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NOVEMBER 19, 2025

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Navigating Enforcement and Recovery Risks in Sukuk Islamic Bonds

As Sukuk Islamic bonds gain global prominence, investors face distinct enforcement and recovery challenges arising from their Sharia-compliant, asset-linked structures. Effective protection of investor value depends on understanding who holds enforcement rights, assessing the true reach of underlying assets, coordinating action across jurisdictions, and ensuring strong engagement among Trustees and Sukuk holders.

With annual issuance approaching US\$200 billion in 2024, Sukuk Islamic bonds have become a critical financing tool for sovereigns, state-owned entities, and private enterprises across the Gulf, Southeast Asia, and beyond.

However, as the market expands, so do the complexities surrounding enforcement, default management, and restructuring. Unlike conventional bonds, Sukuk must comply with Sharia law, which prohibits interest (riba) and speculative transactions (gharar). Instead, Sukuk investors typically receive returns tied to tangible assets or project cash flows.

Key features include:

- **No interest payments:** Periodic distributions are made based on profits or returns generated by the underlying asset or project, rather than a fixed interest coupon.
- **Asset-backed structures:** Investors hold beneficial rights in assets, services, or usufructs that support the Sukuk.
- **Defined term and maturity:** Sukuk are issued for a fixed term, and investors usually receive the return of principal at maturity through the sale, transfer, or redemption of the underlying assets.
- **Tradability:** Many Sukuk are listed or traded in secondary markets.

While these features make Sukuk attractive to a broader investor base, they also complicate recovery and restructuring, particularly when sovereign or quasi-sovereign issuers are involved. When red flags emerge, investors should act early to preserve value and position themselves for either enforcement or a negotiated restructuring.

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1. **Establish Standing, Forum, and Creditor Landscape.** The first step is to determine who has the authority to act and in which jurisdiction. Typically, enforcement rights sit with the Trustee and Delegate, excluding individual sukuk holders, which requires preliminary steps to be taken before litigation can be commenced. It is also critical to identify potential competing creditors, including bondholders or project lenders, to anticipate intercreditor conflict over shared assets.
2. **Clarify Security and Asset Exposure.** Many Sukuk are structured as “asset-based” rather than “asset-backed”, giving investors only contractual claims rather than direct rights over assets. Where the documentation is opaque, it may be necessary to conduct urgent investigations into the issuer’s or obligor’s ability to satisfy its obligations.
3. **Coordinate Legal Action and Interim Remedies.** Effective enforcement requires careful sequencing. Uncoordinated filings in multiple jurisdictions can expose strategies prematurely and allow debtors to restructure around them. Instead, prepare a single, coordinated enforcement plan, starting in jurisdictions with strong discovery and interim relief mechanisms. Early injunctions or freezing orders can be decisive in preventing asset flight. At the same time, attention should be given to any indications of improper management of the trust assets, as such issues may influence the overall enforcement strategy and potentially support avenues for personal accountability where appropriate.
4. **Test Trustee Engagement and Strengthen Coordination.** Sukuk holders should proactively engage Trustees to gauge their willingness to act, consider forming sukuk holder groups to enhance alignment and efficiency, and be prepared to pursue independent action if the Trustee remains inactive. Unified creditor coordination often determines the success of both enforcement and consensual restructurings.

The growing sophistication of Sukuk structures and their increasing use by sovereign and quasi-sovereign issuers means that enforcement and restructuring frameworks must evolve in parallel. Investors who proactively understand their legal position, identify enforcement paths early, and coordinate strategy across jurisdictions are best positioned to protect and maximize recovery in a distressed scenario.

About Kobre & Kim

Kobre & Kim is a global law firm focused on cross-border disputes and investigations, often involving fraud and misconduct. Our team:

- Represents clients throughout the Middle East, Europe, the Cayman Islands and key offshore financial centers, the US, Asia, and Latin America.
- Maintain our independence as advocates ready to litigate against virtually any institution by avoiding repeat client relationships and the conflicts of interest that come with them.
- Leverages our significant experience acting on behalf of creditors to develop and implement enforcement strategies to drive recoveries for aggressive claimants.