended: "The urgent need to establish an Islamically acceptable index to replace the reliance on interest rates in determining profit margins in transactions"²³, Islamic financial institutions have continued to rely on LIBOR. This reliance is often justified with the persistent claim that it is a temporary measure until an Islamic alternative index is established.

II-5- The Complexity of Sukuk Issuance:

In practice, the process of issuing Sukuk is more complex than issuing conventional bonds. Major international credit rating agencies indicate that, despite efforts to simplify procedures and reduce cost gaps in Sukuk issuance, the process remains more complicated compared to conventional bonds. This complexity arises specifically in terms of the time required, the degree of intricacy, the documentation needed, the preparation costs, and the involvement of various parties and entities in the issuance process. A particular challenge lies in the requirement to identify the assets associated with the issuance to meet Sharia compliance requirements.

Figure (04): Duration of Sukuk Issuance Compared to Conventional Bond Issuance



Source: Palestine Capital Market Authority (2016), Report on: Sukuk and the Requirements to Enhance Their Role in the Development of the Palestinian Economy, General Administration for Studies and Development, November 2017, pp. 36-37.

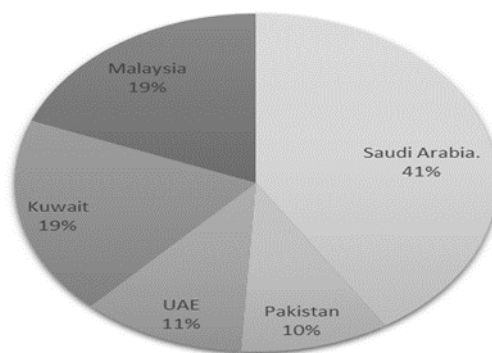
Mohammed Al-Khunaif** emphasized that the vast majority of issuances in the Gulf markets, particularly in the Saudi market, tend toward complex issuance structures, especially hybrid Sukuk. For international investors, understanding such complex issuance structures can be challenging. As a result, these issuances often carry a price premium when offered in international markets, which may burden the treasury with additional costs during Sukuk issuance. This contrasts with issuances structured under ijara or wakala bil istithmar (agency for investment), which have seen increasing demand in recent times.²⁴

II-6- Sukuk Defaults²⁵:

The Sukuk defaults emerged following a series of defaults in the Sukuk market, driven by the impact of the 2008 global financial crisis on certain sectors of the economy. Although the Islamic financial industry was not directly affected by the collapse of Western financial markets, the number of defaults increased significantly during the period (2009–2010), reaching approximately 22 cases with varying proportions, as illustrated in Figure (5) below, which shows the distribution of Sukuk defaults by country.

According to the international financial institutions' database on Sukuk, 16 Sukuk in the market were fully defaulted during that period, while the remainder were on the verge of default. Comparing the value of defaulted Sukuk, totaling \$1.56 billion, with the total Sukuk issuance in the market, which amounted to \$161 billion at the time, reveals that defaults represented only 1% of the market.²⁶

Figure (05): Distribution of Sukuk Defaults by Country During the Period (2008–2010)



Source: ISRA (Islamic Financial Services Board), Islamic Financial System, previously cited reference, p. 503.

The issues surrounding Sukuk defaults, from a Sharia framework perspective, lie in the absence of a clear and precise definition of the concept of Sukuk default (or insolvency). There is significant debate over its jurisprudential meaning, given that Sukuk holders are ultimately the owners of the assets backing the Sukuk issuance.

From a practical standpoint, the challenge observed during the recent defaults between 2009 and 2010 was that Sukuk holders did not possess full ownership of the assets represented by the defaulted Sukuk, and they were unable to reclaim them. Following the restructuring of some defaulted Sukuk by their issuers, the Sukuk structures were tested for the first time in practice, leading to a clearer distinction between asset-backed Sukuk and asset-based Sukuk.

It became increasingly evident that only a limited number of Sukuk genuinely conferred asset ownership. This raised growing concerns about the ability of investors to be protected from the issuer in cases of Sukuk insolvency.²⁷

III- Optimal Future Prospects for the Sukuk Industry:

For the Sukuk industry to have a brighter future, numerous efforts and significant measures are required. The best solutions to its challenges lie in those that engage the widest possible range of stakeholders. This involves integrating the

efforts of Sukuk architects, whether they represent regulatory and supervisory authorities, legal entities, or Sharia scholars, to address two key aspects²⁸:

- **The First Aspect: Framework at the Macro Level:**

For Sukuk to combine compliance with Sharia principles and objectives in Islamic financial transactions while achieving international competitiveness and becoming a comprehensive alternative to conventional bonds, the following macro-level requirements must be considered:

- Developing human capital.
- Raising investor awareness of Sharia aspects.
- Achieving financial inclusion for Islamic finance.
- Enhancing global communication for Islamic finance.
- Creating added value in all fields.

- **The Second Aspect: Development of Tools and Mechanisms:**

This focuses on:

- Designing products based on participation.
- Creating products that align with the maturity terms of financing.
- Developing mechanisms for Sukuk capital protection and ensuring tax neutrality.

It is evident that one of the most important aspects to consider for the future of Islamic finance theorists, if they aim to develop the Sukuk industry, is to find solutions to the challenges it faces by rationalizing Sukuk issuances. Rationalization is seen as a key solution to the issues affecting the Sukuk industry and market.

Rationalization refers to shifting the market's perception of Sukuk to align with their Sharia-compliant nature, recognizing them as investment instruments (not debt instruments) where holders bear the investment risks in accordance with Sharia rules. This includes risks to capital and returns, with continued Sharia supervision until the Sukuk are extinguished.

To achieve this, it is essential to issue asset-backed Sukuk that meet the following criteria²⁹:

1. Sukuk holders must have legitimate and legal ownership of the underlying Sukuk assets (e.g., registering real estate ownership under the name of Sukuk holders via the special-purpose vehicle).
2. Sukuk holders must have the right to recourse to the underlying Sukuk assets.
3. Sukuk holders must bear the risks of damage or loss of the underlying assets as well as the fluctuations in their returns, in accordance with the mechanisms employed.
4. Sukuk holders must bear the direct costs and expenses associated with the Sukuk assets and their investment activities.
5. The role of the Sharia board must not be limited to approving the mechanism and documents of the Sukuk but must extend to supervising their extinguishment.
6. All these requirements must be reinforced by binding legislation and standards issued by regulatory authorities and Sukuk listing markets.

The fulfillment of these conditions in Sukuk issuances will lead to the following outcomes:

- Removing Sukuk assets from the balance sheet of the Sukuk originator from an accounting perspective (this will not be limited to being a Sharia requirement).
- Applying accounting standards to Sukuk that align with their investment nature.
- Once credit rating agencies consider the quality and efficiency of assets, as well as their Sharia compliance, in Sukuk ratings, Sukuk will no longer be viewed as debt instruments (or fixed-income tools).
- Establishing an independent market for their listing and trading.

Ultimately, the goal is for the Sukuk industry to achieve its ideal vision, where its theoretical framework aligns with its practical implementation.

IV- Challenges of the Sukuk Industry in Algeria and Proposed Solutions:

When comparing the challenges faced by the Sukuk industry worldwide, as discussed in the first section of this research, with those specific to Algeria, some challenges may not yet appear in the early stages of Algeria's Sukuk experience. This is because the industry is still in its conceptual phase and has yet to be established, remaining in the stages of legal, legislative, and regulatory development. Therefore, this section will focus more on the legal and regulatory challenges.

IV-1- Legal and Regulatory Challenges for the Sukuk Industry in Algeria and Proposed Solutions:

IV-1-1- Commercial Law:

Currently, there is no explicit legal recognition of Sukuk in Algeria, whether private or sovereign. Regarding private Sukuk, it is evident that Algeria's commercial law does not recognize a financial instrument named Sukuk. It does not allow for the issuance of investment Sukuk representing equal, undivided ownership rights in assets, usufructs, or services, or shares in companies without granting their holders shareholder status. According to Algerian law, the transferable securities that joint-stock companies can issue are limited to either stocks (which do not serve as substitutes for all types of Sukuk) or interest-bearing bonds, which are prohibited by Sharia.

Therefore, a section can be added to the chapter concerning transferable securities issued by joint-stock companies to establish a foundation for Sukuk, considering them as representing the following³⁰:

- Undivided ownership rights in assets, usufructs, or services for Sukuk such as murabaha, salam, istisna', and ijara.
- Undivided ownership rights in the assets of a specific project without granting the holder the status, rights, or obligations of a shareholder (participatory Sukuk, such as musharaka and mudaraba Sukuk).

This would allow for the inclusion of Sukuk as a type of transferable security traded in the Algerian financial market, as outlined in the provisions of commercial law, and for their trading on the Algiers Stock Exchange.³¹

Regarding sovereign Sukuk, despite their absence in commercial law as previously mentioned, there is a narrow legal framework that exists but requires significant clarification. Article 93 of the 2018 Finance Law states: "The Minister of Finance is authorized to: ... Issue sovereign bonds, medium- and long-term, directed toward natural and legal persons, to participate in financing infrastructure and/or public commercial equipment of the state."³²

Although the mentioned Finance Law does not explicitly indicate any Islamic nature for these sovereign bonds, the explanatory memorandum or justification for the draft law (in which this article was numbered 89) states the following:³³ "The proposal to issue sovereign bonds within the framework of participatory financing, referred to as Islamic, as suggested in the draft Finance Law for 2018, aims to involve bondholders in financing infrastructure projects and/or commercial equipment of the state."

Since the final version of the Finance Law does not include the explanatory memorandum or justifications, the term "sovereign bonds" on its own does not necessarily indicate an Islamic nature. Consequently, this legal framework remains ambiguous, although it represents the first attempt to codify Sukuk issuance in the history of independent Algeria.

A clearer acknowledgment of Sukuk came later in Regulation No. 20-03 related to the deposit insurance system. This regulation mentions how funds contributed by Islamic banks and Islamic windows to the Deposit Insurance Fund are to be invested, stating: "Premiums derived from deposits in 'Islamic banking windows' can only be invested through the purchase of bonds or Sukuk issued or guaranteed by the state and compliant with Sharia principles."³⁴

It appears that this regulation applies not only to Islamic windows but also to fully-fledged Islamic banks.

IV-1-2- The Securities Regulation and Supervision Commission (COSOB):

In a 2010 report issued by the Securities Regulation and Supervision Commission (COSOB), the commission refused to recognize what is referred to as Sukuk. This refusal was due to the lack of recognition of Sukuk under Algeria's commercial law, as previously mentioned, and the absence of a legal basis for their operation. The issue specifically pertains to restricted ownership (without the right of use), which is characteristic of certain types of Sukuk.³⁵

Therefore, it is necessary to amend the legal texts and internal regulatory frameworks governing the operations of the Algerian stock exchange to include Sukuk both private and sovereign as part of the financial instruments traded on the market. This is particularly important given that sovereign Sukuk will be essential for financing infrastructure projects or addressing budget deficits in the country. This matter remains under discussion between COSOB and the Ministry of Finance.

IV-1-3- Civil Law:

Some researchers argue that Algerian civil law consolidates ownership into a single form legal ownership which includes the right to use and dispose of property along with its other essential elements, without separating these rights. Transferring the right of disposal from one person to another requires the transfer of all associated rights in an indivisible manner. This principle does not align with certain types of Sukuk, particularly ijara Sukuk, which are used to finance infrastructure projects such as airports and ports. Consequently, they propose amending this law, specifically Articles 674 and 675, to distinguish between legal ownership and beneficial ownership (usufruct), with a special exception for certain financial transactions, particularly Sukuk.³⁶

IV-1-4- Tax Laws:

Taxes in Algeria are derived from multiple sources and laws. Therefore, it is necessary to include provisions in the Direct Tax Law, Indirect Tax Law, Registration Law, and Stamp Duty Law stipulating that purchases followed by sales made by Islamic banks should be treated as a single transaction. This is to prevent double taxation, which may arise in some Islamic financing structures and could also be reflected in Sukuk transactions. Such provisions should mirror the tax treatment applied to leasing operations (Crédit-bail or Leasing) implemented by both conventional and Islamic banks, with the latter often referring to it as ijara muntahia bittamleek (leasing ending in ownership).³⁷

For example, Islamic banks in Algeria have been unable to implement Islamic financing models in real estate, such as murabaha and istisna', which involve transferring property ownership to the customer. Instead, they have relied solely on ijara muntahia bittamleek or Crédit-bail, a practice adopted by conventional banks. This became possible after their representatives in the Association of Banks and Financial Institutions (ABEF) successfully lobbied for the inclusion of a provision in the 2006 Finance Law exempting ownership transfers to customers from registration fees at the end of the lease period.³⁸ This provision led to amendments in the Registration Law reflecting this exemption³⁹, enabling the application of this financing model.

Tax laws should also be amended to formally recognize Islamic financing transactions represented in Sukuk, which are based on purchasing and selling. These transactions should be exempt from certain taxes and fees to prevent double taxation, which ultimately inflates the price of goods, as is the case with the Tax on Professional Activity (TAP).⁴⁰

If the Supplementary Finance Law for 2020 and the Finance Law for 2021 have addressed previous issues in Islamic banking transactions by offering significant tax exemptions, similar exemptions should also be extended to Sukuk. This is essential since Sukuk embody Islamic financing models, as previously explained.

IV-1-5- Securitization Law:

Referring to Law No. 06/05, issued on February 20, 2006, concerning the securitization of mortgage loans, the process of securitization does not align with the Sharia-compliant framework for Sukuk issuance. This law defines securitization as the conversion of mortgage loans into securities⁴¹, effectively restricting securitization to real estate debts. This approach is inconsistent with the Sharia-compliant concept of Sukuk issuance, which involves converting assets and holdings of a project into divisible parts, each represented by a tradable Sukuk for investment purposes in the financial market according to Sharia standards.

Moreover, the securitization process violates Sharia principles, as it involves converting bank loans or debts into tradable securities, essentially permitting the sale and trading of debts. Establishing a dedicated Sukuk law in Algeria would resolve this issue without necessitating amendments to the existing securitization law, as both processes operate within distinct frameworks.

IV-1-6- Absence of a Dedicated Sukuk Law:

Currently, Algeria lacks a specific law governing the issuance, trading, and overall regulation of Sukuk. It is advisable to introduce a detailed and dedicated Sukuk law, as has been done in many Arab and Islamic countries, including neighboring states (e.g., Law No. 30 of 2013 in Tunisia and the 2013 Securitization Law in Morocco). Such a law would address numerous legal and regulatory challenges related to the issuance and trading of Sukuk in Algeria.

Additionally, the Mortgage Refinancing Company (SRH) could assume the role of a Special Purpose Vehicle (SPV) and expand its activities beyond mortgage-backed operations through amendments to its governing legal texts.⁴²

It is also essential for this law to benefit from the previous Sukuk laws enacted in various Arab and Islamic countries to avoid the mistakes encountered in those jurisdictions. A study of Sukuk laws in Sudan, Jordan, Egypt, and Tunisia revealed several common themes among these laws, including:

- The mandatory establishment of a Sharia supervisory board and defining its responsibilities.
- Specifying the Islamic financing contracts on which Sukuk issuance is based.
- Identifying the entities authorized to issue Sukuk.
- Determining the projects for which Sukuk are issued.
- Regulating the Sukuk lifecycle from issuance to extinguishment.
- Defining tax exemptions.
- Detailing the contents of the issuance prospectus, among other elements.⁴³

IV-2- Other Challenges and Supportive Solutions for the Success of the Sukuk Experience in Algeria:

In light of other challenges that may not be as pressing as those previously mentioned, we can propose additional supportive solutions to enhance the success of Sukuk issuance and trading in Algeria. These include:

IV-2-1- The Issue of Absence or Lack of Investment Culture in the Stock Exchange:

It is well known that the Algiers Stock Exchange, established in the 1990s, has remained weak in performance, ranking among the weakest Arab stock exchanges to this day. This underperformance is attributed to several factors, including the limited number of listed companies. Many private economic institutions in Algeria are family-owned businesses, rather than joint-stock companies or entities with open capital. Additionally, the lack of an investment culture among the Algerian population stems from these factors.

To address this, the authorities must promote a culture of stock market investment by restoring confidence in the stock exchange and positioning it as a vital source of economic financing, independent of banks. This involves addressing the

root causes of its poor performance, as mentioned earlier. The stock exchange will serve as an important secondary market for trading Sukuk, further underscoring the need for its development.

IV-2-2- Weak Savings Due to the Financial Crisis in the Country:

This issue falls under the broader challenge of prevailing economic conditions, as previously discussed among the general challenges facing Sukuk. Since the collapse of oil prices in mid-2014, Algeria has faced financial difficulties due to resource shortages, given its reliance on public spending as the primary driver of economic growth. With the decline in public expenditure, the national economy entered a recession, which worsened following the COVID-19 crisis. Despite the gradual recovery from the pandemic and rising global prices, the Algerian economy now suffers from stagflation, significantly affecting citizens' purchasing power and weakening their savings.

For example, the liquidity level in Algerian banks stood at 632.3 billion DZD at the end of 2020 ⁴, while the total monetary supply in Algeria exceeds 17,000 billion DZD.

To address this, deep economic reforms must be initiated to improve the country's overall economic conditions and enhance citizens' purchasing power. Additionally, incentives should be introduced to encourage savings, such as offering rewards to bank savers. For instance, lessons can be drawn from Al Salam Bank Algeria, which conducts an annual draw for holders of its savings and deposit accounts under the program "Omraty," where winners receive a free Umrah trip sponsored by the bank.

IV-2-3- The Issue of an Untrusted Sharia Supervisory Authority:

The Sharia supervisory authority for financial transactions in Algeria poses another challenge to the success of the Sukuk experience, despite the apparent uniformity of the dominant madhhab (Islamic school of thought). In line with the government's efforts to adopt Islamic finance as a key source of national economic funding, the National Shariah Advisory Council for Islamic Financial Industry was established under Decree No. 20-01, issued on April 1, 2020, by the High Islamic Council. The council, chaired by the president of the High Islamic Council, comprises most of its members and is tasked with issuing fatwas to develop the Islamic financial industry in Algeria, including its three main components: Islamic banking, takaful insurance, and Sukuk.

However, the issue lies in the fact that this council does not enjoy widespread consensus or trust nationally. Furthermore, some of its members lack specialization in Islamic financial transactions or fatwas related to them, and a few have previously issued incorrect fatwas on similar matters.

Since Algerians are particularly cautious about falling into the suspicion of riba (usury), the composition of this council should be reconsidered. Membership should be restricted to scholars with extensive expertise in issuing fatwas on Islamic financial transactions, who have conducted in-depth research in the field and enjoy the public's trust in this area.

CONCLUSION

Sukuk and their market, as a specialized industry, face significant challenges and issues, placing a responsibility on practitioners, experts, and researchers in the field to find solutions. These efforts are vital for enhancing the performance of Sukuk, enabling them to play a greater role in financing development in various economies, particularly in Islamic environments. Most importantly, these measures are necessary to prevent Sukuk from losing the trust they have gained in recent years as a vital Islamic financial instrument, especially as they gradually begin to adopt the characteristics of conventional interest-based bonds.

The main findings of this study are as follows:

- The key challenges facing Sukuk today include conflicting fatwas, ownership issues between asset-backed and asset-based Sukuk, legal and regulatory challenges, marketing and competitiveness requirements, and prevailing economic conditions. These challenges require specific actions and measures to address them.
- The gradual transformation of Sukuk into fixed-income instruments, resembling debt tools more than participation instruments, along with issues such as limited trading activity, the gap between Sukuk supply and demand, credit rating challenges (global agencies ignoring Sharia compliance and Islamic agencies neglecting creditworthiness),

pricing Sukuk based on the global interest rate benchmark "LIBOR" due to the lack of an Islamic index, the complexities of Sukuk issuance compared to conventional bonds, and Sukuk defaults and investor protection are pressing issues that require innovative solutions from experts in the field.

- In Algeria, the key legal and regulatory challenges include provisions in commercial law, internal regulations and stock exchange frameworks, civil law, tax laws, and the absence of a specific law governing Sukuk. Addressing these challenges requires amendments to existing laws to facilitate the establishment and efficient functioning of the Sukuk industry, in addition to enacting a dedicated Sukuk law, as has been done in several Arab and Islamic countries.
- Other challenges, though less pressing, include the lack of a culture of stock market investment, weak savings due to the financial crisis in recent years, and the issue of an untrusted Sharia supervisory authority. These challenges also require action from policymakers and stakeholders to ensure the successful establishment of an Sukuk industry in Algeria.

Recommendations:

To ensure a brighter future for the Sukuk industry, two key aspects must be considered:

Macro-Level Framework:

The focus should be on broader requirements, including:

- Developing human capital.
- Raising awareness among investors about Sharia compliance.
- Achieving financial inclusion in Islamic finance.
- Enhancing global communication for Islamic finance.

These efforts will pave the way for Sukuk to combine strict adherence to Islamic Sharia principles and objectives in financial transactions with international competitiveness, ultimately positioning them as a comprehensive alternative to conventional bonds.

Development of Tools and Mechanisms:

The focus here should be on:

- Designing participation-based financial products.
- Creating products aligned with financing terms.
- Developing mechanisms for capital protection in Sukuk and ensuring tax neutrality.

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