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Navigating the UAE sukuk market: Trends, diversification benefits, and legal constraints

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Block 1. Market overview

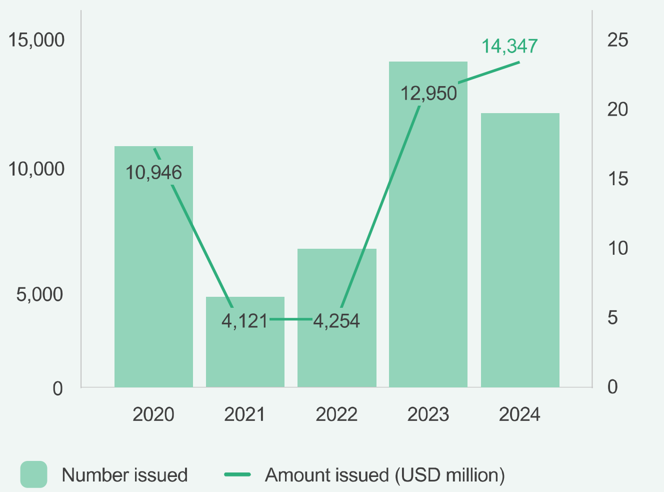
The UAE's debt capital markets (DCM) are expanding steadily, supported by a diverse mix of sukuk and bond issuances, strong investment-grade ratings, and a strategic presence in both regional and global sukuk markets.

The UAE is a key player in the global sukuk market, holding a 7.4% share of total outstanding sukuk.
In 2024, it ranked as the world's fourth-largest sukuk issuer, following Saudi Arabia (USD 48.7 billion), Malaysia (USD 35.6 billion), and Indonesia (USD 14.7 billion). Sukuk accounted for 20.8% of dollar-denominated issuances in the UAE in 2024.

There are currently 116 active sukuk issuances in the UAE, with a total issuance size of USD 68 billion. Of these, 24 sukuk worth USD 13 billion were issued in 2023, while 20 sukuk totaling USD 14.4 billion were issued in 2024.

Sukuk issuance in the UAE has experienced a substantial surge since 2023, driven by the introduction of the UAE Treasury Sukuk (T-Sukuk) and a record-high issuance of green and sustainability sukuk.

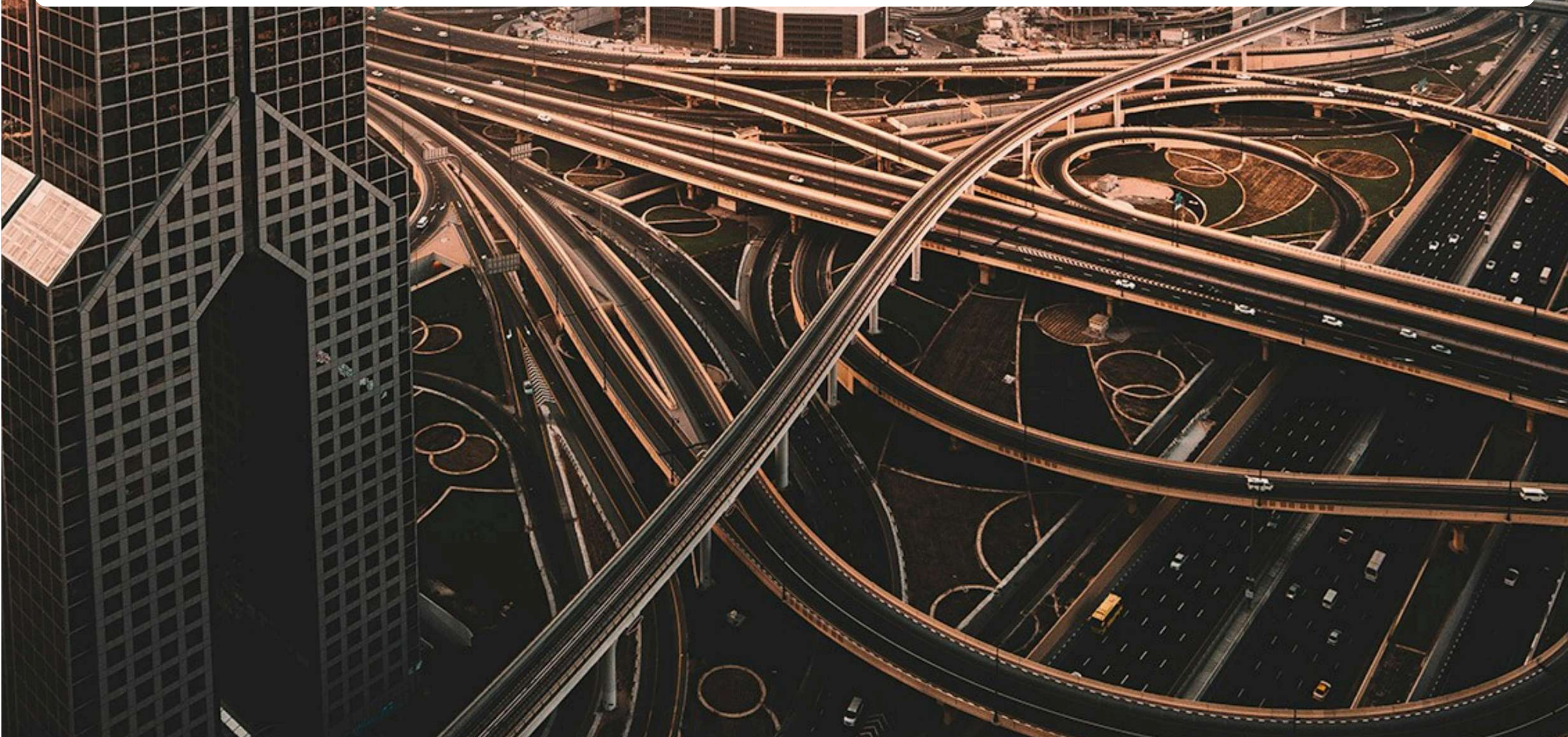
Graph 1. Active sukuk issuance number and amount in the UAE, 2020-2024



Source: Finvizier Consultancies, Bloomberg

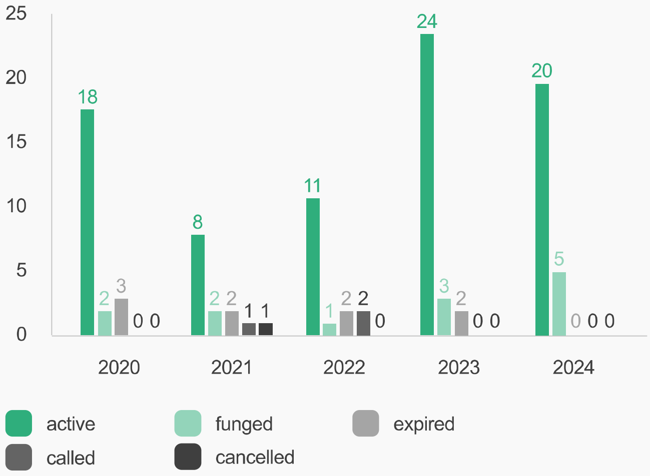
A total of 25 sukuk were issued in 2024, reflecting a 14% year-over-year decrease in number, with a value of USD 15.2 billion — a 3% decline compared to the previous year. Of these, 20 remain active, while 5 have been funged.

S&P Global Ratings expects sukuk issuance in the UAE to remain steady at approximately $14-15 billion in 2025.[1]



[1] https://www.zawya.com/en/economy/islamic-economy/s-and-p-144bln-of-sukuk-issuances-in-uae-in-2024-i2bo5ev6

Graph 2. Number of sukuk issued in the UAE, 2020-2024



Source: Finvizier Consultancies, Bloomberg

Active bond
Currently outstanding; pays interest and trades in the market.

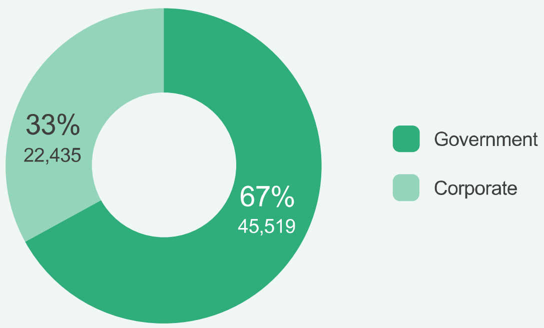
Fungible sukuk
Interchangeable with others of same type, maturity, and terms.

Expired bond
Reached maturity; issuer repays principal and interest.

Called bond
Redeemed early by issuer before maturity.

Canceled bond
Redeemed, matured, or repurchased; no longer valid for trading or interest.

Graph 3. Outstanding sukuk amount by issuer type (in USD million)



Source: Finvizier Consultancies, Bloomberg

Of the outstanding sukuk, 79 have been issued by corporates, including financial institutions, with a total outstanding amount of USD 45.5 billion. Meanwhile, 37 sukuk have been issued by the government, treasury, or central bank, with an outstanding amount of USD 22.5 billion. While many large corporations are starting to issue debt, the funding culture remains primarily bank-focused. Financial institutions account for USD 23.5 billion in outstanding sukuk, compared to USD 22.0 billion across other sectors. In descending order, these sectors include real estate, industrials, investment holding, energy, utilities, healthcare, and consumer staples.

Issuers	Amount outstanding (USD million)	Issuer Type
Sharjah Sukuk Programme Ltd	11,397	Govt/Treasury/Central Bank
DIB Sukuk Ltd	6,550	Corporate
Central Bank of UAE	6,496	Govt/Treasury/Central Bank
FAB Sukuk Company Ltd	4,154	Corporate
DP World Crescent Ltd	4,000	Corporate
Dubai DOF Sukuk Ltd	3,672	Govt/Treasury/Central Bank
MAF Sukuk Ltd	2,800	Corporate
EI Sukuk Company Ltd	2,022	Corporate
ICD Sukuk Company Ltd	1,750	Corporate
Emaar Sukuk Ltd	1,750	Corporate

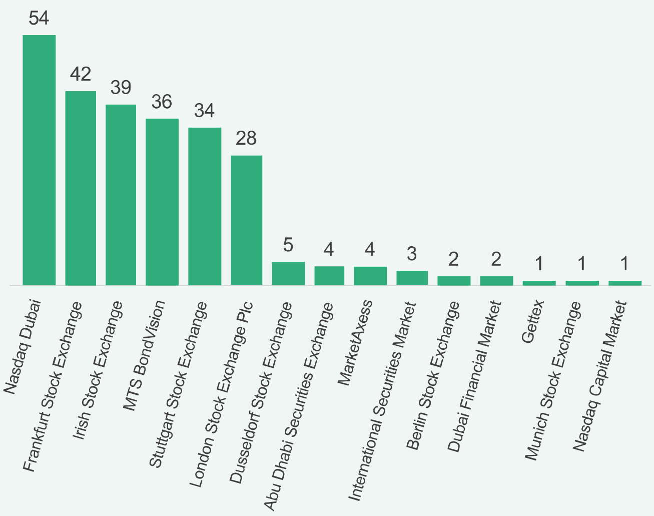
Source: Finvizier Consultancies, Bloomberg

The largest issuers of sukuk in the UAE include Sharjah Sukuk Programme Ltd, DIB Sukuk Ltd, and the Central Bank of the UAE (CBUAE), which together account for 36% of the total issuance, with an outstanding amount of USD 24.4 billion. The top 10 issuers collectively represent 66% of all sukuk issuances in the country.

Nasdaq Dubai remains a major global hub for sukuk listings, while leading European stock exchanges also serve as key venues for UAE sukuk issuances.

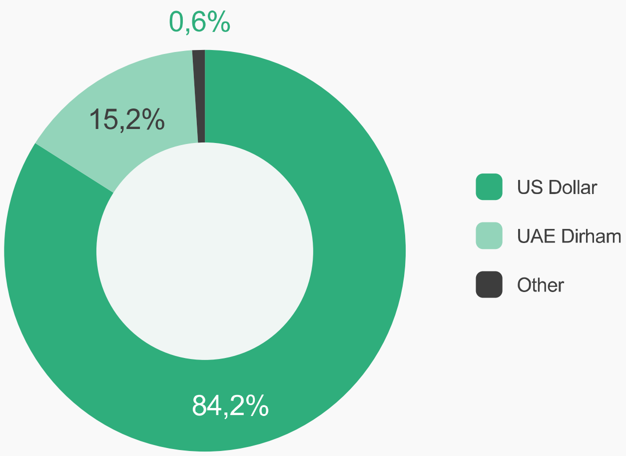
The majority of sukuk—83 out of 116—are exchange-listed and therefore public, while 33 are privately placed or sold over the counter through direct sales to a select group of investors, such as institutions or high-net-worth individuals, rather than through a public offering.

Graph 4. Number of sukuk outstanding by exchange listing



Source: Finvizier Consultancies, Bloomberg

Graph 5. Sukuk outstanding by currency



Source: Finvizier Consultancies, Bloomberg

Sukuk issued in the UAE are mostly denominated in US Dollars (USD 57.3 billion or 84.2%) and UAE Dirhams (USD 10.3 billion or 15.2%). Other currencies include Malaysian Ringgit, Kuwaiti Dinar, and Saudi Riyal, which account for less than 1% of outstanding sukuk. Domestic Dirham-denominated T-Sukuk are issued within government policy to build a UAE dirham-denominated yield curve, offering secure investment options, enhancing the local DCM, improving the investment climate, and promoting sustainable economic growth. Dirham issuance by corporates and banks is rare.[2]

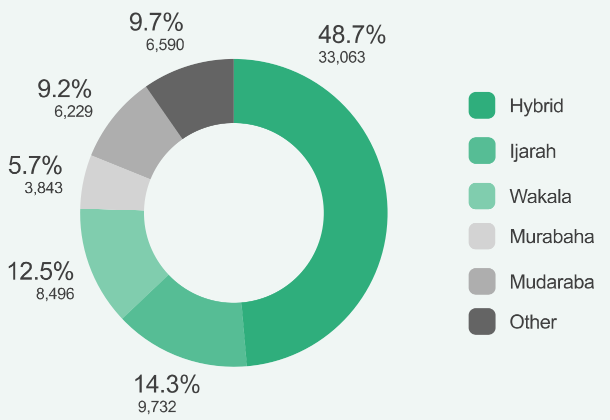
[2] https://mof.gov.ae/aed1-1-billion-islamic-treasury-sukuk-issued-for-q2-2024/

Block 2. Types of sukuk and their role in risk diversification

Several types of Shariah-compliant sukuk structures are issued in the UAE, each designed to align with Islamic principles while catering to different financing needs. The most common types include Ijarah sukuk, where assets are leased to generate returns for investors, and Wakalah sukuk, where investors appoint an agent (Wakeel) to manage a portfolio of Shariah-compliant assets. Murabaha sukuk is another widely used structure, which involves a cost-plus-profit sale structure but is less common due to restrictions on trading debt-based instruments.

Additionally, Mudarabah sukuk operates on a profit-sharing basis, with investors providing capital to an entrepreneur. Hybrid sukuk, which combines multiple structures, is the most widely issued sukuk structure as it offers greater flexibility in terms of tenors and profit-sharing ratios, making it more attractive to a wider range of investors.

Graph 6. Outstanding sukuk amount by structure (in USD million)



Source: Finvizier Consultancies, Bloomberg

TYPES OF SUKUK AND THEIR ROLE IN RISK DIVERSIFICATION

Ijarah sukuk

Structure:

Sukuk representing ownership of equal shares in leased real estate or its usufruct. These sukuk grant holders the right to own the property, receive rental income, and trade their sukuk without affecting the lessee's rights.

Risk Exposure:

Sukuk holders are responsible for maintenance costs and any damages to the property. Asset risk arises as the leased asset becomes damaged or obsolete, the value of the sukuk could decrease. Credit risk emerges if the lessee, i.e. the entity using the asset, defaults on lease payments, investors may not receive returns. Market risk is explained by changes in interest rates that can affect the lease payment structure and hence the profitability of the sukuk.

[3] https://assets.dfm.ae/docs/default-source/default-document-library/base-prospectus-(sukuk).pdf?sfvrsn=79544c81_0

EXAMPLE

Dubai DOF Sukuk Ltd

ISIN:	XS1062038143
Amount outstanding:	USD 750 000 000

Use of proceeds: The net proceeds of each Tranche issued will be paid by the Issuer to the Seller as the purchase price for the Lease Assets.

Each Certificate will evidence an undivided ownership interest of the Certificateholders in the Trust Assets of the relevant Series, and will be a direct, unsubordinated, unsecured and limited recourse obligation of the Trustee.

The following information is summarized from the official base prospectus of Dubai DOF Sukuk Limited.[3]

Risk factors relating to the Trust Certificates are as follows:

01. Absence of secondary market/limited liquidity:
    The market value of Trust Certificates may fluctuate and a lack of liquidity, in particular, can have a material adverse effect on market values

02. The Trust Certificates are limited recourse obligations

03. The Trust Certificates may be subject to early redemption.

Risk factors relating to the Lease Assets:

01. Transfer of the Lease Assets:
    Investors in the relevant Trust Certificates may not receive back the full amount of their investment as no assurance is given that any ownership interest in the Lease Assets relating to any Series will be effectively transferred to Dubai DOF Sukuk Limited.

02. Total Loss Event:
    The total loss or destruction of, or damage to the whole of, the relevant Lease Assets.

The ability of the Issuer to pay amounts due will primarily be dependent upon receipt by the Issuer from the Government of all amounts due under the Lease Agreement and the Purchase Undertaking which, in the aggregate, may not be sufficient to meet all claims under the relevant Trust Certificates and the Transaction Documents.

Trust Certificates to be issued under the Programme are not debt obligations of the Issuer. Instead, the Trust Certificates represent an ownership interest solely in the Trust Assets.

TYPES OF SUKUK AND THEIR ROLE IN RISK DIVERSIFICATION

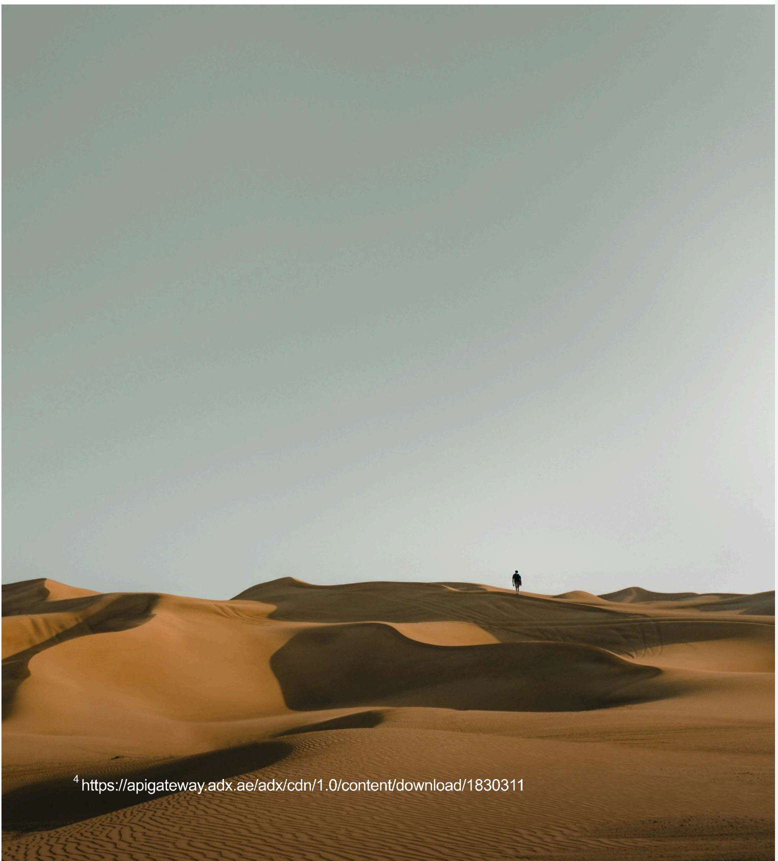
Wakalah sukuk

Structure:

The issuer appoints an agent (usually the sukuk holders) to invest funds in specific assets or projects, and profits (after fees) are shared.

Risk Exposure:

Agency risk arises when the agent mismanages funds or fails to act in the best interests of sukuk holders, potentially leading to significant losses. Credit risk refers to the issuer's default risk on its obligation to pay returns to sukuk holders. Additionally, market risk arises as the performance of assets under the agent's management may be affected by market conditions, impacting returns.



[4] https://apigateway.adx.ae/adx/cdn/1.0/content/download/1830311

EXAMPLE

Aldar Sukuk Ltd

ISIN:	XS2068063465
Amount outstanding:	USD 500 000 000

Use of proceeds:

The Obligor shall use the Purchase Price and the funds received from its on-sale of the commodities for its general corporate purposes.

Each Certificate will represent an undivided ownership interest of the Certificateholders in the Trust Assets and will be limited recourse obligations of the Trustee.

The following information is summarized from the official base prospectus of Aldar Sukuk Ltd.[4]

An ownership interest in the Usufruct over the Wakala Assets comprising the Initial Wakala Portfolio will pass to the Trustee. Certificateholders will have an ownership interest in the Usufruct over the Wakala Assets.

Risk factors relating to the Trust Certificates are as follows:

01. The Certificates are limited recourse obligations and investors may not be able to seek full recourse for failure to make payments due on the Certificates
02. There can be no assurance that a secondary market for the Certificates will develop
03. Certificates may be illiquid and difficult to trade
04. The Certificates may be subject to early redemption

Risks relating to the wakala assets are as follows:

01. Ownership over the Wakala Assets:
    The Wakala Assets will be selected by the Obligor. No investigation or enquiry will be made and no due diligence will be conducted in respect of any Wakala Assets.

Risks relating to the Usufruct are as follows:

01. There can be no assurance that an Abu Dhabi court would recognise the validity of the sale and purchase and grant of the Usufruct over the Wakala Assets either as between the parties or as against the rights of third parties.

TYPES OF SUKUK AND THEIR ROLE IN RISK DIVERSIFICATION

Murabaha sukuk

Structure:

Sukuk investors provide financing for the purchase of an asset, with the asset sold to the issuer at a markup (profit margin), and the issuer repays the sukuk holders in installments.

Risk Exposure:

Credit risk arises when the issuer fails to make timely payments, potentially putting the investor’s capital at risk. Market risk occurs due to fluctuations in the value of the underlying asset, which may impact expected returns. Liquidity risk emerges when sukuk are less liquid than conventional bonds, especially if the underlying asset itself is illiquid.

EXAMPLE

Emaar Sukuk Ltd

ISIN:	XS2052469165
Amount outstanding:	USD 500 000 000

Use of proceeds:

The proceeds are applied in the following proportion:
(a) the percentage of the Issue Proceeds specified in the applicable Final Terms as the purchase price for the Assets to be purchased from Emaar pursuant to the Purchase Agreement; and
(b) the remaining percentage (if any) to be applied by Emaar for its general corporate purposes.

The following information is summarized from the official base prospectus of Emaar Sukuk Ltd.[5]

Risk factors relating to the Trust Certificates are as follows:

01. Absence of secondary market/limited liquidity

02. The Certificates are limited recourse obligations

03. The Trust Certificates may be subject to early redemption

Risk factors relating to the Murabaha Contracts are as follows:

01. Taxation risk:

The Seller shall enter into a Murabaha Contract with the Buyer using the Murabaha percentage specified in the applicable Final Terms.
To the extent that taxation costs arise in respect of the Buyer's acquisition, ownership or disposition of the commodities, there may be a material adverse effect on the Buyer's ability to perform its obligations (including payment obligations) under the Master Murabaha Agreement and, in turn, in respect of the Trust Certificates.

02. Price fluctuation risk:

If, after the Buyer has purchased any commodities, the market for the commodities becomes over- supplied or flooded, the price at which the commodities can be on-sold or traded subsequently may be adversely affected.

03. Commodity risk:

(i) the commodities may suffer damage of a nature that reduces their value whilst in storage or during transit;

(ii) the Buyer's storage and/or transfer of the commodities may cause environmental damage, such as pollution, leakage or contamination, which may breach environmental laws or regulations making the Buyer susceptible to legal or financial recourse;

(iii) the commodities may be liable to theft and or vandalism; and

(iv) the commodities may be damaged by terrorist attacks, natural disasters, fire or other catastrophic events that are beyond the control of the Buyer.

[5] https://www.dfsa.ae/application/files/9515/8253/7820/Project-Zebra9-Base-Prospectus-243329-3-22-v7-FINAL_2.pdf

TYPES OF SUKUK AND THEIR ROLE IN RISK DIVERSIFICATION

Mudarabah Sukuk

Structure:

These are investment sukuk that represent ownership of units of equal value in the Mudaraba equity and are registered in the names of holders on the basis of undivided ownership of shares in the Mudaraba equity and its returns according to the percentage of ownership of shares.

Risk Exposure:

Business risk arises from reliance on the Mudareb's (borrower's) performance, as the Mudareb itself may fail or underperform, potentially leading to losses for sukuk holders. Profit-sharing is tied to management performance, and poor management decisions could negatively impact returns, leading to management risk. Liquidity risk arises as these sukuk are often harder to trade due to their link to specific projects or businesses.

EXAMPLE

DIB Tier 1 Sukuk 4 Ltd

ISIN:	XS2258453443
Amount outstanding:	USD 1 000 000 000

Use of proceeds:

Proceeds are used by DIB to enhance its tier 1 capital as well as for general corporate purposes.

Each Certificate will represent an undivided ownership interest in the Trust Assets, and will be a limited recourse obligation of the Trustee.

According to the annual financial statement of Dubai Islamic Bank PJSC for 2024, Tier 1 Sukuk are perpetual Mudaraba sukuk which are not redeemable by sukuk-holders and bear an entitlement to profit distributions that is non-cumulative and at the discretion of the Board of Directors.[6] Accordingly Tier 1 Sukuk are presented as a component of equity instruments issued by the Group in equity.

The Trustee's only material assets, which it will hold on trust for the Certificateholders, will be the Trust Assets, including its right to receive payments under the Mudaraba Agreement.

[6] https://www.dib.ae/docs/default-source/financial-reports/dib-fs-dec-2024-en.pdf?sfvrsn=546dcf94_6

Block 3. Considerations for portfolio diversification

Risk sharing in sukuk

Risk sharing is a fundamental principle of sukuk that differentiates it from conventional bonds. In Islamic finance, sukuk holders are not merely creditors but also investors who share in the underlying asset's risks and rewards. This is because sukuk structures are based on asset-backed or asset-based financing, aligning with Shariah principles that prohibit riba (interest).

Unlike conventional bonds, where investors receive fixed interest payments regardless of the issuer's financial performance, sukuk returns are typically tied to the cash flows generated by the underlying assets or business activities. This means that in cases of profit, investors benefit, but in situations of loss, they may bear a portion of the financial burden, depending on the sukuk structure.

The degree of risk sharing varies by sukuk type. For instance:

Mudaraba and Musharaka sukuk fully embrace risk sharing, as they represent profit-and-loss-sharing partnerships where investors and issuers share both gains and losses.

Ijarah sukuk, which are based on leasing agreements, provide investors with periodic rental income rather than profit-sharing, reducing direct exposure to business performance risks.

Murabaha and Istisna sukuk are more debt-like and have limited risk-sharing features since they involve predetermined payments rather than variable returns.

Risk sharing in sukuk enhances financial stability by reducing excessive leverage and speculative activities. However, it can also introduce additional complexities for investors, such as *legal uncertainties and valuation challenges,* especially in default scenarios.

Performance correlation with a conventional bond

Most sukuk are senior unsecured obligations, ranking equally with other senior unsecured debt, including conventional bonds.

However, sukuk structures are inherently more complex than bonds, featuring additional dissolution triggers such as tangibility events and total loss events.

Fitch Ratings' analysis indicates that the prices of comparable sukuk and bonds maintained *a strong correlation* throughout the first half of 2024, continuing a trend observed over the past five years. However, occasional short-term price volatility can lead to temporary declines in correlation.[7]

Any factors that influence the credit risk profile of sukuk, including sharia-related considerations, may impact future pricing correlation.

Episodes of volatility driven by shifts in interest rate expectations, fluctuations in oil prices, and geopolitical developments—along with the complexities of Shariah compliance for sukuk—have occasionally led to abrupt declines in pricing correlation.

However, these disruptions have typically been short-lived, with correlations eventually returning to their historical averages. This pattern is expected to persist in 2025, though macroeconomic developments and Shariah-related complexities could introduce additional challenges.

"The portfolio advantages of sukuk: Dynamic correlations between bonds and sukuk" (Alfalah, Stevenson, & D'Arcy, 2022) examines pairs of sukuk and bonds issued by the same entities in the Malaysian market using an unbiased comparison approach, applying both an unconditional correlation methodology and the GARCH-DCC model (Engle, 2002) to analyze their relationship. The research finds that the correlation between sukuk and bonds closely mirrors that of bonds alone, suggesting that sukuk offer *limited diversification benefits,* as no significant differences were observed between the two asset classes.[8]

[7] https://www.fitchratings.com/research/islamic-finance/sukuk-bond-pricing-remains-correlated-as-spreads-narrow-despite-volatility-20-02-2025
[8] https://digitalcommons.odu.edu/cgi/viewcontent.cgi?article=1038&context=finance_facpubs

Valuation challenges in sukuk

The valuation of sukuk differs significantly from that of conventional bonds due to their underlying asset-based nature. Sukuk are priced according to the *value of the assets backing them,* whereas bonds are primarily priced based on the issuer's credit rating and prevailing interest rates. This fundamental difference introduces unique complexities in sukuk valuation, as asset price fluctuations directly impact their market value. Even though sukuk are asset-based, their pricing is not solely determined by the value of the underlying assets. The issuer's credit rating remains a key factor affecting the yield, market demand, and overall pricing of sukuk.

Unlike bonds, which provide fixed interest payments regardless of asset performance, sukuk returns are tied to the profitability or appreciation of the underlying assets. When these assets increase in value, sukuk prices may rise accordingly, offering potential capital gains to investors. In contrast, bondholders receive predetermined interest payments (riba), which remain fixed regardless of changes in asset valuation. These differences can create pricing challenges, particularly in secondary markets, where sukuk valuation depends on both asset performance and market perceptions of Shariah compliance.

Example:

The price of the basic sukuk Ijarah sukuk will be the sum total of the following items:

Total PV of periodic payments received + PV of expected sale price of underlying asset at maturity [9]

Using an appropriate discount rate, the present value of periodic lease payments is determined. This total is then combined with the present value of a single cash flow representing the sale proceeds of the underlying asset to the mudarib.
If the sale price is predetermined, its present value is simply calculated based on the given amount and the timing of the cash flow. However, if the sale price is not predetermined, an estimate must be made. One approach involves assigning probabilities to potential sale prices and computing a weighted average, which serves as the expected sale price. Thus the pricing of sukuk is significantly influenced by the value of the underlying assets that back them.

[9] https://www.sciencedirect.com/science/article/pii/S2214845018301765

Block 4. Market infrastructure and regulatory challenges

Structural and regulatory constraints for sukuk

In recent years, several countries, both with and without majority Muslim populations, have issued sukuk with a view to diversifying the investor base. Although sovereign sukuk in essence has a similar financial effect as conventional sovereign bonds, in strict terms, it is actually different from a regular bond. A fundamental distinction between sukuk and conventional bonds lies in their underlying structure as sukuk relies on the *transfer of ownership or usage benefits* on an underlying asset.

The assets backing sukuk must *comply with Shariah principles,* ensuring they do not involve activities prohibited in Islam, such as gambling, alcohol, or interest-based financing. In contrast, bonds may be backed by a wide range of assets, including those that may not align with Islamic ethical and financial principles.

Purchase of sukuk entails *acquisition of a share in the underlying assets,* entitling them to a portion of the generated returns. Conversely, selling bonds involves transferring debt obligations rather than ownership rights.

Therefore, the differences between a traditional bond and sukuk require the adoption of a more *comprehensive legal framework,* especially in non-Islamic jurisdictions. [10] *Legal complexities* exist particularly in areas such as investor rights, default scenarios, and enforceability in jurisdictions where Islamic finance regulations may not be fully developed.

Addressing these complexities requires *greater standardization and regulatory clarity* to enhance the transparency and legal certainty of sukuk transactions.

One of the major challenges for sukuk market investors and creditors is the *lack of harmonized accounting and regulatory standards.* Differences in financial contracts and product structures across institutions made it difficult for regulators and market participants to ensure consistency. Although organizations such as the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) have made efforts to introduce global standards, industry-wide adoption remains fragmented. Greater alignment of regulatory frameworks is necessary to enhance transparency and market confidence.

The rapid expansion of Islamic finance has outpaced the development of expertise in the field which resulted in shortage of skilled professionals.[11] Industry professionals—including bankers, regulators, and supervisors—must possess knowledge of both conventional finance and sharia principles to navigate the increasing complexity of Islamic financial products. A shortage of specialized talent not only limits innovation but also affects the ability to manage risks unique to Islamic finance effectively. Addressing this gap requires greater investment in education and training programs tailored to the industry's needs.

[10] https://openknowledge.worldbank.org/server/api/core/bitstreams/1be207fe-906f-5122-8720-7077bfadd704/content
[11] https://icd-ps.org/uploads/files/ICD-Refinitiv%20IFDI%20Report%2020201607502893_2100.pdf

Shariah interpretation

The UAE follows a decentralized approach to Shariah compliance in the Islamic finance industry. According to Article 6 of the UAE Islamic Banking Law, "The respective articles and memorandum of association of each Islamic Bank, financial institution and investment company should clearly stipulate that a Shariah Supervision Authority shall be formed of minimum three members to *render their transactions and practices accordant with the principles and provisions of Islamic Shariah Law."* Thus the Shariah Supervision Authority of each entity ensures that its transactions and practices conform to Islamic law. Therefore, this decentralized approach to Shariah compliance in the Islamic finance industry may lead to significant repercussions and potentially hinder the global growth of Islamic financial institutions.

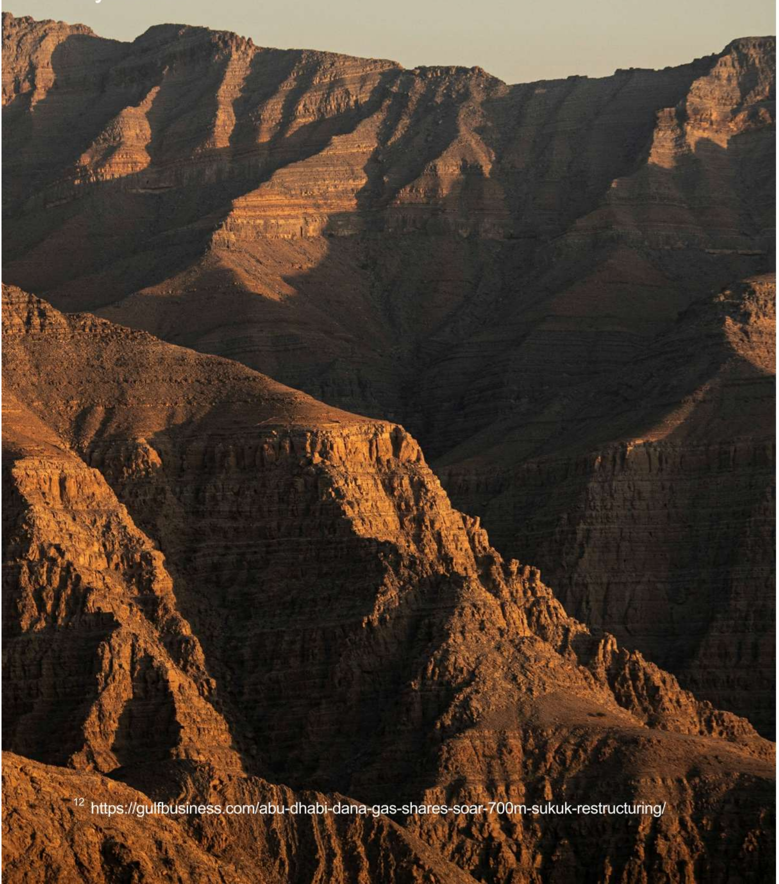
Standardizing the Shariah interpretation of sukuk structures has become increasingly important in the Islamic capital market. A consistent framework would reduce the risk of non-Shariah compliance and potential defaults. Moreover, to ensure clarity, the market needs standardized legal documentation in a timely manner.

Achieving this standardization in both Shariah interpretation and legal documentation will require significant collective efforts from Shariah scholars and legal councils in the region. The role of AAOIFI in this process is crucial, as its Shariah standards on sukuk can serve as a comprehensive guide for the UAE's Islamic capital market.

Geographical constraint

Islamic finance is primarily concentrated in a limited number of countries, mainly in the Middle East, Southeast Asia, and parts of South Asia.

In contrast, Islamic finance remains underdeveloped or niche in many other regions, including Central Asia, most of Africa, Europe, and the Americas. The reasons include a lack of regulatory frameworks, limited demand, and the dominance of conventional banking systems.



Dana Gas sukuk restructuring

In 2017, Dana Gas declared its mudarabah sukuk as a *non-Shariah-compliant instrument,* citing legal advice that reflected the evolving nature of Islamic financial instruments and their interpretation. The company stated, "Due to the evolution and continual development of Islamic financial instruments and their interpretation, the company has recently received legal advice that the sukuk in its present form is not Shariah-compliant and is therefore unlawful under the UAE law. As a result, a restructuring of the current sukuk is necessary to ensure that it conforms to the relevant laws for the benefit of all stakeholders."[12]

It is vital that the sukuk structure of Dana Gas is centered on the law of the UAE. Whereas the English law regulates the "Purchase Undertaking Agreement". The agreement stipulates that, following the investment plan, the funds received by the trustee should be invested by Dana Gas Limited. As per the Dana Gas agreement, the revenue generated from mudarabah assets is to be distributed periodically between Dana Gas PJSC (the mudarib or entrepreneur) and the trustee (rab-al-mal) in a 99:1 ratio.

However, guaranteeing a fixed profit in a mudarabah sukuk for any contracting party violates Shariah principles. Consequently, the purchase undertaking method used in this structure was found to be inconsistent with Shariah standards.

The lack of an effective regulatory framework from both legal and Shariah perspectives has contributed to this instability.

The complexity of integrating English law with local legal frameworks for Shariah-compliant products can sometimes lead to conflicts, as demonstrated in the Dana Gas case.

[12] https://gulfbusiness.com/abu-dhabi-dana-gas-shares-soar-700m-sukuk-restructuring/

Block 5. Differences in investor base breakdown

The recent increase in sukuk issuance has facilitated access to a more diverse range of *institutional investors and sovereign wealth funds,* particularly in markets where Islamic finance plays a significant role, such as the UAE.

The investor base for sukuk primarily consists of institutions and individuals that require compliance with Islamic finance principles. Key investor groups include:

01. Islamic Banks and Financial Institutions:
    Islamic banks play a fundamental role in the UAE's financial ecosystem, with Islamic financing accounting for 29% of total sector financing by the end of the first half of 2024. Leading Islamic banks in the UAE, such as Dubai Islamic Bank (DIB), Abu Dhabi Islamic Bank (ADIB), and Sharjah Islamic Bank (SIB), actively invest in sukuk as part of their liquidity management strategies and balance sheet allocation. These banks primarily *invest in Shariah-compliant financial instruments,* including Islamic sukuk, which serve as an alternative to conventional bonds by adhering to asset-backed structures that align with Islamic law. Additionally, they provide Islamic financing solutions, ensuring that financial transactions comply with ethical and religious standards.

02. Sovereign Wealth Funds (SWFs):
    UAE-based SWFs, including Abu Dhabi Developmental Holding Company, Abu Dhabi Investment Authority, and Investment Corporation of Dubai, incorporate sukuk into their portfolios to align with Shariah-compliant investment mandates while achieving portfolio diversification.

03. Takaful Operators and Pension Funds:
    Islamic insurance providers and pension funds allocate investments to sukuk to maintain compliance with Islamic financial principles while seeking stable, risk-adjusted returns.

04. Retail and High-Net-Worth Individuals (HNWIs):
    Sukuk also attract retail investors and HNWIs seeking halal fixed-income alternatives, particularly through Islamic mutual funds and exchange-traded funds (ETFs).

Conventional bonds in the UAE attract a wider range of global investors due to their established market infrastructure and liquidity. Major investor groups include:

01. Global Asset Managers and Institutional Investors:
    International hedge funds, pension funds, and sovereign wealth funds invest in the UAE bonds as part of their fixed-income portfolios, benefiting from well-defined regulatory frameworks and established credit ratings.

02. Commercial Banks:
    Both domestic and international banks allocate capital to UAE government and corporate bonds to enhance portfolio stability and manage interest rate risk.

03. Corporate Investors and Multinational Firms:
    Large corporations invest in bonds to manage liquidity, hedge against economic fluctuations, and secure stable long-term returns.

04. Retail Investors:
    Bonds are widely included in investment funds, including fixed-income mutual funds, which appeal to both local and international investors seeking predictable returns.

Comparative Analysis of Investor Preferences

While sukuk primarily attract investors operating within the Islamic finance ecosystem, conventional bonds benefit from a more extensive and globally diversified investor base due to their standardized regulatory structures and greater market liquidity. The UAE's dual issuance strategy—offering both sukuk and conventional bonds—enables it to engage with a broad spectrum of investors, reinforcing its position as a leading financial center in the Middle East.

Block 6. Sukuk market trends and future outlook

Local currency-denominated sukuk issuance

Both UAE conventional bonds and sukuk are predominantly denominated in US dollars across both international and domestic markets.

However, in recent years, market trends have shifted. The Dirham Monetary Framework (DMF) was established by the CBUAE in 2017 to regulate liquidity and interest rates within the country's financial system. As part of this framework, in April 2023, the UAE Ministry of Finance, in collaboration with the CBUAE, launched the issuance of dirham-denominated T-Sukuk with an initial benchmark auction size of AED 1.1 billion. This initiative aimed to foster the development of a local currency bond market, diversify funding sources, strengthen the domestic financial and banking sector, and provide secure investment opportunities for both local and international investors.

Following the introduction of the DMF, the share of Dirham-denominated debt instruments in the domestic capital market increased significantly, reaching 21.1% by the end of the first half of 2024, compared to just 0.5% at the end of 2020.

Additionally, by the end of 2024, the UAE recorded a marginal decline in foreign-currency sukuk issuance compared to the previous year.

Financial institutions in DCM

Financial institutions are the dominant participants in the UAE DCM, holding 51% of the total share, followed by corporates at 21%, as of the end of the third quarter of 2024.

This trend is evident in both the sukuk and conventional bond markets in the UAE, as financial institutions serve as the primary issuers of debt instruments within the sector.

Regulatory Shifts and Structural Implications for Sukuk

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is the leading international not-for-profit organisation primarily responsible for development and issuance of standards for the global Islamic finance industry. AAOIFI Shariah standards are adopted as mandatory regulatory requirements in many countries and jurisdictions across the globe including the UAE.

Besides the UAE, the leading countries for sukuk issuance over the past five years include Indonesia, where AAOIFI accounting standards have been used as the basis for developing national accounting standards, and Kuwait, where AAOIFI standards have been recommended as guidelines. On the other hand, Malaysia follows International Financial Reporting Standards (IFRS) for financial reporting by Islamic financial institutions, while Saudi Arabia has adopted a separate regulatory framework.

AAOIFI released an exposure draft of Shariah Standard No. 62 on sukuk in early November 2023.[13] The standard is still under review and is expected to be finalized later this year.[14] AAOIFI emphasized that the primary objective of the standard is to streamline and unify the requirements for sukuk issuances, especially in jurisdictions where regulators have implemented AAOIFI's Shariah guidelines. This standard is expected to play a significant role in shaping the future of the sukuk market. Although comprehensive analysis is not possible without finalized text, the introduction of asset-backed or quasi-equity structures could expose sukuk investors and issuers to greater credit, market, legal, operational, and liquidity risks compared to conventional bonds.

Adoption of Shariah Standard No. 62 could alter the structure of sukuk from asset-based to asset-backed and make sukuk more expensive as compared to conventional bonds by requiring the transfer of ownership of the underlying assets to investors, among other changes.[15] Firstly, transferring an asset comes with risks. Secondly, it remains uncertain whether sovereign issuers, who dominate the sukuk market, would be willing to transfer sovereign assets to certificate holders, given factors such as foreign ownership restrictions.

For corporates and financial institutions, asset transfers may also be impractical if they significantly impact their balance sheets and credit profiles. In contrast, asset-based sukuk generally do not require asset removal from the obligor's balance sheet, avoiding such concerns. However, in certain cases, transferring assets off the balance sheet can be a key advantage of asset-backed financing, depending on the specific circumstances.

If the implementation of Shariah Standard No. 62 leads to the issuance of *secured sukuk with additional protection* for investors, these instruments could potentially be rated higher than an issuer's senior unsecured debt.[15] However, most Islamic finance jurisdictions lack clear legal precedents on how bankruptcy courts would treat sukuk holders in the event of a default. Structuring sukuk as secured debt could further increase uncertainty regarding investor recourse, enforcement mechanisms, debt ranking, and recovery prospects.

According to Fitch Ratings, 60% of reported Muslim-majority countries fall under Group D in its Country-Specific Treatment of Recovery Ratings Criteria—the lowest category—where expected recoveries in a default scenario range from average to poor, and secured debt typically does not receive any notching uplift for recovery potential.[15]

The impact of Shariah Standard No. 62 will largely depend on who adopts it and whether its implementation is phased or immediate. If adoption and enforcement vary across jurisdictions or entities, it could lead to greater market fragmentation. The potential disruption from adopting the new standard could be minimal if most sukuk remain senior unsecured obligations of the issuer, ranking pari passu with other debt and lacking asset recourse. For instance, the introduction of Shariah Standard No. 59 in 2021 resulted in stricter tangibility ratio requirements and new dissolution triggers in sukuk documentation. However, it did not fundamentally change existing structures that replicate the economic effects of conventional bonds.[15]

13 https://aaoifi.com/wp-content/uploads/2023/11/DRAFT-AAOIFI-SS-62-ArEn.pdf

14 https://www.spglobal.com/ratings/en/research/articles/250205-sukuk-brief-more-time-to-adopt-aaoifi-standard-62-13405446

15 https://www.fitchratings.com/research/non-bank-financial-institutions/aaoifi-standard-62s-final-form-adoption-to-determine-impact-on-sukuk-04-12-2024

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