2.7 Reasons for default

As stated below, the causes of default are split into the internal causes and external causes.

2.7.1 Internal causes

- It is vital that the *sukuk* structure of Dana Gas is centered on the law of UAE. Whereas the English law regulates the "Purchase Undertaking Agreement". As the agreement implies that following the investment plan the funds received by the trustee should be invested by Dana Gas Limited. According to the Dana Gas agreement, the revenue earned by *mudarabah* assets will be distributed periodically between Dana Gas PJSC (*mudarib*) (entrepreneur) and the trustee (*rab-al-mal*) in a ratio of 99 percent to 1 percent. Nevertheless, assuring a confirmed profit in a *mudarabah sukuk* to any of the contracting parties is a breach of Shariah principle. As a result, the method of purchase undertaking employed was inconsistent with Shariah standards (Busari, 2019).
- It is investigated that the mechanism of dividend payout of Dana Gas Sukuk was imitating to some extent to the traditional bond output, contradicting to the standards of AAOIFI and UAE (Hekmatyar, 2018).

2.7.2 External causes

- It is cited that the liquidity constraints induced by late payments from Egypt and Iraq's Kurdistan provinces was one of the causes for Dana Gas Sukuk default ("UAE's Dana Gas Misses", 2012). Whereupon 729 million dirhams were remained unpaid from Egypt gas supplies and 1.2 billion dirhams in the Kurdistan province ("UAE's Dana Gas won't", 2012).
- Finally, it can be asserted that the absence of an effective regulatory framework from both a legal and *Shariah* aspects have led to this instability. Since then, the UAE has a fragmented Shariah compliance structure in place for Islamic finance industry. Article 6 of the UAE Islamic banking law declares "that each Islamic Bank (IB), financial institution and Investment Company should establish its own Shariah Supervisory Authority to ensure that its transactions and practices conform to Islamic law. It also states the establishment of Higher Shariah Authority to supervise Islamic Banks, financial institutions and investment companies". Art. 5, Federal Law No. 6 of 1985. (Hamza, 2013). In fact, the Higher Shariah Authority was not in place by that time, and Shariah Supervisory Boards (SSBs) are undertaking the obligation of *Shariah* governance (Hamid, 2015). Similarly, the governing laws and jurisdictions are primarily split amongst English and UAE law. "The Declaration of Trust, the Agency Agreement, the Purchase Undertaking, the Sale Undertaking, the Security Agreement, the Security Agency Agreement, the Ordinary Certificates and the Exchangeable Certificates are governed by English law and subject to the non-exclusive jurisdiction of the English Courts. Whereas the *Mudarabah* Agreement, the UAE Share Pledges and the UAE Mortgage were governed by the laws of the UAE" (Hekmatyar, 2018).

3. Research Methodology

To accomplish the objectives of this research the study applies a qualitative method by using the library research and content analysis approach. From the library research, the study employs comparative and content analysis methods. In this essence, the secondary data was collected through different sources like, English law, the law of UAE, verdicts of English court, articles, books, websites, and academic writings and then compare and analyze them using analytical methods. The research analyzes the issuance of Dana Gas Sukuk in UAE to discover the factors that caused the default of this *sukuk*. Furthermore, the research also tries to urge the IFIs practitioners and academicians to comprehend the nature, structure, and governance framework of Islamic capital market of this jurisdiction (Mohtesham, 2021; Hai, 2021).

4. Finding and Discussion

There were many repercussions and shockwaves around the Islamic finance industry, since then, most *sukuk* issuance come with warranties to prevent obligors from declaring non-*Shariah* compliance. As the case with any default, if standardization of Islamic products would have been in place, we would not be seeing this day. Where standardized *Shariah* interpretations would eliminate the likelihood of someone arguing that something is not *Shariah* compliant, and this would help to prevent such dilemmas in the first place.

Furthermore, to remove the uncertainty and ambiguity the market urgently requires standardized legal documentation. As Dr. Mohamed Damak, the global head of Islamic finance at S&P Global Ratings asserts that this would make the rating agencies life easier in rating *sukuk*. The intricacy of mixing English law and local law for the *Shariah* products at times creates conflict as is seen in the Dana Gas. Further, the UAE has a decentralized version for *Shariah* compliance matters in Islamic finance industry. Article 6 of the UAE Islamic banking law declares "that each Islamic Bank (IB), financial institution and Investment Company should establish its own Shariah Supervisory Authority to ensure that its transactions and practices conform to Islamic law. It also states the establishment of Higher Shariah Authority to supervise Islamic banks, financial institutions and investment companies". Art. 5, Federal Law No. 6 of 1985 (Hekmatyar, 2018; Hamza, 2013). Hence, this form of decentralized version for Shariah compliance matters in Islamic finance industry may cause to many repercussions in the industry and hinder the growth of IFIs across the globe.

5. Conclusion and Recommendation

Based on the above deliberation the study aims to recommend some strategies and procedures to avoid such defaults and repercussions to the Islamic finance industry. Thus, the study aims to make the following recommendations:

1. The study finds that there is dire need to standardize the *Shariah* interpretation of *sukuk* structures used in the Islamic capital market. As the standardized *Shariah* interpretation would reduce the risk of non- Shariah compliance and would help to avoid *sukuk* defaults. Moreover, to eliminate the suspension and ambiguity, the market imminently requires standardized legal documentation. Thus, the likelihood of standardizing the *Shariah* interpretation and legal documentation can be accomplished by the *Shariah* scholar's and legal council's considerable collective efforts of the region. The role of AAOIFI in this recommendation would be vital, as the AAOIFI *Shariah* standards on *sukuk* will provide a comprehensive guidance to the UAE's ICM.
2. Decentralized version of *Shariah* compliance matters in Islamic finance industry may cause many issues and hinder the growth of IFIs in the region. Thus, seminars, forums and round table discussions should be held amongst the *Shariah* scholars of the region to centralize the *Shariah* compliant matters and harmonize the *Shariah* rulings of Islamic finance industry. Since seminars and forums will enhance the understanding of *Shariah* scholars with regards to the development, and regulatory requirements of Islamic capital market of the province. These efficient platforms will assist in identifying the rulings that can be centralize in the UAE.
3. The study also suggests that the regulators should reshape their organizations and practices in ways that explicitly and effectively safeguard transparency throughout the *sukuk* insolvency process and protect equally all creditors' rights in cross-border insolvencies. Without these legislative initiatives, jurisdictions would inevitably see that the confidence of foreign investor is eroded further, which in time will slow the modernization of their economies and jeopardize long-term growth. The study further suggests that a detailed review needs to be done by the regulator with regards to the *sukuk* legal framework and the local regulatory requirements as in most cases *sukuk* documents in relation to sale and purchase of assets of the underlying *sukuk* assets are governed of the local laws and the overall *sukuk* documentation is governed by the English law.
4. As far as the process of documentation is concerned the research highlights the need for care by banks and their lawyers to ensure that offering documentation fully describes the scope of the role that the institution agrees to perform in the transaction and the need to draft disclaimers to encompass acts and omissions in carrying out all the constituent elements of that role.
5. Finally, default in a financing structure is not new to any financial industry but at times what gets disappointing is the wrong expectation from the parties regarding a financial structure. The challenge of structuring a *sukuk* is quite evident that from credit perspective it needs to behave

like a debt instrument irrespective even though if it is structured in an equity or profit-sharing format. In this *sukuk* default also a message was quite clear and that is even though it was a *mudarabah sukuk* and there was a genuine market condition in the form of financial crisis still the payment obligation of the partner (i.e., the client) was enforced. Few industry participants consider this to be an act of misrepresentation, but the fact of the matter is all the parties including the investors are made aware of their rights, obligations, and risk in the *sukuk*. This approach is taken not to misrepresent but under the current challenge of finding a suitable *sukuk* structure because at times the client does not have enough assets to match the issuance size of the *sukuk* and in such scenarios a *mudarabah* avenue is ventured into. The study here suggests that sufficient assets need to be identified and an easy access should be provided to *sukuk* issuers so that they can have smooth issuance of *sukuk*.

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