Journal of Islamic Finance, Vol. 15 No. 1 (2026) 92-102
IIUM Institute of Islamic Banking and Finance
ISSN 2289-2117 (O) / 2289-2109 (P)

Enhancing Sukuk Default Remedies: A Shariah and Legal Perspective

Mohd Shahid[a*], Safinar Salleh[b] , Uzaimah Ibrahim[c] , Syed Marwan Mujahid[d]

[a,b,c] *Ahmad Ibrahim Kulliyyah of Laws, International Islamic University Malaysia, Kuala Lumpur, Malaysia.*
[d] *Institute of Islamic Banking and Finance, International Islamic University Malaysia, Kuala Lumpur, Malaysia.*

**Corresponding author: shahidazminadwi@gmail.com*

Abstract

This research evaluates the efficacy of Shariah and legal remedies in resolving Sukuk defaults within the rapidly evolving Islamic finance landscape. Despite the theoretical emphasis on asset ownership and risk-sharing, contemporary default resolution mechanisms remain structurally inadequate. Employing a qualitative methodology comprising doctrinal analysis, comparative legal studies, and case examinations, this research identifies a critical disconnect: the dominance of asset-based Sukuk diminishes investor ownership rights and shifts the risk profile toward unsecured credit risk. Key impediments include legal ambiguities regarding beneficial ownership, an overreliance on purchase undertakings, and a lack of harmonized, Shariah-compliant insolvency regimes, particularly in cross-border contexts. These factors drive protracted litigation, inflate transaction costs, and erode investor confidence. To bridge these gaps, this study proposes a standardized framework that synchronizes legal enforceability with Shariah objectives (Maqasid al-Shariah). The findings advocate for reinforced regulatory coordination, the modernization of contractual structures, and the integration of financial technology to enhance transparency. Such reforms are vital for bolstering investor protection and ensuring the long-term stability of the global Sukuk market.

Keywords: Sukuk default, Islamic finance, Shariah compliance, legal remedies, financial stability

1. Introduction

Sukuk have assumed a pivotal role in the Islamic capital market as a Shariah-compliant alternative to conventional bonds (Afifi, 2024). The global market has experienced exponential growth over the past two decades, driven by a burgeoning demand for ethical finance, increased sovereign and corporate issuances, and the rising prominence of Islamic financial institutions. By 2024, annual Sukuk issuance reached approximately USD 180 billion, propelling the total outstanding market toward the USD 1 trillion milestone. Notable issuances, such as Indonesia's 30-year green Sukuk, Saudi Arabia's USD 5 billion issuance, and the Islamic Development Bank's USD 2.5 billion sustainability Sukuk (Bennett & Coyle, 2025), signal a strategic shift toward utilizing Sukuk for long-term, ESG-aligned financing.

Despite this rapid expansion, the rising prevalence of Sukuk defaults has exposed critical vulnerabilities within existing resolution frameworks. Unlike conventional bonds, which benefit from

Article history
Received: 11 March 2025
Accepted:19 March 2026

established and predictable insolvency regimes, Sukuk defaults are complicated by the intricate interplay of Shariah principles, jurisdictional variations, and the legal enforceability of contractual terms (Busari et al., 2019). A fundamental challenge in resolving these defaults lies in the structural distinction between asset-backed and asset-based Sukuk. While asset-backed structures grant investors a legal claim to the underlying assets, providing a tangible degree of security, asset-based Sukuk merely create a payment obligation. This exposes investors to the same credit risks as traditional unsecured bonds without fulfilling the Shariah ideal of true risk-sharing. This structural dichotomy carries profound implications during default scenarios. Asset-based Sukuk holders often lack direct access to underlying assets due to the legal limitations of nominal or "beneficial" ownership, leading to legal uncertainties and protracted court proceedings (Tasnia et al., 2017). Landmark defaults, such as the East Cameron Sukuk, The Investment Dar Sukuk, and the Dana Gas Sukuk, have starkly illustrated the risks associated with incomplete ownership transfer, the enforceability of purchase undertakings, and the friction of applying conventional insolvency laws to Islamic financial arrangements (Lukonga, 2015).

Furthermore, differing Shariah interpretations across jurisdictions compound these complexities. The Dana Gas dispute, for instance, highlighted the legal paralysis resulting from conflicting interpretations of English common law and UAE domestic law, leading to substantial investor losses and diminished market confidence (Berrahlia & Benseghir, 2025; Busari et al., 2019). This research seeks to critically analyze the efficacy of current Sukuk default remedies from both Shariah and legal perspectives. Specifically, it examines the structural, governance, and jurisdictional impediments that curtail investor protection under modern Sukuk practices. The study aims to assess the extent to which existing resolution tools—particularly those concerning asset ownership, contractual enforceability, and insolvency proceedings—embody the core Islamic finance principles of risk-sharing (*al-ghunm bil ghurm*), true ownership (*milkiyyah*), and fairness.

By employing a triangulated methodology of doctrinal evaluation, comparative legal analysis, and empirical case studies, this article identifies major deficiencies in existing regulatory frameworks, most notably the absence of a harmonized, Shariah-compliant insolvency regime for cross-border settings. Ultimately, the research proposes an integrated framework that aligns legal enforceability with Shariah objectives (*Maqasid al-Shariah*). Through practical recommendations—ranging from regulatory harmonization and enhanced contractual clarity to the integration of financial technology (fintech)—this study aims to foster a more resilient Sukuk market that bolsters investor confidence, minimizes systemic inefficiencies, and ensures the long-term viability of the global Islamic capital market.

2. Literature Review

The exponential growth of Sukuk in the global financial framework has amplified the urgent need for robust, Shariah-compliant frameworks to mitigate default risks. Although Sukuk are theoretically grounded in the principles of asset ownership and risk-sharing, the literature consistently demonstrates that practical default scenarios are marred by severe enforcement hurdles, inadequate investor protection, and jurisdictional friction. In response to these challenges, recent scholarship has coalesced around several major themes: structural vulnerabilities, cross-jurisdictional legal disparities, governance failures, and the critical need for regulatory standardization. Despite ongoing efforts by institutions like AAOIFI to enhance market discipline, the literature reveals that a comprehensive framework capable of balancing Shariah principles with reliable legal enforceability remains conspicuously absent.

Structural Vulnerabilities: The Asset-Backed vs. Asset-Based Dichotomy

A central debate within the literature revolves around the structural classification of Sukuk and its implications for investor recourse. Scholars widely agree that the legal distinction between asset-backed and asset-based structures is the primary determinant of recovery success during a default

(Ali, 2019; Tasnia et al., 2017). True asset-backed Sukuk offer superior default safeguards by utilizing true sale structures that grant investors legal ownership and direct recourse to the underlying assets (Tasnia et al., 2017). Conversely, the majority of modern issuances are asset-based, operating largely as unsecured debt where investors must rely solely on the creditworthiness of the issuer (Zaheer & van Wijnbergen, 2024). Cases such as the East Cameron Partners and Nakheel Sukuk underscore how these asset-based structures often mimic traditional debt instruments, exposing investors to heightened risks and rendering the theoretical promise of "asset ownership" ineffective in practice.

Jurisdictional Conflicts and Legal Ambiguity

The complexity of Sukuk defaults is further exacerbated by the intersection of Islamic jurisprudence and conventional legal systems. The literature extensively documents the hazards of operating under dual legal regimes, with the Dana Gas dispute serving as the paramount case study. In this instance, discrepancies between UAE domestic law (governing the Sukuk structure) and English common law (governing the purchase undertaking) resulted in conflicting judicial decisions and prolonged legal paralysis (Busari et al., 2019; Zada & Muhammad, 2018). Ali (2022) notes that the absence of a standardized, globally accepted legal framework for Islamic finance leaves default resolutions highly vulnerable to jurisdictional arbitrage. Consequently, courts across different regions have demonstrated marked inconsistency in handling disputes, particularly where local Islamic finance legislation remains underdeveloped (Ali, 2019; Zaheer & van Wijnbergen, 2024).

Governance Failures and “Post-Issuance” Shariah Risk

Beyond structural and legal flaws, researchers highlight severe gaps in corporate and Shariah governance as primary catalysts for default. Weak transparency, inadequate disclosure, and conflicts of interest significantly undermine market stability (Adisa, 2022). More critically, the literature points to the weaponization of “Shariah non-compliance” claims by issuers seeking to evade payment obligations. As observed in the Dana Gas and Investment Dar cases, obligors have successfully used retrospective claims of Shariah invalidity to stall enforcement, exposing the limitations of current Shariah regulatory oversight (Zada & Muhammad, 2018; Ali, 2022). Even in equity-based Musharakah models, such as the Villamar Sukuk, operational constraints and the absence of clear buyback guarantees have led to protracted insolvency proceedings, contradicting the inherent risk-sharing ethos of the structure (Ali, 2017; Swandaru & Muneeza, 2024).

The Path Forward and Remaining Research Gaps

To address these pervasive issues, scholars advocate for the implementation of robust contractual tools, such as cross-default clauses, though their strict conformity with Maqasid al-Shariah remains a subject of ongoing debate (Zakariyah & Busari, 2019). Furthermore, while there is a strong consensus on the need for regulatory harmonization and enhanced oversight (Swandaru & Muneeza, 2024), the literature struggles to reconcile these theoretical proposals with practical market behavior and insolvency realities. Crucially, the existing body of research remains fragmented. While governance weaknesses, jurisdictional dispersion, and the debt-like nature of modern Sukuk (Nawaz, 2025) are well-documented as isolated phenomena, there is a distinct lack of empirical analysis connecting these variables. Specifically, empirical data illustrating how differences in asset-backed versus asset-based structures translate into actual recovery rates and enforcement efficacy across various jurisdictions are scarce (Shahid et al., 2025). Therefore, a significant gap exists for a comprehensive, interdisciplinary analytical framework that integrates ownership structures, contractual arrangements, insolvency regulations, and Shariah governance. Addressing this gap is imperative to move beyond the current theoretical discourse and develop actionable, robust default remedies that can stabilize the global Islamic capital market.

3. Research Methodology

This study employs a qualitative research design to evaluate the efficacy of Sukuk default remedies from both Shariah and legal perspectives. The primary objective is to identify structural, legal, and governance inefficiencies, ultimately facilitating the development of a more cohesive, Shariah-compliant resolution model. The research is anchored in foundational Islamic finance principles—specifically risk-sharing (*al-ghunm bil ghurm*) and true asset ownership (*milkiyyah*)—alongside conventional legal theories of enforceability and insolvency. These theoretical foundations are utilized to assess whether contemporary Sukuk practices successfully align with both Shariah objectives and legal certainty. To achieve this, the research triangulates doctrinal, comparative, and multiple case study approaches, enabling a systematic analysis that bridges theory and practice.

Doctrinal Analysis

Doctrinal analysis forms the conceptual and normative foundation of the study. This involves a systematic review of primary and secondary materials, including classical juristic texts, contemporary Shariah standards (such as those issued by AAOIFI), statutory legislation, regulatory frameworks, and legal jurisprudence. This approach is utilized to critically evaluate the legal and Shariah underpinnings of Sukuk structures, with a particular focus on default triggers, enforcement mechanisms, ownership rights, and contractual features like purchase undertakings. Through this analysis, the research delineates the extent to which current frameworks deviate from core Shariah principles and how such deviations contribute to systemic vulnerabilities.

Comparative Legal Analysis

Building upon the doctrinal foundation, a comparative legal analysis is employed to explore how Sukuk defaults and enforcement are navigated across different jurisdictions. The study focuses on Malaysia, the United Arab Emirates (UAE), and the United Kingdom, selected based on three criteria: (i) their status as leading hubs in the global Sukuk market; (ii) their diverse legal traditions (common law, civil law, and hybrid systems); and (iii) their extensive practical experience in adjudicating cross-border Sukuk disputes. By reviewing regulatory frameworks, court decisions, and enforcement practices within these jurisdictions, the study identifies the discrepancies in legal treatment, Shariah governance, and judicial reasoning that drive jurisdictional inconsistency and enforcement uncertainty.

Multiple Case Study Approach

To supplement the normative and comparative elements, the study utilizes a multiple case study approach to provide empirical insight into the practical resolution of Sukuk defaults. The East Cameron Sukuk (US), The Investment Dar Sukuk (Kuwait/UAE), and Dana Gas Sukuk (UAE/UK) were purposively selected based on the following criteria:

1. Their precedential value in the evolution of Sukuk default jurisprudence.
2. Their representation of differing structural models (asset-backed versus asset-based).
3. Their involvement in complex cross-border legal and Shariah disputes.

These cases are evaluated using a systematic analytical framework developed specifically for this research. The framework assesses each case across four dimensions:

1. The nature of asset ownership and investor recourse rights.
2. The enforceability of contractual devices (including purchase undertakings and guarantees).
3. The interaction and friction between the governing law and Shariah compliance.
4. The overall effectiveness of dispute resolution mechanisms and recovery outcomes.

The combination of these three research methods ensures a robust and cohesive research design. The doctrinal analysis sets the theoretical baseline, the comparative analysis contextualizes the jurisdictional friction, and the case studies empirically demonstrate how these challenges manifest in real-world litigation. This triangulated methodology validates the study's central premise that existing Sukuk default remedies are structurally and institutionally deficient, providing a rigorous foundation for proposing a unified, legally viable, and Shariah-compliant resolution model.

4. Results and Discussion

The results of this research highlight the inherent inadequacies of existing solutions to Sukuk defaults based on both Shariah and legal perspectives. The discussion suggests that despite the development of Sukuk structures as Shariah-compliant alternatives to traditional bonds, their default resolution procedures are unsatisfactory and often face challenges in aligning with Islamic financial principles. One of the key problems identified is the reliance on the conventional methods of financial restructuring, such as cash injection, rescheduling, and debt-for-equity swaps, and haircuts, which may face challenge in adhering to Shariah principles of equity, risk-sharing, and ethical financial practices (Abd Hafiz et al., 2017).

The paper suggests that beneficial ownership, which is a common idea in asset-based Sukuk poses significant enforcement challenges, particularly during times of default. Despite nominal ownership rights, Sukuk holders are often faced with barriers to direct access to underlying assets owing to the legal and structural limitations of beneficial ownership (Oseni, 2015). This undermines the underlying concept of asset-backed transactions in Islamic finance and puts investors at risk as financial distress sets in. Empirical data suggest that the majority of Sukuk are still in the form of senior unsecured obligations, and investors have limited or non-exercisable rights to underlying assets, which undermines the realising of ownership and risk-sharing principles (Nawaz, 2025).

The analysis of the purchase undertakings and capital guarantees show that these mechanisms tend to blur the distinction between equity-based risk-sharing instruments and financial guarantees aimed at protecting investors. These tools are a source of concern regarding Shariah non-compliance because they are similar to traditional guarantees that reduce the inherent risk of the Islamic finance investment (Zakariah and Aziz, 2013; Sawari et al., 2018; Busari et al., 2024; Muneeza & Mustapha, 2020; Laldin, 2012; Muhammad et al., 2011; Lahsasna, 2014). This paper shows that such mechanisms result in the false portrayal of Sukuk as risk-free investments; a claim that goes against the fundamental tenets of Islamic finance that emphasise the importance of sharing profits and losses. Empirical studies have long pointed out that fixed repurchase obligations and capital guarantees were found in a significant percentage of Sukuk issues, effectively converting them into instruments that provide bond-like assurance of returns (Usmani, 2008; Godlewski et al., 2013). This market-driven structural design is indicative of a deeper preference for predictability and protection of investors even in situations where it contravenes the underlying Shariah principle of *al-ghunm bil ghurm* (entitlement to gain contingent upon risk).

The complexity of Sukuk structures makes it harder to introduce default remedies. The involvement of different stakeholders, including issuers, investors, trustees, Shariah boards, and regulatory authorities, and differing interpretations of Shariah across jurisdictions lead to a fragmented and inconsistent system of default resolution. The lack of legal and regulatory standards exacerbates the issue, as it leads to prolonged court cases and increased investor risk (Busari et al., 2019; Jobst et al., 2008). This disintegration is also enhanced by the unavailability of binding judicial precedent in most Sukuk-issuing jurisdictions, which reduces the predictability of legal outcomes and investor confidence in enforcement mechanisms (Nagano, 2017).

The study highlights the inadequacy of the existing insolvency laws in dealing with Sukuk defaults. The classical Islamic jurisprudence focuses mainly on individual insolvency, creating gap between the classical Islamic principles and the modern financial conditions. The absence of Shariah-compliant insolvency legislation that specifically address corporate parties limits the recourse of Sukuk investors and results in delays and inefficient resolution of defaults (Van Wijnbergen & Zaheer, 2013; Zaheer & Van Wijnbergen, 2024; Al-Ali, 2019). This is supported by quantitative data, which shows that recovery performance in most Organisation of Islamic Cooperation (OIC) jurisdictions ranges from average to poor, due to weak creditor protection systems and lack of enforcement capacity (Fitch Ratings, 2024). In addition, the absence of clear court-based resolutions, as most defaults are resolved through out-of-court settlements, further restricts the development of jurisprudence and limits the development of reliable guidelines on future cases.

The fragmented nature of Shariah governance, where different interpretations of Islamic financial principles are applied across jurisdictions complicates the enforcement of Sukuk default remedies. This difference leads to non-uniform legal treatment of cross-border Sukuk dealings, and it undermines investor trust in the dependability of such instruments (Busari et al., 2019). The Dana Gas case offers a critical example of such problems, with contradictory interpretations between the UAE and English courts on the compliance with Shariah and contractual enforceability exposing the limitations of legal certainty and the jurisdictional breakdown (Ercanbrack, 2019).

East Cameron Partners (ECP) failed to meet its payment obligations under the Sukuk and went into Chapter 11 bankruptcy in the United States. The case highlighted the pitfalls of having two different interpretations of the law as the court had to determine whether the Sukuk was a true sale of property or a secured loan. These examples demonstrate the challenges of adopting Sukuk default solutions in different jurisdictions (Lukonga, 2015). It is interesting to note that, despite these high-profile defaults, the overall default rates of Sukuk are incredibly low at less than 0.25% globally, and about 81% of rated Sukuk are investment-grade (Fitch Ratings, 2024). This paradox indicates that the perceived stability of the Sukuk market is not necessarily related to strong legal protections but to structural conservatism, sovereign backing, and low exposure to defaults.

The changes proposed by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) that require the issuers to transfer the legal ownership of underlying assets to investors aim to standardise issuance across jurisdictions and enhance Shariah authenticity. Nevertheless, analysts warn that the changes could create legal complexity, increase transaction costs and also lead to a decline in investor appetite. Empirical evidence based on scenarios indicates that extreme enforcement of such standards might result in a lower volume of issuance, wider pricing spreads and may even fragment the global Sukuk market, but a gradual and coordinated approach would help balance between authenticity and competitiveness (Nawaz, 2025).

These instances show how different interpretations of Shariah rules and legal systems across jurisdictions can lead to different legal consequences in cross-border transactions involving Sukuk and thus reducing investor confidence in such instruments. One of the most notable outcomes of the research is the necessity of a more comprehensive, standardised and Shariah-compliant insolvency regime on Sukuk defaults. This framework should address the inadequacies of the existing solutions including explicit enforcement mechanisms, enhanced legal protection for investors, and ensuring that the strategies of default resolution are aligned with the Shariah principles of justice, transparency, and equitable risk-sharing.

The research suggests the need to improve the harmonisation of regulations to resolve the inconsistency in Shariah interpretations and legal requirements across different jurisdictions. The development of clear rules concerning ownership rights and protection of investors and dispute resolution tools will be crucial in enhancing resilience and the credibility of the Sukuk market. This is particularly relevant given the ongoing growth of the Sukuk market, where the overall amount of outstanding Sukuk is over USD 850 billion as of 2023 and the annual issuance is approaching USD 180 billion as of 2024, with the market expected to reach USD 1 trillion in the coming years. This continuous rise, combined with the evidence that yield spreads generally move in the same direction as traditional bond markets, underlines the increasing role of Sukuk in the global financial market and suggests that any structural changes should be made cautiously, taking into account the overall financial market trends (Fitch Ratings, 2024; Bennett and Coyle, 2025). The results of this research show that the current system of dealing with the default of Sukuk is inadequate from both Shariah and legal perspectives. Sukuk have become a vital component of Islamic finance, but their default resolution processes are not sufficiently developed, thereby exposing investors to significant risks and to undermine market confidence. To ensure Sukuk as a financial instrument are sustainable over time, a multi-faceted, Shariah-compliant legal and regulatory structure is necessary to address the risks of default, which sufficiently reduce default risk without contravening the ethical and financial principles of Islamic finance. The strengthening of these structures will not only increase the level of protection for investors but also strengthen the position of Sukuk as a viable alternative in the global capital markets to traditional financial instruments.

The findings of this research highlight the inherent inadequacies of existing Sukuk default resolution frameworks from both Shariah and legal perspectives. Despite the evolution of Sukuk as a Shariah-compliant alternative to conventional bonds, current default procedures routinely fail to align with foundational Islamic financial principles. A primary issue identified is the over-reliance on conventional financial restructuring methods—such as cash injections, rescheduling, debt-for-equity swaps, and haircuts—which often contravene Shariah principles of equity, ethical practice, and true risk-sharing (Abd Hafiz et al., 2017).

Structural Contradictions: Beneficial Ownership and Guarantees: A significant enforcement barrier lies in the concept of "beneficial ownership," a hallmark of asset-based Sukuk. During a default, despite holding nominal ownership rights, investors face severe legal and structural limitations in accessing the underlying assets (Oseni, 2015). This reality undermines the concept of asset-backed transactions and severely disadvantages investors during financial distress. Empirical data supports this, demonstrating that the majority of modern Sukuk function as senior unsecured obligations, granting investors limited or non-exercisable rights and completely bypassing the principle of risk-sharing (Nawaz, 2025).

Furthermore, the prevalent use of purchase undertakings and capital guarantees blurs the line between equity-based risk-sharing and conventional debt protection. These mechanisms essentially guarantee the return of principal, raising profound Shariah compliance concerns because they eliminate the inherent risk required in Islamic investments (Zakariah and Aziz, 2013; Sawari et al., 2018; Busari et al., 2024; Muneeza & Mustapha, 2020; Laldin, 2012; Muhammad et al., 2011; Lahsasna, 2014). Consequently, Sukuk are often falsely marketed as risk-free investments, contradicting the Shariah maxim of *al-ghunm bil ghurm* (entitlement to gain is contingent upon risk). Studies confirm that fixed repurchase obligations effectively convert these instruments into bond-like assurances of returns (Usmani, 2008; Godlewski et al., 2013), reflecting a market-driven preference for investor protection over Shariah authenticity.

Jurisdictional Fragmentation and Insolvency Gaps: The complexity of Sukuk structures, combined with the involvement of diverse stakeholders (issuers, trustees, Shariah boards) and varying regional Shariah interpretations, creates a highly fragmented resolution landscape. The absence of harmonized legal standards exacerbates this, leading to prolonged litigation and heightened investor risk (Busari et al., 2019; Jobst et al., 2008). This unpredictability is compounded by a lack of binding judicial precedent in most Sukuk-issuing jurisdictions (Nagano, 2017). Crucially, existing conventional insolvency laws are ill-equipped to handle Sukuk defaults. Classical Islamic jurisprudence focuses primarily on individual insolvency, leaving a gap when applied to modern corporate entities. The absence of Shariah-compliant corporate insolvency legislation limits investor recourse and delays resolution (Van Wijnbergen & Zaheer, 2013; Zaheer & Van Wijnbergen, 2024; Al-Ali, 2019). Quantitative data reinforces this: recovery performance in most Organisation of Islamic Cooperation (OIC) jurisdictions ranges from average to poor due to weak creditor protection and enforcement capacity (Fitch Ratings, 2024). Consequently, most defaults are resolved via opaque out-of-court settlements, stunting the development of reliable legal guidelines.

Cross-Border Enforcement and the Low Default Paradox: Fragmented Shariah governance severely complicate cross-border enforcement. The *Dana Gas* case serves as a critical example, where contradictory interpretations between UAE and English courts regarding Shariah compliance and contractual enforceability exposed deep jurisdictional rifts (Ercanbrack, 2019). Similarly, the

East Cameron Partners (ECP) Chapter 11 bankruptcy in the United States highlighted the legal friction of determining whether a Sukuk constitutes a "true sale" of property or a secured loan under conventional bankruptcy law (Lukonga, 2015).

Interestingly, despite these high-profile structural vulnerabilities, global Sukuk default rates remain incredibly low at less than 0.25%, with approximately 81% of rated Sukuk achieving investment-grade status (Fitch Ratings, 2024). This paradox indicates that the market's perceived stability stems not from robust legal protections, but from structural conservatism, heavy sovereign backing, and an overall low exposure environment.

Regulatory Reforms: The AAOIFI Mandate To address these gaps, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has proposed sweeping changes requiring issuers to transfer true legal ownership of underlying assets to investors. While these standards aim to restore Shariah authenticity, analysts caution that aggressive enforcement could trigger legal complexities, inflate transaction costs, and cool investor appetite. Scenario-based evidence suggests that abrupt shifts could widen pricing spreads and fragment the market, necessitating a gradual, coordinated transition (Nawaz, 2025).

Towards a Harmonized Resolution Framework: Ultimately, this research underscores the urgent need for a standardized, Shariah-compliant insolvency regime. With the total outstanding Sukuk market surpassing USD 850 billion in 2023 and annual issuances approaching USD 180 billion in 2024, the stakes are exceptionally high (Fitch Ratings, 2024; Bennett and Coyle, 2025). To ensure long-term sustainability, a multi-faceted regulatory structure must be implemented. By establishing explicit enforcement mechanisms, harmonizing cross-border legal requirements, and aligning default strategies with the ethical principles of *Maqasid al-Shariah*, the industry can protect investors and solidify Sukuk as a resilient alternative in global capital markets.

5. Conclusion and Recommendations

This article set out to critically evaluate the Shariah and legal deficiencies inherent in current Sukuk default resolution frameworks and to propose a more cohesive, enforceable model. The findings substantiate the hypothesis that, despite the robust expansion of the global Sukuk market, existing default mechanisms remain highly fragmented and frequently incongruent with the foundational principles of Islamic finance. Complex structural designs, jurisdictional disparities, and divergent Shariah interpretations continue to obstruct investor protection, ultimately undermining broader market confidence.

A primary conclusion of this study is the critical impact of the structural dichotomy between asset-backed and asset-based Sukuk on default outcomes. While asset-backed structures offer superior legal recourse through enforceable ownership rights, the market's overwhelming reliance on asset-based structures subjects' investors to heightened credit and legal risks. The prevalent use of purchase undertakings and debt-like capital guarantees blurs the distinction between risk-sharing and risk transfer, eroding Shariah authenticity and reinforcing the conventional bond-like nature of modern Sukuk. Furthermore, the absence of a harmonized, Shariah-compliant insolvency framework represents a profound structural defect. Discrepancies in legal systems and Shariah governance across jurisdictions yield inconsistent judicial outcomes and protracted litigation. These regulatory gaps generate quantifiable economic friction, including inflated transaction costs, higher risk premiums, and a potential reduction in the competitiveness of Sukuk relative to conventional instruments.

Policy and Regulatory Recommendations

To address these systemic vulnerabilities, this study advocates for a coordinated, transnational reform agenda. Regulators and standard-setting bodies, such as AAOIFI, must collaborate to synchronize Shariah principles with modern insolvency legislation. Practical steps should include:

Standardization: Adopting universal Sukuk documentation with explicit legal recognition of both beneficial and legal ownership rights.

Dispute Resolution: Establishing cross-border resolution protocols, including the creation of specialized international arbitration centers dedicated to Islamic finance disputes.

Phased Implementation: Employing a gradual approach to regulatory overhauls to carefully balance Shariah authenticity with market viability.

Implications for Industry

Participants and Investors For industry practitioners—issuers, arrangers, and legal advisors—this study underscores the necessity of designing Sukuk that feature genuine asset ownership, unambiguous contractual terms, and explicit risk allocation. Strengthening disclosure standards and due diligence protocols will organically enhance resilience to default risks. Consequently, improved structural transparency will empower investors to conduct more accurate risk assessments and achieve better portfolio diversification, thereby optimizing capital allocation within the Islamic financial markets.

Technological Innovations

This research also highlights the transformative potential of financial technology in mitigating structural inefficiencies. The integration of blockchain and smart contracts can automate Shariah compliance, enhance transparency in asset ownership, and streamline the monitoring of underlying assets. By reducing information asymmetry and transaction costs, these technological tools directly address the enforcement limitations identified in this study.

Avenues for Future Research

Methodologically, this article bridges the gap between conceptual Shariah principles and practical legal enforcement. However, there remains a pressing need for interdisciplinary research that integrates doctrinal legal analysis with quantitative empirical data. Future studies should focus on quantifying recovery rates across varying Sukuk structures, testing the real-world efficiency of cross-border insolvency regimes, and evaluating the market impact of new regulatory guidelines, such as AAOIFI Shariah Standard No. 62.

Broader Socio-Economic Impact

Ultimately, refining Sukuk default frameworks is not merely a legal or financial imperative; it is essential for preserving the social validity of Islamic finance. Ensuring that Sukuk structures genuinely reflect the ethical philosophies of justice, transparency, and risk-sharing (al-ghunm bil ghurm) will bolster public trust. By implementing the holistic, technology-enhanced, and standardized framework proposed in this study, the global Sukuk market can achieve long-term sustainability, safeguard investor rights, and effectively contribute to broader economic development and ethical financial inclusion.

References

Abd Hafiz, R., Samah, Z. A., & Hassan, R. (2017). Challenges of Islamic debt restructuring in a multi creditor environment. Journal of Islamic Finance, 6, 054-072.

Adisa, M. K. (2022). Sukuk default/near default and governance failure: The need for a strong and sound governance framework (the role of Securities Commissions and other regulatory authorities) [Doctoral dissertation]. (International Centre for Education in Islamic Finance).

Afifi, Z. K. (2024). Financial sukuk: Concept, legal principles, and types. Asian Journal of Economics, Business and Accounting, 24(2), 98-106.

Ahmed, E. R., Islam, M. A., Alabdullah, T. T. Y., & Amran, A. B. (2019). A qualitative analysis on the determinants of legitimacy of sukuk. Journal of Islamic Accounting and Business Research, 10(3), 342-368.

Al-Ali, S. (2019). Raising capital on ṣukūk markets: structural, legal and regulatory issues. Springer.

Ali, M. I., Hasan, A., & Sharofiddin, A. (2022). Evaluating sukuk default factors: a case study on dana gas sukuk in the UAE. Journal of Islamic Finance, 11(1), 33-40.

Ali, S. S. (2017). Ṣukūk Default and Issues in Their Resolution: The Case of Villamar Ṣukūk. Developments in Islamic finance: challenges and initiatives, 65-88.

Askari, H., Iqbal, Z., Krichne, N. and Mirakhor, A. (2015), "Risk sharing in finance: the Islamic finance alternative", Risk Shar. In Financ.: The Islam. Financ. Altern, p. 285, doi: 10.1002/9781119199328.

Bennett, M., & Coyle, H. (2025). State of the sukuk market and prospects for growth. World Bank. https://blogs.worldbank.org/en/allaboutfinance/state-of-the-sukuk-market-and-prospects-for-growth?utm.

Berrahlia, B., & Benseghir, M. (2025). Limits of Legal Certainty: A Commentary on the "Dana Gas" Case. Laws, 14(2), 22.

Busari, S. A., AbdulAziz, A., Zakariyah, L., & Amanullah, M. (2019). Dana Gas Sukuk default: a juristic analysis of court judgement. International Journal of Islamic and Middle Eastern Finance and Management, 12(4), 569-585.

Busari, S. A., Zakariyah, L., & Aziz, A. B. A. (2019). Sukuk default regulation in Malaysia and United Arab Emirates: Comparative analysis. International Journal of Fiqh and Usul al-Fiqh Studies, 3(1), 90–102.

Busari, S., Suleiman, H., & Salhab, B. (2024). Application of Guarantee contracts in Islamic Financial Transaction: Analysis of BNM and AAIOFI. Journal of Fatwa Management and Research, 29(3), 46-62.

Chapra, M. U. (2008). The Islamic vision of development in the light of Maqāsid al-sharī 'ah. Islamic Research and Training Institute Islamic Development Bank Jeddah, DOI, 10.

Ercanbrack, J. (2015). The transformation of Islamic law in global financial markets. Cambridge University Press.

Fitch Ratings. (2024). Global sukuk outlook dashboard 2024. https://www.fitchratings.com/research/islamic-finance/global-sukuk-outlook-dashboard-2024-10-01-2024.

Godlewski, C. J., Turk-Ariss, R., & Weill, L. (2013). Sukuk vs. conventional bonds: A stock market perspective. Journal of Comparative Economics, 41(3), 745-761.

Jobst, A., Kunzel, P., Mills, P., & Sy, A. (2008). Islamic bond issuance: what sovereign debt managers need to know. International Journal of Islamic and Middle Eastern Finance and Management, 1(4), 330-344.

Lahsasna, A. (2014). Shari'ah non-compliance risk management and legal documentations in Islamic finance. John Wiley & Sons.

Laldin, M. A. (2012). Sukuk in Various Jurisdictions: Sharī´ ah and Legal Issues. Journal of Islamic Business and Management, 2, no. 1 (2012). 22.

Lukonga, I. (2015). Islamic finance, consumer protection, and financial stability (IMF Working Paper No. WP/15/107). International Monetary Fund.

Muhammad, M., Yaacob, H., & Hasan, S. (2011). The bindingness and enforceability of a unilateral promise (wa ‘d): an analysis from Islamic law and legal perspectives. ISRA Research Paper, 30, 2011.

Muneeza, A., & Mustapha, Z. (2020). Practical application of Kafalah in Islamic banking in Malaysia. PSU Research Review, 4(3), 173-187.

Nagano, M. (2017). Sukuk issuance and information asymmetry: why do firms’ issue sukuk? Pacific-Basin Finance Journal, 42, 142-157.

Nawaz, T. (2025). Balancing Shariah Authenticity and Market Stability: A Scenario-Based Framework for Implementing AAOIFI Shariah Standard No. 62 in the Global Sukuk Market. Journal of Risk and Financial Management, 18(11), 604.

Oseni, U. A. (2015). The Legal and Beneficial Ownership Conundrum in Sovereign Ṣukuk Structuring. Al-Shajarah: Journal of the International Institute of Islamic Thought & Civilization, 20.

Oseni, U. A., & Ahmad, A. U. F. (2015). Dispute resolution in Islamic finance: A case analysis of Malaysia. Ethics, governance and regulation in Islamic finance, 127.

Sawari, M. F. M., Abdullah, N. A. N., Shamsuddin, M. M. J., & Aziz, A. A. (2018). The Enforceability of Wa ‘d Mulzim (Binding Promise) from a Fiqh Perspective: A Critical Analysis of Wa ‘d Application in Sukūk Contracts: قابلية التنفيذ للوعد الملزم في ضوء الفقه الإسلامي: دراسة تحليلية نقدية لتطبيقات الوعد في عقود الصكوك. International Journal of Fiqh and Usul Al-Fiqh Studies, 2(1), 119-131.

Shahid, M., Salleh, S., Omoola, S., & Hassan, R. (2025). Analysing Sukuk Default Cases: Causes, Remedies and Regulatory Implications. IIUMLJ, 33, 241

Swandaru, R., & Muneeza, A. (2024). Causes for Near Default Sukuk Cases in the 21st Century and Their Rescue Mechanisms. Jihbiz: Jurnal Ekonomi, Keuangan dan Perbankan Syariah, 8(1), 1-13.

Tasnia, M., Mustapha, I. M., & Shakil, M. H. (2017). Critical assessment of the legal recourse for the case of Sukuk default for the asset-backed and asset-based Sukuk structures. European Journal of Islamic Finance, Special Issue: Islamic Banking & Finance, (7), 1-6.

Uddin, R., & Cotterill, J. (2025). Rule change threatens to throw Islamic debt market into turmoil.

Usmani, M. T. (2007, February). Sukuk and their contemporary applications. In Translated from the original Arabic by Sheikh Yusuf Talal DeLorenzo, AAOIFI Shari’a Council meeting, Saudi Arabia.

Van Wijnbergen, S., & Zaheer, S. (2013). Sukuk defaults: On distress resolution in Islamic finance (Tinbergen Institute Discussion Paper No. TI 13-087/VI/DSF 57). Tinbergen Institute. https://ssrn.com/abstract=2293938.

Zada, N., & Muhammad, M. (2018). The intricacies of default in Islamic finance: a case study of dana gas sukuk litigation. Journal of Islamic Business and Management, 8(S).

Zaheer, S., & Van Wijnbergen, S. (2024). Sukuk defaults: On distress resolution in Islamic finance. Qualitative Research in Financial Markets, 17(2), 292-311.

Zakaria, M. Z., & Aziz, A. A. (2013). Purchase Undertaking in Equity-Based Sukuk: Does It Amount to Guarantee. The Journal of Muamalat and Islamic Finance Research, 43-68.

Zakariyah, H., & Busari, S. A. (2019). Analysis of sukuk cross-default clause: a fiqh perspective. Journal of Islamic Finance, 8(2), 50-57.