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DISTINGUISHING BETWEEN SUKUK AND CONVENTIONAL BOND FOR HALAL INVESTMENT

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Abstract: *This paper are motivated to reviews, discuss and proposed a valuations technique for sukuk as opposed to conventional bonds since it is considering a relatively new in the capital market. The discussion on capital market history and developments encompassing sukuk trading mechanism, especially in Malaysia is significantly contribute to the halal investment follows shariah compliance. We have seen the importance of sukuk in contemporary finance as an alternative the traditional practice of seeking financing from banks. Bonds were introduced to finance major investments with greater flexibility to accommodate the changing landscape and dynamism of international finance. With the growth in demand for Islamic financial alternatives, sukuk were introduced which has led to greater financial inclusion and has contributed towards unifying the conventional and Islamic frameworks of finance. Since, sukuk investment applies the halal theory in not only this investment financing product but also the way of dealing with cost charging and how to manage and monitors the investment performance based on Islamic principles. Sukukholders demand halal investment to achieve Maqasid Al-Shariah encourage the issuer to offer or issue sukuk. In Islam, halal investment is compulsory for all Muslims.*

Keywords: *Sukuk, Conventional Bond, Halal, Yields*

An Introduction for Bonds and Sukuk Market Development

The bond market was originated in 1550. Through the evolution, reformation and development in northern Europe as promoted by few monarchies and semi-democracies, the standards of business ethics for this market developed. Both governments and corporations issued modern bonds. At all times, social pressure is essential to support any system of ethical standards for this market and that an effective system of ethical standards is an essential precondition to creating a liquid capital market (Homer, 1975). This debt liquidity can trace the beginnings of the high yield bond market to the late 1970s or early 1980s when a wide cross-section of public

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companies issued non-investment grade bonds. These public companies issued bonds in international and domestic markets, and the markets have become more closely integrated in the latter half of the 1980s (Reilly, Wright & Gentry, 2009). However, the stability of the spread between Euro and US dollar bond yields is particularly noticeable after the year, 1980 until the mid-1990s (Benzie, 1992; Khalid, 2007). This happened as many East Asian and Southeast Asian countries embarked on policies of financial sector reforms, capital market and banking liberalisation, deregulation and financial market developments. After that, by the mid-1990s, most countries were enjoying the benefits of a liberalised financial market leading to a more open economy. However, until recently as the closing years of the 20th century, these countries lacked a well-established and well-functioning domestic bond market (Khalid, 2007).

Thus, the development of a bond market was viewed as a priority because it served as an alternative source for raising capital (Sharma, 2001; Zakaria, Hussin, Noordin & Mohamed Sawal (2010). However, the development of corporate bond markets should be viewed as a gradually incremental matter rather than rapidly implements process (Sharma, 2001) for depending on banking institutions financing especially in huge amount. In addition to the conventional banking system, Islamic banking also correspondingly offers the funding via sukuk certificates starting some 20 years ago. Sukuk, the Islamic capital market's primary instrument, is a rapidly expanding subset of the Islamic financial industry. The worldwide sukuk market has expanded dramatically since the 2008 financial crisis, which helped boost sukuk's visibility and encourage investors to perceive it as a viable means of financing (Boukhatem, 2022).

Considering this scenario, SC introduced Policies and Guidelines on Issue/Offer of Securities (Issues Guidelines) in July 1998 for additional capital-raising flexibilities. Further action was taken place with the formation of the National Economic Recovery Plan (NERP) in 1998 that highlighted the need for a broad, deep and well-developed bond market that would provide a more stable source of financing which would also diversify the risks associated with cyclical economic bearish. As claimed by Zakaria, et al.(2010), to recover the economic crisis, Malaysia needs to have developed an environment where capital can be mobilised to finance long-term investment and to provide a better match between risks and returns.

In addition, the SC has become the sole authority for all corporate bond issuances approval since July 2000. The SC has to work with the laws such as Capital Markets and Services Act 2007, Sections 212(2)(a) and 212(4), guidelines such as Guidelines on the Offering of Islamic Securities and Guidelines on the Registration of Bond Pricing Agencies in July 2004 and January 2006 respectively and practices notes such as Recognition of Credit Rating Agencies in January 2006 for the purpose of rating bond issues. Besides, Minister of Finance (MOF), Bank Negara Malaysia (BNM) and Rating Agency Malaysia (RAM) are also regulators which are monitoring the Malaysian capital market performance. These regulatory bodies are also responsible for serving rules and regulatory structure including specific guidelines to Islamic financial and capital market in Malaysia.

The pace of development in the Islamic financial market has gathered momentum with the formation of various international Islamic recognised bodies including the Islamic Financial Services Board (IFSB), the International Islamic Financial Market (IIFM) and the Accounting & Auditing Organisation for Islamic Financial Institutions (AAOIFI). Islamic financial instruments are less volatile and outperform their conventional counterparts during crisis periods, according to prior studies, because of their unique qualities including risk-sharing, low

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leverage, and strong linkage to the real economic activities (Yarovaya, Elsayed, & Hammoudeh, 2021; Billah, Elsayed & Hadhri, 2023)

Development of ICM in Malaysia complements the conventional system. As stated by Hesse, Jobst & Sole (2008), the development of ICM assets and structured finance in several Islamic jurisdictions countries such as Bahrain, Malaysia and Dubai are encouraging shariah-compliant debt issuance in a bid to promote themselves as centres for Islamic finance. The leading financial centres, e.g., Hong Kong, London, New York and Singapore are making significant progress in establishing the legal and prudential foundations to accommodate Islamic finance side-by-side with the conventional financial system including sukuk market. Islamic finance assets reached US$2.44 trillion in 2019 after 30 years of rapid growth (Homsi, Muhamad Sori, & Mohamad, 2023). For both sovereign and quasi-sovereign issuers, Sukuk are the most often used forms of debt financing. The Sukuk market is concentrated, with 90.44 percent of the $443.78 billion in outstanding Sukuk belonging to five significant markets: Malaysia, Saudi Arabia, the United Arab Emirates, Indonesia, and Bahrain (IIFM,2019). Sukuk, the fastest-growing component of the Islamic financial system, grew 22.2% in 2019 (IISB, 2020). Sukuk have grown in favor as long-term alternatives to interest-based bonds and fixed-income assets. Sukuk issuance has increased 120-fold since 2001, from US$1.172m to US$145,7bn in 2019(IIFM, 2020). Study by Aman, et al.,(2022) indicated a favorable correlation between the sukuk market and macroeconomic variables such as economic growth, banking infrastructure, money supply, and current account balance, however an inverse relationship between sukuk and economic size and exports.

Thus, the objectives of this study are to reviews, discuss and proposed a valuations technique for sukuk as opposed to conventional bonds since it is considering a relatively new in the capital market. Therefore, the paper are organized as stated with the literature reviews and discussion for the gap, follows by proposed methodology to ensure that sukuk are halal investment as opposed to conventional bonds, then concludes with recommendations.

Unique Characteristics of Sukuk Compared to Conventional Bonds

A sukuk (plural of sakk) is a security issued by a special purpose vehicle (SPV) for the financing of any assets and rights, and which entitles its holders to a proportionate share of the earnings generated by those assets and rights (Pirgaip, Arslan-Ayaydin, & Karan, 2021). The features of sukuk are similar to conventional bonds in Malaysia e.g., time to maturity, the coupon rate, trades on the normal yield price relationships (Saeed, et al., 2021), fixed term maturity, principle payment guarantee at maturity, and income stream to which holders are entitled (Billah, et al., 2023). In the conventional bonds the underlying asset is money (debt) and in the sukuk the underlying asset is indeed an asset (Afshar, 2013). Despite some similarities, the difference mainly related to their ownership, issuance and pricing procedures (Billah, et al., 2023). Additionally, Balli et al. (2021) provide evidence that bond yields are substantially more sensitive to fluctuations in global markets than sukuk yields.

Sukuk is structured such that the issuance is not an exchange of paper for money consideration with the imposition of interest (yields) as per the conventional. It is based on an exchange of approved assets for financial consideration that allows the investors to earn profits from the transactions. This means that, in contrast to bondholders, sukukholders will share in the profits made by the underlying asset (Mseddi,2022). Market risk in sukuks and information asymmetry risk are two sources of uncertainty that are highlighted by Uddin et al. (2022). Additionally, since Sukuk offerings are priced differently than bonds because the partnership's principal and

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profits are not pre-guaranteed, thus it's reasonable to expect investors and issuers to react differently to sukuk issuance (Aman et al.,2022); thus the features and characteristics of sukuks necessitate a different method of bond pricing (Katterbauer et al., 2022). Approval of the assets and the contract of exchange would be based on shariah principles, which is necessary to meet the Islamic law. On the other hand, conventional bonds are standard bonds bearing a coupon, paying interest either yearly, twice a year or quarterly and have a maturity date at which they will redeem their bonds at face value or par value. The price of conventional bonds will change primarily with the change in interest rate, which could include trading activities that are deemed prohibited and are not regarded as suitable for Muslim investors.

Issuer Cost of Debt/ Investor Return (Profit-Loss Sharing)

The concept of the profit-loss (return-risk) sharing (PLS[1]) feature of sukuk makes this instrument convenient, and mutual interest funding for infrastructure project as yields are linked weightage of profit-sharing instead of capital outlay. Investment in sukuk generates return or income based on market price of certain assets in real economic activities though underlying assets (SC, 2009). The return categorises are the primary and secondary level. In the primary level, conventional bonds' return is an extra interest charge on the loan amount but it is rare for the sukuk to use a loan contract because no value is added for return from debt leveraging due to the prohibition of charging an excessive interest rate in a loan transaction. In the secondary level, trading of conventional bonds is normally with discounting but for sukuk the tradability depends on the nature of underlying assets (SC, 2009, p.13).

Sukukholders are entitled to become partial ownerships to the assets (Jamaldeen, 2015; Aloui, Hammoudeh & Hamida, 2015; Azmat, Skully & Brown, 2014a; Vishwanath & Azmi, 2009; Al-Nasser, 2009) and return cannot be guaranteed since the face value is a true value of the sukuk assets (Jamaldeen, 2015; Taqi Usmani, 2007). These unique features make sukuk a good choice among issuers compared with conventional bonds. In conventional bonds, the returns are derived from a predetermined share of debt (Jamaldeen, 2015; Shahida & Sapiyi, 2013) regarding the future value of money at a fixed rate of return during the maturity period (Alshamrani, 2014; Dalal, 2013; Al-Nasser, 2009). This return is guaranteed even though their face value can be overvalued or undervalued (Taqi Usmani, 2007).

There should be no question on sukuk default since it is PLS in what was intended as a (limited liability) equity-like instrument. Moreover, sukuk are publicised as securities backed by real assets. In that case, the investors should only be exposed to the risk of capital loss, the risk that arises due to fluctuations in the market value of underlying assets, and of the periodic returns (rentals) generated by these assets. However, normally there would be no default of the entire principal sukuk amount, as sukukholders are presumed to have recourse to the sukuk assets, being the legal owner of those assets. Defaults did happen, and not all were resolved in line with the expectations raised by these new capital market instruments (Zaheer & Wijnbergen, 2013).

This might happen because a sukuk replicates conventional bonds on how it generate returns and cash flow claims which is similar for both debt mechanism (Alam, Hassan & Haque, 2013; Miller, Challoner & Atta, 2007). The association of this PLS reported positive relation (Aboody, Hughes & Ozel, 2014). However, correlations of sukuk returns are much smaller

[1] PLS represents a key element of sukuk structuring, it is a mutual transaction in which one collection of property rights is exchanged for another through the purchase and resale of goods as well as the supplying of services for fees based on an agreed upon contract (Taoual, 2016)

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compared to conventional bonds implying that the yield which is a cost to the issuer and returns to sukukholder and bondholders are low for sukuk (Cakir & Raei, 2007).

The development of new sukuk instruments in the form of PLS, for instance; mudharabah sukuk, musyarakah sukuk and hybrid sukuk introduced a unique class of instruments which is based on "Islamic spirit" of risk and profit-sharing which distinguish them from conventional bonds. This new breed of sukuk requires different mechanisms and structures regarding yields measurement. Therefore, there should be a different way of computing the yields for these sukuk as opposed to conventional bonds. These new mechanisms are genuinely based on the PLS arrangement which is absent in any type of conventional bonds structures. Supposedly, the different emolument of yields which will produce a different pattern of yields movement from conventional bonds.

Shariah-Compliance

In Malaysia, all the sukuk issuances should follow and comply with the shariah principles endorsed by the SAC of the SC. However, for Gulf Corporation Countries' (GCC) sukuk issuances, they should comply with shariah standards and guidelines issued by AAOIFI.

Sukuk instruments either debt-based or equity-based are a halal investment since it is based on shariah principles. This shariah-compliant instrument is a better choice to the issuer for their capital funding to achieve the maqasid al-shariah (shariah objectives) in Islam. This investment follows the Islamic law and principles. Meaning that, the market is free from non-permissible activities. Even if some of the companies' project or activities dealing with the non-permissible elements, sukuk financing can still apply as long as it belongs to an SAC benchmark on the shariah-compliant assessment on their stock screening process. The method of assessment is by quantitative and qualitative measures towards the level of mixed contributions from permissible and non-permissible activities relative to their group turnover and group profit before tax of the companies.

In the quantitative method, the calculated contributions from non-permissible activities will then be compared to the benchmarks which have been established by the SAC based on ijtihad[2] either at 5%, 10%, 20% or 25% compliance level. This four-tier level of benchmarks currently used since 1995 has been revised by adopting only two-tier level that is 5% and 20% by public listed companies in Bursa Malaysia effective from November 2013 to be in line with the CMP2 for capital growth strategies.

Even though the SC's SAC has been revised the stock screening methodology, the activities which are clearly prohibited in the transactions remain in this new two-tier level of benchmark setting. For instance, the elements are riba[3] (usury) either riba al Buyu' (exchange transaction)

[2] Ijtihad is the process by which the law revealed in the Al-Quran and Sunnah may be interpreted, developed and kept alive in line with the intellectual, political, economic, legal, technological and moral developments of society. In relation to the sukuk, it is possible to argue that ideas about sukuk also developed today in such a context (Saeed & Salah, 2014, p.41).
[3] Riba refers to any excess in quantity, addition or increase of a thing over and above its original size or amount (ISRA & SC, 2015.p.91).

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or riba al Duyun (loan or debt transaction), maysir[4] (gambling), gharar[5] (speculating or uncertainty) consists of gharar fahish (excessive or major), gharar mutawasit(intermediate) or gharar yasir (tolerable or minor), tala'ub[6] (manipulation), ihtikar[7] (hoarding), najsh[8] (artificial price hiking) and tadlis[9] (concealment of a defect).

Avoiding the elements of riba and gharar are clearly mentioned in the Al-Quran and Sunnah (Hadith). The details of these prohibited elements are also deeply discussed by shariah scholars through ijtihad and qiyas (analogical reasoning)[10]. This qiyas on avoiding usury elements in issuing sukuk is revealed in Surah Al-Baqarah. Allah (SWT) said:

> "Those who consume usury cannot stand (on the Day of Judgement) except as one stands as being beaten by Saytan into insanity. That is because they say: Trade is just like usury; whereas Allah has permitted trading and forbidden usury. So, whoever has received an admonition from his Lord, and (he) refrained (in obedience thereto), he shall keep (the profits of) that which is past, and his affair (henceforth) is with Allah. But, whoever returns (to dealing in usury) – such are rightful owners of the Fire. They will abide therein.
>
> (Al-Quran 2:275)(ISRA & SC, 2015, p.63).

Istihsan in the ijtihad are significant approaches of the Lawgiver in legislating shariah which is based on Al-Quran and Sunnah. According to ISRA (2015), the principle of this istihsan has been indicated in both the Al-Quran and Sunnah as follows:

> "Who listen to what is said and follow what is best"
>
> (Al-Quran, 39:18)

> "Follow the best teaching sent down to you from your Lord, before the punishment suddenly takes you, unawares"
>
> (Al-Quran, 39:55)

> "Anything that is considered by the Muslim as good, it is also good in the eyes of Allah"
>
> (Musnd Ahmad, Hadith narrated by Ibn Masuud)

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[4] Maysir means any activity which involves betting whereby the winner will take the entire bet and the loser will lose his bet ISRA & SC, 2015.p.96).
[5] Gharar implies uncertainty and deceit which lead to dispute and cause injustice to any of the parties. Shariah is very concerned with that and therefore it requires the parties to the contract to be as specific as possible so that their agreements may not give rise to future disputes (ISRA & SC, 2015.p.93).
[6] Tala'ub refers to manipulation which considered a crime in conventional jurisdictions. As for shariah, it is obvious that such an act is prohibited as it is part of the prohibited types of deception ISRA & SC, 2015.p.98).
[7] Ihtikar means purchasing essential commodities then hiding them from the market to cause an increase in price because of the artificial dearth of supply in the market ISRA & SC, 2015.p.98).
[8] Najsh means concealment or a practice in which hunters used to rouse and chase game for the sole purpose of trapping or snaring it (ISRA & SC, 2015.p.99).
[9] Tadlis is an act of intentional concealment of the goods' defects in a sale transaction ISRA & SC, 2015.p.99).
[10] See; Wilson (2013); Ashfar (2013); Taqi Usmani (2008); Dusuki (2010); ISRA & SC (2015); Arif et. al., (2012)

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> "Whoever pays in advance the price of a thing to be delivered later should pay it for a specified measure at specified weight for a specified period"
>
> (Sahih Al-Bukhari, Hadith of the Prophet (SAW)

In the qualitative method, the SAC considers two additional criteria for mixed activities companies. The assessments that will be taken into consideration are the company must have good public perception and corporate image. The core activities of the company considered maslahah (benefit) and mafsadah (harm) to the Muslim ummah (nation) and the country, as well as the non-permissible element is very small and involves matters such as `umum balwa, `uruf (custom) and the rights of the non-Muslim community which are accepted by Islam (SC, 2013). This is supported by Adam & Thomas (2004) by citing the hadith as follows:

"Abu Huraira asked Marwan if he permitted selling sakaak. Answer given by Sulayman bin Yassar mentioned that Abu Huraira said to Marwan, "You have permitted the sale by riba". Marwan replied. "what do I do? "You permitted the sale of sakaak and it was forbidden by the Messenger of God to sell food before you possessed it". Then Marwan sermonised to the people, forbidding this practice".

Regardless of prohibiting excessive charging of interest rate plus other prohibited elements as discussed in sukuk yields based on shariah principles, conventional bonds are, however, interest-based generated income (Alshamrani, 2014). This type of fixed income interest payment (Dalal, 2013) comes from sources of riba (Kahf, 2006; Al-Amine, 2008; Jobst, Kunzel, Mills & Sy, 2008), uncertainty or gambling (Azmat, Skully & Brown, 2014b; Fathurahman & Fitriati, 2013) and deal with business financing that contradict Islamic values such as distilleries, casinos for gambling, alcohol or piggeries or pork even no restrictions for conventional bonds financing (Jobst, Kunzel, Mills & Sy, 2008; Azmat, Skully & Brown, 2014c).

Conventional bonds are a proof of debt that include a fixed rate of interest regardless of return either profit or loss, while sukuk are a proof of ownership related to the original legal contract that governs the relationship between the sukuk issuer and sukukholders (Al-Nasser, 2009). In addition, conventional bonds expire at their pre-agreed value, whereas sukuk expire at either their market value, a prearranged figure which is agreed upon by the two parties or at a fair value. Replicating the conventional bonds multifaceted by sukuk is a breech of shariah rulings and is prohibited.

Sukuk is protected by shariah rulings and it is debt-free compared to conventional bonds (ISRA & SC, 2015; Kamarudin, Kamaluddin, Ab. Manan & Mat Ghani, 2014; Fathurahman & Fitriati, 2013; Afshar, 2013). However, Jabeen & Javed (2007) argued that most of the sukuk traded are bond-like structures and their risk and return are comparable to the market rates and pattern. The flexibility and hybrid structure existing in sukuk become a challenge to the SAC. Furthermore, the different interpretation of shariah law (i.e. SC's SAC of Malaysia and AAOIFI standards used by UAE) with regards to sukuk structures has raised challenges to the determinations of yield to maturity traded in the global market. Consequently, it is difficult to recognise the bond risks (Taoual, 2016). One of the significant issues that urge the SAC to revise and monitor the current rulings further is that 85%[11] of musharakah and mudharabah product principles of the sukuk issued in the market are not fully compliant with shariah rulings

[11] Sheikh M Taqi Usmani, chairman of the AAOIFI Shariah Board, released a statement in November 2007

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(Lahsasna & Lin, 2012; SC, 2010; Khaleq & Crosby, 2009; AL-Maghlouth, 2009; Jobst, Kunzel, Mills, & Sy, 2008).

Another issue is the widespread use of credit enhancement mechanisms, namely, the liquidity facility and purchase undertaking at par, does not conform to the maqasid al-shariah (objectives and rationale of shariah) (Dusuki, 2010). Further, Khaleq & Crosby (2009) mentioned that the bone of contention was a breach of shariah principles as the originator of musharakah sukuk typically provides the issuer with a purchase undertaking to buy back the underlying assets from the issuer at face value on the expiration date of the sukuk or in the event of default. In this case, actually, the purchase undertaking should not be based on strike price but must be based on agreed yields at the business dealing time or current market price. This guiding principle was clearly disclosed in Principal Terms and Conditions of the IMTN Programme for each company or issuer[12.]

Additionally, liquidity concerns are cited as the reason for the large yield spread between government-issued sukuk and bonds in the Malaysian market, which is confirmed by the research of Asmuni & Tan (2021). Concerning liquidity facility, the sukuk manager or obligor provides a facility to top up any shortfall happened in actual return or profit (yields not upon the maturity) merit to sukuk investors. As indicated by Dusuki (2010), the cash provided by the obligor in order to ensure smooth profit payment can be in the form of a loan or other shariah-compliant facilities such as tawarruq[13]. These issues are unsolved and still need a special Muzakarah (in-depth discussion by expertise in the field) to find the solution to achieve the maqasid al-shariah.

Types of Bonds and Sukuk Structure

Conventional bonds and sukuk have different types and structure in theory and practices. However, the instrument shared similar features. For instance, both of these instruments have traded for long-term and medium-term issuances as well as unlimited tenure and at specified yield to maturity.

Conventional Bonds and Default Risk

A conventional bonds is a debt instrument issued by a corporation for borrowing capital funding and promises to repay it in the future at certain yields under clearly defined terms (Gitman & Zutter, 2015, p. 283). The term is usually applied to medium to longer-term debt instruments, with a maturity of at least one year. Commonly, these types of conventional bonds are categorised as either secured or unsecured whereby both of them typically offer some form of interest payment or yields to the bondholder. The payment mode can be in fixed rate, floating rate or zero coupon rates. Fixed Rate Bonds provide fixed interest payments on a regular schedule for the life of the bond. Floating Rate Bonds have variable interest rates that are periodically adjusted. Zero Coupon Bonds do not pay periodic interest at all, but offer an advantage in that they are can be bought at a discounted price of the face value and can be redeemed at face value at maturity (Gitman & Zutter, 2015; Ross, Wasterfield & Jaffe, 2010). In each of the yields payment, the possibility that the issuer of conventional bonds failed to pay interest or principal amount as scheduled represents a default risk.

[12] For example, see Imtiaz Sukuk Berhad (2012) had disclosed in detail the particular information for Musharakah sukuk issuance, p. 14-18 and p.31.
[13] Tawarruq defined as a sale contract whereby a buyer buys an asset from a seller with deferred payment and subsequently sells the asset to a third party for cash at a price less than the deferred price, for the purpose of obtaining cash (Dusuki & Abozaid, 2007).

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Sukuk Structures and Default Risk

There are no standardised and official sukuk structures for the firms to issue (Al Trad & Bhuyan, 2015). However, the basic sukuk structure and its guidelines as to how sukuk is structured was produced by AAOIFI for fourteen (14) types of sukuk, i.e; Al-Ijarah, Ijarah Mowsufa Bithima, Manfaa Ijarah, Manfaa Ijarah Mowsufa Bithima, Milkiyat al-Khadamat, Al-Salam, Al-Istisna'a, Al-Murabaha, Al-Musyarakah, Al-Mudharabah, Al-Wakala, Al-Muzra'a, Al-Musaqa and Al-Muqarasa. In Malaysia, the SC has structured six (6) types of sukuk in their Guidelines on the Offering of Islamic Securities 2004, i.e. Sukuk Al-Bai-Bitamal Ajil (BB A), Sukuk Al-Murabaha, Sukuk Al-Ijarah, Sukuk Al-Istina, Sukuk Al-Musyarakah and Sukuk Al-Mudharabah. Though, Manaf (2007) discussed in his study, there are seven (7) types of Islamic bonds based on the model of financing and trades which the bond structure. These are mudaraba/muqarabah sukuk, musharaka sukuk, Ijarah sukuk, Murabaha sukuk, Salam sukuk, Istisna sukuk and hybrid sukuk. Wilson (2014) revealed five (5) types of sukuk that are salam securities, ijarah bonds, istisna bonds, mudaraba bonds and musharakah bonds..

Kalimullina, & Hassan, (2022) reveal that sukuk continue to mimic the bond market in terms of default risk, and that the industry's reliance on poorly structured sukuk makes it difficult to return to sukuk's intended goal as an investment tool. The varying levels of financial performance of an issuer could be reflected in a variety of Sukuk structures. Since Sukuk provide investors with fixed rates, they are vulnerable to interest rate risk in the same way that fixed-rate bonds (Muhamed, Elhaj,& Ramli, 2022).

Even though various sukuk types and structure exist in the Islamic Capital Market (ICM), different purposes of financing require difference structures for SPV or non-SPV. Several contract types, or even a hybrid of contract types, can be used to structure a Sukuk. There are various types of sales contracts, leasing agreements, partnership agreements, and agency agreements. However, they advocate risk sharing, property rights, and the sanctity of contracts in accordance with Islamic principles and exclude components regarded forbidden to Shariah, such as interest, gambling, and excessive uncertainty (Muhamed et al.,2022). Unlike conventional bonds which are a debt instrument usable for all financing purposes depending on issuer business or project decisions, sukuk have a different structure, and different parties may be involved in the issuances. Since sukuk must adhere to shariah law, many sukuk forms have developed to accommodate this requirement, including asset-based, debt-based, equity-based, agency-based, and hybrid sukuk (fundamental ethical principles of Islamic finance and business). Also, because of the legal distinctions, sukuk pricing is distinct from that of traditional bonds (Mseddi, 2022). A sukuk's value, unlike that of a bond, is not tied to the issuer's creditworthiness because sukuk shares represent ownership in tangible properties, usufruct, or services provided by revenue-generating issuers (Hazrin et al.,2022; hence, the value of the underlying asset and the issuer's creditworthiness might affect the price of a sukuk (Pratama et al., 2022).

A Proposed Methodology and Valuations Techniques for Halal Investment in Sukuk Market based on Shariah Compliance

Fabozzi, & Fabozzi, (2021) stated that yield is comprised of both current yield and yield to maturity. Current yield is the ratio of a bond's annual interest coupon to its market price, while yield to maturity is the compound rate of return that investors will receive if they buy the bond at its current market price and hold it until it matures. Presently, come to yield calculation (refer to yield to maturity; YTM), it was applied the same equation for both debt instruments either sukuk or conventional bonds. Therefore, there should be a different mechanism of yields

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computation for the sukuk as opposed to conventional bonds. Not specifically focus on yield and ratings, Abd. Sukor, Muhamad and Gunawa (2008) recommended that, the ICM has grown tremendously and has drawn increasing interest among market players which are required for establishment of appropriate measures in recognizing and measuring transactions relating to the issuance and investment to ensure they are compliance with shariah law.

Here, the valuation and computation of conventional bonds yield takes into account the current market price, par value, coupon rate and numbers of period until maturity. Variability in bond yields was one of the economic benefits offered to bond investors (Fitriadi, & Marsoem, 2022).YTM is a cost of bond to the issuer and it is internal rate of return to sukukholder or bondholder who buys a bond certificate today, at market price and hold it until maturity period, to gain all profit or coupon payment (Rodriguez, 2003; Fabozzi, 2007; Ramasamy, Munisamy and Mohd Helmi, 2011; Arif and Safari, 2012; Mohd Saad, et al, 2020, Usman, Chandra,& Syofyan, 2021; Djamaluddin, 2022; Fitriadi, & Marsoem, 2022) . The first equation, Eq 1 for YTM is stated below:

$$(CF/P) - 1 \ldots\ldots\ldots\ldots (1)$$

Where;
CF is cash flow in period, and
P is price of the financial instrument.

The risk is represent by the WACC model from Modigliani (1963) as stated in the second equation, Eq.2 below:

$$(D/V)\,(1\text{-}Tc)rd + (E/V)re \ldots\ldots\ldots\ldots (2)$$

Where,
D is the market value of debt
Tc is the corporate tax rate
V is the market value of the firm
rd is the cost of debt
E is the market value of equity
re is the cost of equity

However, the Eq. 2 is the conventional representations of risk which has include the use of excessive interest charge or non-fixed interest charge that was prohibited in the Islamic law (Shariah) because involve issues of riba, gharar, usury and maisir. Thus in order to fulfill the Shariah compliant towards issuing sukuk, this study try to developed a new model through modification of existing model introduced by Modigliani (1963) as per below shown by third equation, Eq.3;

$$WACC\ sukuk = (S/SV)(rS)(1\text{-}Z\text{-}T) + (SCS/SV)(rSCS) \ldots\ldots\ldots\ldots (3)$$

Where,
S is the market value of sukuk (i= 1,2,3….n)
Tc is the corporate tax rate (i= 1,2,3….n)
SV is the market value of the Shariah-compliant securities (i= 1,2,3….n)
rS is the cost of sukuk (i= 1,2,3….n)

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SCS is the market value of equity for Shariah-compliant securities (i= 1,2,3….n)
rSCS is the cost of equity for Shariah-compliant Securities of the (i= 1,2,3….n)
Z is the Zakat payment (i= 1,2,3….n)

The market value of the sukuk (S) is equal to the total sukuk issuances and the total market value of equity for the Shariah-compliant Securities (SCS) is equal to the current market price of of securities multiplied by the number of securities outstanding. The market value of the Shariah-compliant securities (SV) is the total of market value of the sukuk (S) and market value of equity (SCS). The cost of sukuk issued is the YTM of the current price of the sukuk relative to the coupon payments and the par value of the sukuk at maturity. Followed Gardner et. al, (2010), this study will used the cost of sukuk by estimate the YTM by using sukuk rating provided by RAM. Next, the cost of Shariah-compliant Securities (rSCS) followed the Capital Asset Pricing Model (CAPM) framework that has been developed by Sharpe (1964) as stated by the fourth equation, Eq.4 below.

rSCS = Rf + Beta(Rm-Rf) ……..(4)

Where,
refers to Shariah-compliant Securities' beta
Rf refers to risk free rate, Malaysian Government Shariah Securities, and
Rm refers to market risk, KLSI.

Then, this model states that the expected rate of return for Shariah-compliant Securities is equal to the risk free rate of return plus a risk premium. This study will used the returns on the FTSE Bursa Malaysia EMAS Shariah Index) as a proxy for returns on the market portfolio. This index comprises constituents of the FTSE Bursa Malaysia EMAS index that are Shariah-compliant according to the Securities Commission's SAC screening methodology and FTSE's screens of free float, liquidity and invest-ability. The index has been designed to provide investors with a broad benchmark for Shariah-compliant investment. The proxy for risk-free rate of return is based on the Malaysia Government Securities bills. Then, the beta was represented by the slope coefficient of the characteristic line, measures the systematic component of risk for the Shariah-compliant Securities as represented by fifth equation, Eq.5 as follows:

Beta = cov (ra,rp)/ [Var,)rp)]……………..(5)

Where,
ra measures the rate of return of the shariah securities
rp measures the rate of return of the portfolio, FTSE Bursa Malaysia EMAS Shariah Index
cov (ra, rp) is the covariance between the rates of return.

Conclusion

The policy maker and development agencies should explore a variety of options for structuring and issuing more inventive sukuk to fully harness the sukuk market's potential as a source of development funding (Atrizka, & Pratama, 2022). In practice, sukuk investment does not show a marked difference to conventional bonds with regards to their yields. Computation of sukuk yields replicate the methods of conventional bonds. It mimicks conventional bonds whereby sukuk features replicate conventional bonds (Lahsasna & Lin, 2012; Saeed et al., 2021) by having the similar or same features in time to maturity, a coupon rate, and trades on the normal yield price relationships (Safari, Ariff & Mohamed, 2013; Ariff, Safari & Mohamed, 2013) and often resembles as mainstream bond (Saeed et al., 2021) and in their late payment penalty upon default, trading of debt-based sukuk, purchase undertaking in equity-based structures and ownership status in asset-based transactions (Lahsasna & Lin; 2012). Nanaeva & Mammadov (2010) also argued that sukuk shares some features with, and therefore often resemble, conventional bonds. However, sukuk has a different underlying structure and provision compared to conventional bonds since it follows shariah principles as a halal investment. In addition, the valuations of yield that supposedly to embed the zakah payment so that the mechanisms of such investment follows the Islamic principles. Priori sukuk literature try to formulate the predictor of sukuk yield based on the issuers characteristics (i.e . Asmuni, & Tan, 2021; Syakdiyah & Putra, 2021), then next paper will validate such associations.

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