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Development of Sukuk Mudarabah in Malaysia: A Literature Review

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Abstract
Sukuk is one of the Shariah-compliant financial instruments in the Malaysian capital market. The growth of the Sukuk in Malaysia has shown impressive development over the decades. In addition, Sukuk show grow positive trend internationally. Each country uses different types of contracts in their Sukuk. In Malaysia, various types of contracts are involved in the practice of Sukuk such as ijarah, mudarabah, musharakah, wakalah, ijarah or hybrid structures based on combinations of Shariah contracts and others. Thus, this study aims to examine the development of sukuk mudabarah in Malaysia. This study uses a qualitative approach involving a literature review covering books, journals, newspapers, official virtual sites and related circulars. The materials obtained will be analysed using the document analysis method. Based on the study's findings, one Mudarabah sukuk practiced in Malaysia, which was practiced by Cagamas Berhad in 1994. The findings of this study show that the mudarabah sukuk is less popular in the industry in Malaysia because it brings risks to investors. The Sukuk seem particularly advantageous for the Islamic banks rather than the investors. It is because the Sukuk assets could be falling below the par value which would likely lead to a reduced payout at maturity. Mudarabah Sukuk is an equity-based Sukuk structure where profits and losses are shared between the partners. Besides that, investment from a Shariah viewpoint does not allow a fixed return as well as the guaranteed principal amount at maturity to the investors.
Keywords: Mudarabah, Sukuk, Malaysia, Musharakah, Cagamas Berhad

Introduction

Sukuk originated from an Arabic term; it is a plural of the term *Sak* which means certificate. Sukuk are referred to as 'Islamic Bonds', but the correct translation of the Arabic word of Sukuk is 'Islamic Investment Certificates'. Under Sukuk structure, the Sukuk holders (investors) each hold undivided beneficial ownership in the 'Sukuk assets' (Afshar, 2013). The

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) officially defined Sukuk as certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services (El Mosaid & Boutti, 2014).

According to Malaysia Debt Securities and Sukuk Market sources, in 2011 Sukuk may bedefined as certificates of equal value that represent an undivided interest (proportional to the investor's interest) in the ownership of an underlying asset (both tangible and intangible), usufruct, services or investments in particular projects or special investment activities. Through this concept, Sukuk enjoy the benefit of being backed by assets, thereby affording the Sukuk holder or investor a level of protection which may not be available from conventional debt Bonds (Ahmed et al., 2014). Although a common starting point in differentiating both Sukuk and conventional Bond is to explain the Shariah point of view, it is essential to ascertain the fundamental comparison between these two instruments. It is clearly understood that Sukuk adhered to Shariah principles and Bond is definitely involving riba due to its fixed interest in nature (Asni et al., 2021; Ishak & Asni, 2020).

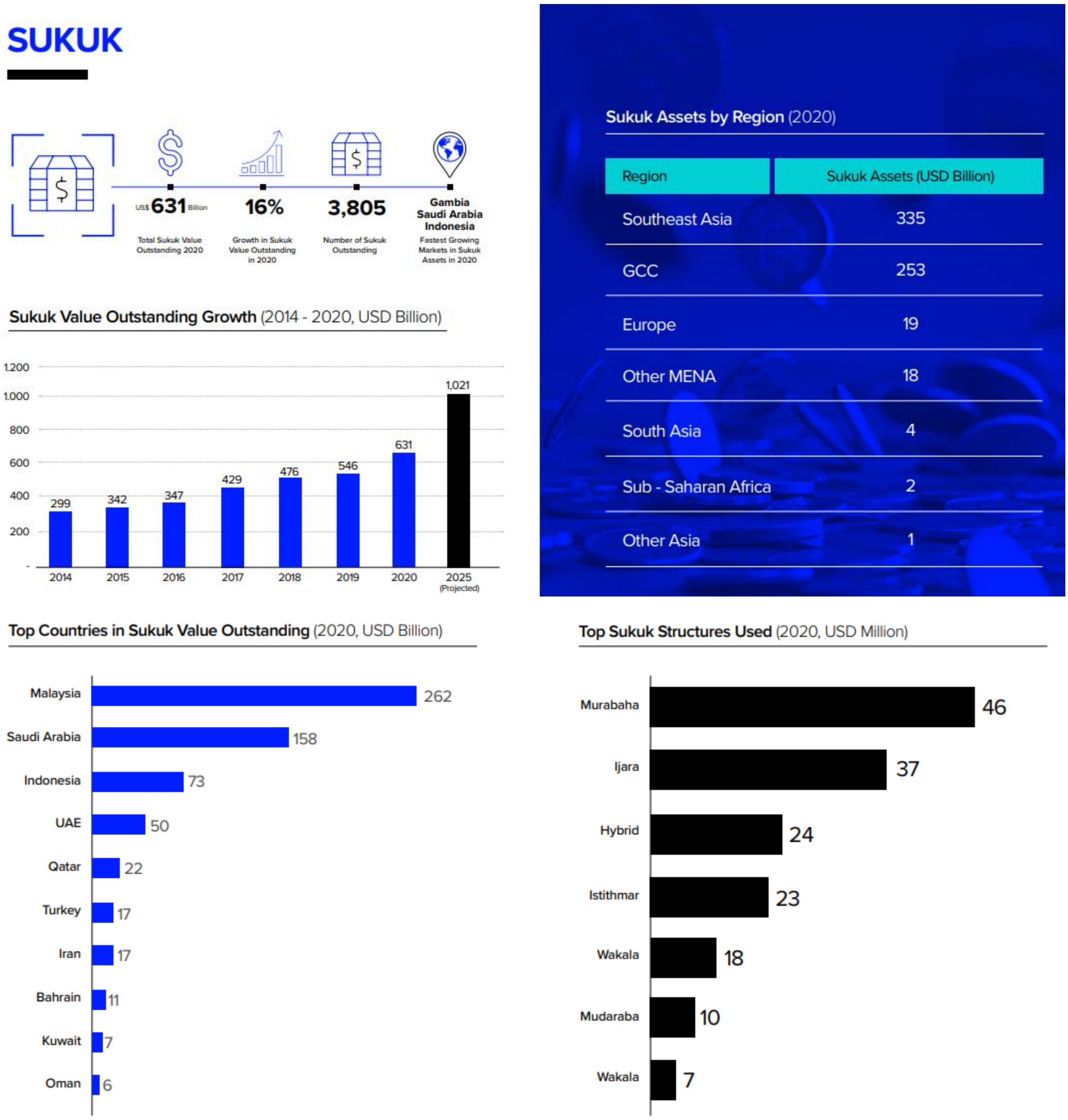
Since conventional Bond is prohibited in the Islamic financial system due to interest-bearing and fixed income, Sukuk were designed based on Shariah principles as an alternative instrument for all investors looking for a Shariah-compliant instrument. In addition, Sukuk were introduced for Islamic banks and financial institutions as a noble effort to move beyond riba (Asni, 2020; Asni, 2019; Asni & Sulong, 2018). Security has become the most significant tool for raising domestic and international capital. In 1990, the first RM125 million Sukuk was structured by Bank Islam Malaysia Berhad and issued by Shell MDS, a foreign-owned company (Haron, 2012).

In 2002, world's first sovereign Sukuk and global corporate Sukuk was issued RM600 million. Eventually, in 2007, Securities Commission Malaysia issued Sukuk guidelines under Capital Markets and Services Act 2007. Indeed, Sukuk are particularly interesting because the difficulties with Sukuk arising from the world economic crisis resulted in notable governmental responses (Salah, 2010). Sukuk, now the most vital segment in Islamic finance, are involved in the international market and generate a significant cross-border flow of funds as may be achieved beyond domestic markets (Ahmed et al., 2014).

Study Background

Global Sukuk

According to IFDI, based on data 2020, Murabahah and Ijarah are the two most preferred structures by most issuers, where issuance of Sukuk Murabahah shares 46% and Sukuk Ijarah 37% globally.



a) Sukuk Issuance on Course For Record Year, With Double-Digit Growth

The value of outstanding Sukuk grew by 16% in 2020. There was a record level of demand in the first half of 2021 when Sukuk issuances crossed the $100 billion threshold, compared to $88.7 billion for the same period in 2020. Forecasts point to $180 billion by the end of 2021. Higher issuances from the GCC and Turkey drove this strong start and continued sizeable issuances from Southeast Asia (Malaysia, Indonesia, Brunei). Saudi Arabia nearly doubled its domestic issuances during the second-quarter of 2021.

In 2020, governments in the GCC and Southeast Asia collectively accounted for $588 billion in Sukuk outstanding, making up 93% of the supply of sovereign Sukuk. However, while governments in Southeast Asia continued to tap the Sukuk markets in the fourth quarter of 2020 to fund their economic recoveries due to continuing internal movement and travel restrictions, the GCC region tapered off significantly over the same period. In the fourth-quarter of 2020, Southeast Asia issued $23.2 billion in Sukuk, an increase of 44% over the same period in 2019 ($16.1 billion), while the GCC issued $10.5 billion, a decrease of 42% from the same three months in the previous year ($18.1 billion). This GCC drop was due to previous high borrowing and fiscal measures undertaken by the region's governments.

b) Several Sovereigns Are Issuing Sukuk To Meet Strong Demand

Oversubscription rates for sovereign Sukuk indicate continued strong demand, which sovereigns are meeting with several jumbo issuances in 2020 and more recently in the first half of 2021. In 2020, 15 countries issued Sukuk, with Nigeria and Egypt being notable returnees to the market after their absence in 2019. The top five sovereigns – Malaysia, Saudi Arabia, Indonesia, Turkey, and Kuwait – collectively made up 86% of total Sukuk issuances in 2020. In the first half of 2021, 12 countries issued Sukuk, with notable returning issuers the United Kingdom and the new sovereign of Maldives.

The United Kingdom issued a £500 million ($686.9 million) Sukuk, its second-ever after its debut issuance in 2014, to help bolster its domestic Islamic finance industry and its credentials as a choice conduit for Islamic finance in the West. The Maldives' $200 million issuance in April 2021 was its debut sovereign issuance and raised an additional $100 million after being reopened. Key drivers for this issuance included economic diversification away from China and channeling funds to address the challenges caused by the COVID pandemic in the tourism-driven economy

Evolution of Malaysia's Sukuk

Over the last decades, we can perceive the keen interest and attention in the Islamic finance industry on the international financial landscape. The growing demand for the instrument has created a flourishing Islamic financial system specifically in Malaysia. The sukuk market has grown previously in predominantly Muslim countries, but now this instrument has been one of the significant discussions in the world's leading conventional financial system. Sound economic development relies on the capability of the capital market. Hence, it is important to note that the resilient capital market would eventually contribute to the rapid growth of the Islamic finance industry.

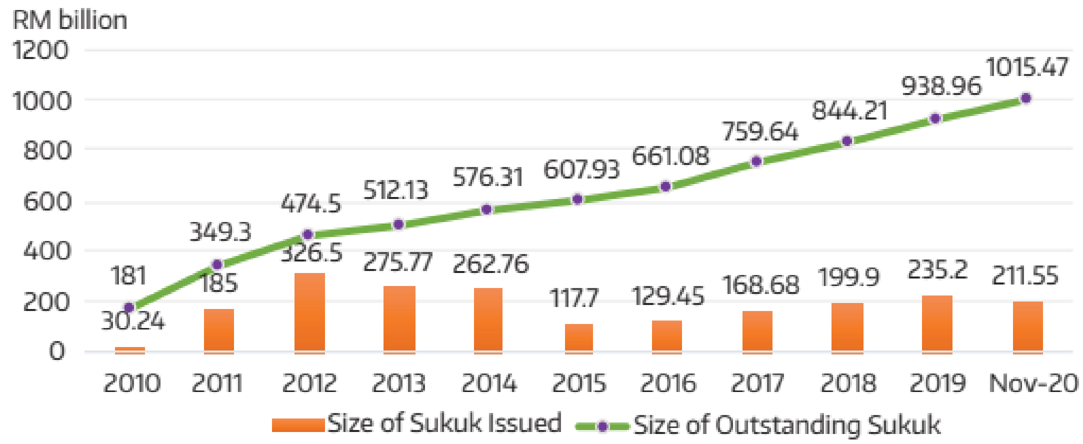
Since 1990, when the first corporate Sukuk, worth RM125 million, were issued in Malaysia by Shell MDS, the Sukuk market in Malaysia continues to thrive while supported by Malaysia's conducive issuance environment, facilitative policies for investment activities and comprehensive Islamic financial infrastructure. Malaysia maintained its lead by country with a market share of 28.8% in the first half of 2017. Malaysia recorded RM 138.7 billion (+20.6% y-o-y) of Sukuk issuance as of end-October 2017. According to Bix Malaysia, the growth was led by increased issuance by quasi-government (+32.2% or RM 38.2 billion), government (+17.7% or RM 46.5 billion) and corporate (+17.7% or RM 54.0 billion) sectors.

Source: MIFC

Malaysia, being the largest issuer of Sukuk globally, is recognised as the most developed Islamic financial market in the world as measured by Islamic Finance Development Indicator. Malaysia has a deep domestic market that supports local currency Sukuk issuances.

Malaysia maintained its leadership position in the global Sukuk market in 2020. Malaysia commands a market share of 45.1% of the global Sukuk outstanding, followed by the Kingdom of Saudi Arabia with 24.6%. Corporates have driven increased volumes with 57.5% share of total annual issuance. Malaysia also contributed 45.4% market share of total global corporate issuance in 2020 (Labuan FSA, 2021).

Figure 2: Total Sukuk Issued and Total Sukuk Outstanding



Source: Malaysian ICM bulletin

Sukuk and Economic Development

Sukuk has proven to be an important part of the global economy in ensuring and promoting financial stability. The emergence of this instrument has finally changed the financial landscape. In fact, the first Sukuk al-Ijarah was issued by the government in July 2002 and was based on property assets traded in the international market. Its purpose was to expand the nation's Islamic financial instrument and to generate the liberalization of the Islamic capital market (Hussin et al., 2012). Another essential function of Sukuk is to provide capital and liquidity to the demanders of a fund in the overall financial system. In fact, the notable trend from 2013 to 2014 was the Sukuk issuances which support Islamic financial institutions' compliance with Basel III liquidity and capital requirements (Global Sukuk Report 1Q 2015, 2015).

Besides that, Sukuk also promote the development of the capital market by allowing small capitalized investor or market players to actively participate in the market. On the corporate side, Sukuk plays an important role as a source of financing for large-scale projects and investments managed by corporations. In terms of investment diversification, this long-term security provides other new asset classes to accommodate investors' preferences. Sukuk plays an important role in financing the economy accounting for more than half of the country's total debt, both in balance outstanding and issuance (Haron & Ibrahim, 2012). Sukuk became the essential means in the Islamic finance industry to obtain a return on liquid reserves. In addition, this instrument can foster the development of capital markets by allowing thinly capitalized market players with specialization in securitization and issuance to participate in the capital market (Ali, 2005).

According to The Edge Market (2022), Bank Negara Malaysia (BNM) said investors had oversubscribed for the Malaysian government's RM4.5 billion worth of Islamic bonds or Sukuk, which were issued on Tuesday (Feb 22) after RM7.87 billion worth of bids were placed for the RM4.5 billion Government Investment Issues (GII) during a tender exercise between Thursday (Feb 17) and Monday (Feb 21). In a filing with BNM's Fully Automated System for Issuing/Tendering (FAST) website, the central bank said investors placed 237 bids for the RM4.5 billion worth of GII, which come with an annual profit rate of 4.369%. The GII's maturity date is on Oct 31, 2028, according to BNM.

According to BNM's website updates, the trading yield on Malaysia's seven-year GII which matured in October 2028, closed up one basis point at 3.62% on Monday (Feb 21). BNM said RM391.11 million worth of seven-year GII were transacted.

Structure of Sukuk

Sukuk is a structured financing/loan from the Sukuk holder to the Sukuk issuer. The general concept of pricing in Sukuk is similar to bonds. Sukuk uses the time value of money where the present value is the price of Sukuk while Sukuk will be redeemed at future value or face value at maturity and yield income. The yield income may be fixed or variable when incomes are linked to some index or returns of some asset. The coupon will determine whether the yield incomes are fixed or variable. When the coupon is fixed, the Sukuk is called fixed-income security (Krichene, 2013).

Bix Malaysia stated that, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) which issues standards on accounting, auditing, governance, ethical, and Shariah standards has laid down 14 different types of Sukuk. There are seven types of Sukuk mostly used in the Malaysia Sukuk market. The Sukuk structures rely on creating a Special Purpose Vehicle (SPV).

A special purpose vehicle or SPV will issue Sukuk, representing an undivided ownership interest in an underlying asset, transaction or project. A special purpose vehicle or SPV is a company registered as a subsidiary with a legal status which allows it to secure its asset structure in such a manner that the respective entity will not be affected in the situation in which the parent company enters into bankruptcy. In other words, SPV is a bridge that helps the parties involved in the contract to get their shares accordingly and to monitor their rights (Bix Malaysia).

Sukuk vs Bond

	SUKUK	**BOND**
OWNERSHIP	Partial ownership of an asset of an asset	Debt obligation
COMPLIANCE	Compliance with country law and Shariah	Compliance with country law
PRICING	The face value is the price according to the value of the assets backing them	Based on credit rating
RISK AND RETURN	- Receives a share of profit from the underlying asset - Accepts a share of any loss incurred	- The returns correspond to fixed interest - Their principal is guaranteed to be returned at the Bonds' maturity date
EFFECTS OF COSTS	Affected by the costs related to the underlying asset. The higher cost may translate to lower investor profits and vice versa.	Are not affected by costs related to the asset, project, business or joint venture they support. The performance of the underlying asset does not support the investor rewards.
SALES	Sale of ownership in the assets backing them	Sale of debt

Sukuk are financial instruments that allow market players to obtain a large amount of cash or capital from investors. It can be done by developing various structures of Sukuk with underlying property or assets. The bonds process involves lenders and borrowers while the Sukuk process involves the Sukuk issuers and the investors via Islamic contracts. Sukuk issuers will securitise assets to issue Sukuk. Investors interested in subscribing or buying the Sukuk will get a certificate representing ownership of the asset, risk, and cash flows. Upon maturity, those investors are entitled to get the money equivalent to the value of the Sukuk. The value of Sukuk could be varied according to the value of the asset that is backing them. These criteria differentiate Sukuk from bonds (Razak et al., 2018).

Although some may argue that the differences between Sukuk and Bonds are mere technicalities, these differences matter to Muslims. In fact, the practice of profiting from money alone, at the expense of productivity and real people has been one of the drivers for many inflations of prices based on debt rather than on real value is the main reason why bubbles form, burst, and then lead to recessions and depressions (Bix Malaysia).

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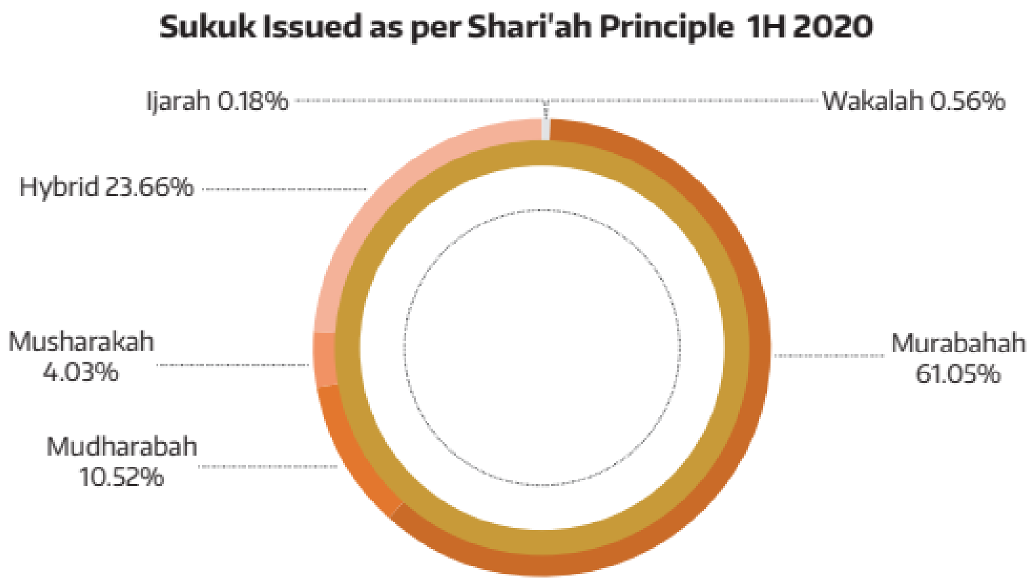
Types of Sukuk

Figure 4: Sukuk Issued as per Shari'ah Principle in 1H 2020



Source: Malaysian ICM bulletin

There are seven types of Sukuk mostly used in Malaysia Sukuk market (Securities Commission Malaysia, 2019):

1) Sukuk Bai' Bithaman Ajil

Certificates of equal value evidencing the certificate holder's undivided ownership of the asset, including the rights to the receivables arising from the underlying contract

2) Sukuk Ijarah

Certificates of equal value evidencing the certificate holder's undivided ownership of the leased asset and/or usufruct and/or services and rights to the rental receivables from the said leased asset and/or usufruct and/or services

3) Sukuk Istisna`

Certificates of equal value are issued to mobilise funds to be employed for the production of goods so that the goods produced to come to be owned by the certificate holders. This type of Sukuk has been used for the advance funding of real estate development, major industrial projects or large equipment such as: turbines, power plants, ships or aircraft (construction/manufacturing financing).

4) Sukuk Mudarabah

Certificates of equal value evidencing the certificate holder's undivided ownership in the Mudarabah venture. It is an investment partnership between two entities; one entity is mainly a provider of capital and the other is mainly the manager.

5) Sukuk Murabahah

Certificates of equal value evidencing the certificate holder's undivided ownership of the asset, including the rights to the receivables arising from the underlying contract. This is a pure sale contract based Sukuk, which based on the cost plus profit mechanism.

6) Sukuk musharakah

Certificates of equal value are issued to use the mobilized funds for establishing a new project, financing business activity, etc., on the basis of any partnership contract so that the certificate holders become the project owners. It is an investment partnership between two or more entities which together provide the capital of Musharakah and share in its profits and losses in pre-agreed ratios.

7) Sukuk Wakalah bi Alistithmar

Certificates of equal value evidencing the certificate holder's undivided ownership in the investment assets pursuant to their investment through the investment agent.

Issuers of Sukuk

Only the following issuers are eligible to issue corporate Sukuk under these Guidelines (SC 2019):

1) A public company whose shares are listed and quoted on a stock exchange
2) A licensed bank, licensed investment bank or licensed Islamic bank
3) Cagamas Bhd
4) Danajamin Nasional Bhd
5) Khazanah Nasional Bhd
6) A public company whose shares are not listed and quoted on a stock exchange, provided that:
   i) The corporate bonds or Sukuk are irrevocably and unconditionally guaranteed in full by any of the entities referred to in the above sub-paragraphs (1), (2), (3), (4), (5) or the Credit Guarantee and Investment Facility; or
   ii) The Sukuk are issued by a public company established by any of the entities referred to in the above sub-paragraphs (1), (2), (3), (4), (5) with full recourse to the establishing entity in its capacity as obligor.

General Shariah Rulings Applicable to Sukuk

a) Naming of Sukuk

The name of Sukuk must not be misleading and must be based on the following where the Sukuk are structured using a single Shariah principle, the Sukuk must be named according to that Shariah principle. For example, Sukuk that are structured under the musharakah principle must be named Sukuk musharakah; or where the Sukuk are structured using multiple Shariah principles, the Sukuk may be named according to the name of the issuer or obligor (where applicable); Sukuk istithmar (investment); or based on any other names according to the principles endorsed by the SAC from time to time. The application of the multiple Shariah principles must be disclosed in the principal terms and conditions of the Sukuk.

b) Requirement of identified assets, ventures and/or investments

In relation to Sukuk bai` bithaman ajil, Sukuk murabahah, Sukuk istisna` and Sukuk ijarah, an asset, whether tangible or intangible, available for such Sukuk issuance are subject to the following:

a) The identified asset and its use must comply with Shariah requirements
b) If the identified asset is subject to any encumbrance or is jointly owned with another party, prior consent must be obtained from the chargee or joint-owner;
c) Where the identified asset is in the form of a receivable, it must be mustaqir (established and certain) and transacted on the spot, either in cash or commodities.

In relation to Sukuk musharakah, Sukuk Mudarabah and Sukuk wakalah bi alistithmar, the ventures or investments must comply with Shariah requirements.

c) Asset Pricing Requirements

The purchase price of an identified asset under Sukuk issuance structured based on any Shariah principles must not exceed 1.51 times the fair value of the asset; or any other appropriate value of a such asset.

The asset pricing requirements are not applicable to Sukuk which are structured based on any Shariah principles that do not involve the sale and purchase of identified assets including but not limited to Sukuk ijarah which involves the lease and lease-back of the identified assets.

d) Ibra' (Release of rights)

Ibra' may be applied in the following contracts (including but not limited to) Bai` bithaman ajil, Murabahah and Musawamah, which Ibra' refers to the release of rights on debts or amount due and payable under a contract; and Ijarah, which Ibra' refers to the release of rights on accrued rental.

Ibra' may be applied in the event of early redemption, where,

a) Sukuk holders may offer ibra' to the issuer based on the application made by the issuer for early redemption of Sukuk upon the occurrence of any event of default, call option, regulatory redemption or tax redemption
b) the formula for the computation of early settlement may be stated as a guide to the issuer
c) The ibra' clause and the formula for the computation of early settlement may be stated in the main agreement of Sukuk bai` bithaman ajil, Sukuk murabahah and Sukuk ijarah. However, the ibra' clause in the main agreement shall be separated from the part related to the price of the transacted asset. The ibra' clause shall only be stated under the section for the mode of payment or settlement in the said agreement.

Practice of Sukuk

The Sukuk issuance process lies in the following steps (Rafay, 2019)

1) A feasibility study must be prepared in detail
2) A general framework is to be prepared in addition to setting up an organizational structure
3) The work should be in line with the structure and principles of Shari'ah
4) Conducted by a leading manager
5) Arrangement of agreed Islamic legal documentation;
6) Arrangement of special purpose vehicles (SPV) to represent Sukuk holders
7) Circulation of the Sukuk into the financial markets.

Importance of Sukuk

The Sukuk market has a number of features that have made it attractive to issuers and investors. These include its ability to meet the changing and differentiated demands of the modern economy, develop innovative and cutting-edge structures and products and achieve such issuances at competitive pricing (Abrorov, 2020).

As a result, the Sukuk market has drawn increasing interest from sovereigns, multilateral institutions, and multinational and national corporations from advanced, emerging, and developing economies to finance investments in various economic activities and development projects. For the investors, Sukuk offer diversification into multiple asset classes and different techniques used to structure medium to long-term instruments. The sovereign Sukuk are generally the first inroad into Shari'ah-compliant funding in the capital market, enabling the creation of reference prices over time, to which private sector entities can benchmark their fundraising activities. Furthermore, sovereign Sukuk also facilitate liquidity management by central banks.

The risk-sharing aspect of Sukuk gives them a clear advantage as a funding instrument for infrastructure. Nearly all conventional infrastructure projects contain separate equity and debt components, especially during the greenfield phase. This leads to a concentration of risk in the equity tranche and complex contracts. Furthermore, there is limited flexibility to handle unforeseen but common events such as delays in revenue generation. Sukuk are designed from the outset to spread the risk more broadly because all investors share in the same manner. Sukuk can also be used flexibly over time because payments are tied to underlying returns rather than fixed schedules.

Methodology

This study uses a qualitative approach involving a literature review including books, journals, newspapers, official websites and related circulars. The researchers first highlighted the evolution of sukuk in Malaysia, sukuk structure, sukuk types, sukuk issuers, sukuk practices and the importance of sukuk. Then the researchers identified the mudarabah sukuk practice in Malaysia. Once the data is obtained, it will be analyzed using the content analysis method (Lebar, 2018).

Sukuk Mudarabah Practiced in Malaysia

These certificates represent projects or activities managed based on a Mudarabah (partnership based on trust) contract. There will be one party or partner called the mudarib who will manage the project. Besides the mudarib, there is another partner called robbul-mal (owner of capital) who is the capital provider of the project. In this transaction, the issuer of these certificates is the mudarib (the managing partner), the subscribers are the capital owners and the mobilised funds are the Mudarabah capital. The certificate holders own the assets of Mudarabah and share the profit as per the agreement. They are also the capital providers and bear the losses if any.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, 2015) has defined Mudarabah Sukuk as certificate represents ownership of units of equal value in Mudarabah equity and registered in the names of holders based on undivided ownership of shares in Mudarabah equity and its returns according to the percentage of ownership of share. The owners of such Sukuk are the rabbul maal.

This Sukuk gives its owner the right to receive his capital when the Sukuk are redeemed, and an annual portion of the realized profits as mentioned in the issuance publication. The Sukuk can play a vital role in the development financing because it is related to the profitability of the projects. Financing through Mudarabah is more efficient in terms of resource allocation than financing based on interest rate, which does not reflect the profitability of the projects.

According to Sadad et al (2020), Mudarabah Sukuk is a tool for investment to raise funds, based on dividing Mudarabah capital by equal value units, registered under Sukuk holder's name (recorded bonds), which reflect the common asset in Mudarabah capital. In other words, Mudarabah Sukuk mean the document of definite value issued in the name of their owner against funds they pay to the owner of the project. Sukuk owners acquire a definite proportion of the project profit, which is set out in the Sukuk issuance publication (prospectus). Mudarabah Sukuk neither yield interest nor entitle owner to make claims for any definite annual interest. This means that Mudarabah Sukuk are like shares with regard to various returns, which are accrued according to the profits made by the project.

Besides that, Mudarabah Sukuk must represent a common ownership and entitle their holder to shares in a specific project for which the Sukuk have been issued to fund. A Sukuk holder is entitled to all rights, which have been determined by shariah upon his ownership of the Mudarabah Sukuk in matters of sale, gift, mortgage, succession and other. The contract in Mudarabah Sukuk is based on the official notice of Sukuk sale. Subscription in these Sukuk is considered as an offer from the investor and approval of the issuer is then regarded as acceptance of the contract. Official notice of sale must contain all the conditions which are required by shariah in Mudarabah contract and the distribution of profit should be in conformity with shariah rules.

On the other hand, the Sukuk holder is given the right to transfer the ownership by sale or trade in the securities market at his discretion on the expiry of the specified period of the subscription. Then, the disposal or sale of the Sukuk must follow the rules that stated below (Rosly & Sanusi, 1999):
1) If the Mudarabah capital after the subscription period is over and before the operation of the specific project still in the form money, therefore, the trading of Sukuk would be based on the exchange of money for money and it must satisfy the rules of sarf.
2) If such capital is still in form of debt, it must be based on the principle of Islamic debt trading or exchange debt for debt.
3) If such capital is in the form of money, debt, assets and benefits, trade must be based on the market price evolved by mutual consent.

With regard to the distribution of profit, the following rules must be observed (Rosly & Sanusi, 1999):
1) The mudharib, the person who has received the fund also been charged with the duty to run the affairs of the specific project or business, profit realized from investment in Mudarabah Sukuk will be distributed between the mudharib and investor according to the agreement.
2) Mudharib's share with the investor, the ownership of the assets in accordance with his participation to the total value of the company/project assets.
3) It is not permissible to guarantee him a fixed lump sum amount of profits.
4) The issuer has the right to purchase Sukuk offered for the sale by others according to the prices declared from time to time by the issuer.
5) The mudharib is considered as the depositary of the common fund and the project assets entrusted to him. If he is negligent or has committed dishonesty leading to losses, he shall be liable for the losses.

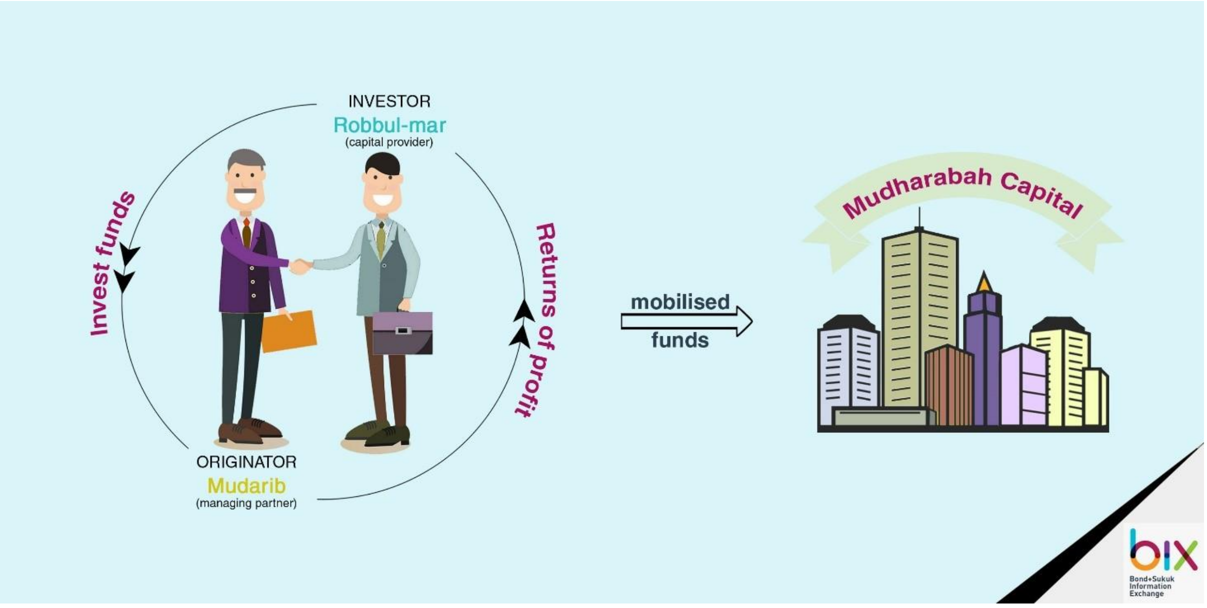
In matter of concerning the guarantee of Mudarabah Sukuk, the following points must be observed (Rosly & Sanusi, 1999):
1) It is permissible for the third party (the government) to promise to compensate any losses sustained in the specific project. However, this guarantee should be concluded in a separate contract and not included in the main contract of Mudarabah Sukuk between issuer and the investor.
2) It is not permissible for the issuer to guarantee the capital of the Mudarabah (the investor would not bear any loss in the value of the Sukuk) or to guarantee the investor a fixed

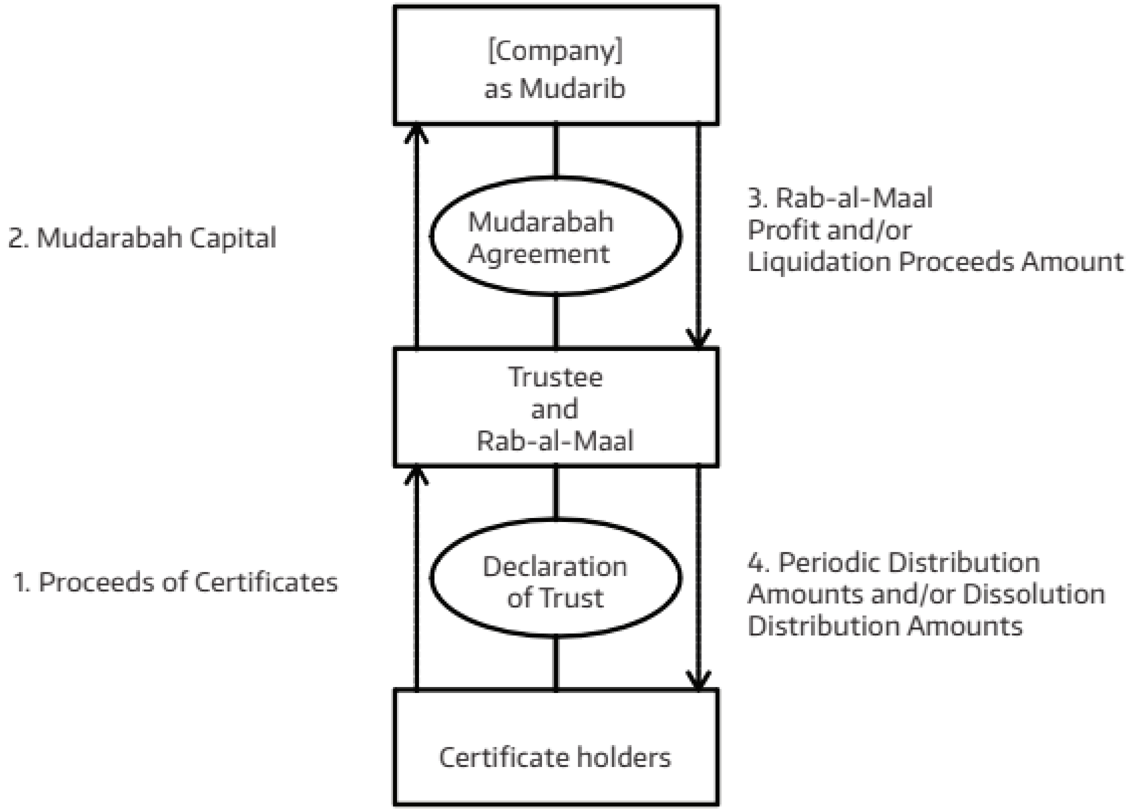
amount paid as profit.

3) It is permissible for the mudharib and the investor to agree to put aside a specific or certain portion of the profit as reserves to provide for protection or to meet any losses arising during the implementation of the project.

Structure of Sukuk Mudarabah

Sukuk al Mudarabah is structured through the Mudarabah contract, with one party looking for Shariah compliant financing, the originator. The originator will establish the SPV and enter into a Mudarabah contract with this SPV. Both the originator and the SPV will be partners to the Mudarabah contract. The originator will act as the managing partner, the entrepreneur of the Mudarabah venture. As the mudarib, the managing partner will contribute his labor, skills, and expertise. The SPV will act as the silent partner, the rabbul mal of the Mudarabah venture. As the rabbulmal, the SPV contributes in the form of financial investment. The SPV will issue Sukuk certificates to the Sukuk holders. The Sukuk proceeds will be used to make the financial investment in the Mudarabah. The SPV will declare a trust over all the units it is holding in the Mudarabah in favor of the Sukuk holders according to an agreed percentage of the realized revenues. The participation in the Mudarabah will continue until maturity date. At maturity date, the managing partner will buy the units in the Mudarabah from the Sukuk holders through the SPV. The managing partner will pay an amount to the SPV to purchase the units in the Mudarabah. That amount is used by the SPV to pay the Sukuk holders their capital back, so that the Sukuk certificates can be redeemed.





Pricing of Mudarabah Sukuk

There are two steps in pricing this Sukuk, the first step is described by the following formula is with a face value basis of RM100.

$$P = \left[\frac{100\left(100 + \left(\frac{C \times E}{365}\right)\right)}{100 + \left(\frac{r \times T}{365}\right)}\right] - FV\left(\frac{C \times t}{36500}\right)$$

where,
P = Price per RM100 face value
C = Indicative coupon for the current coupon period
E = Number of days in the current coupon period
T = Number of days from the transaction date to the next coupon payment day
r = Yield to maturity
t = Number of days from the last coupon payment date to the value date
FV = Face value of SMC transaction (RM100)
The second step is the transaction value or proceeds. It can be determined as:

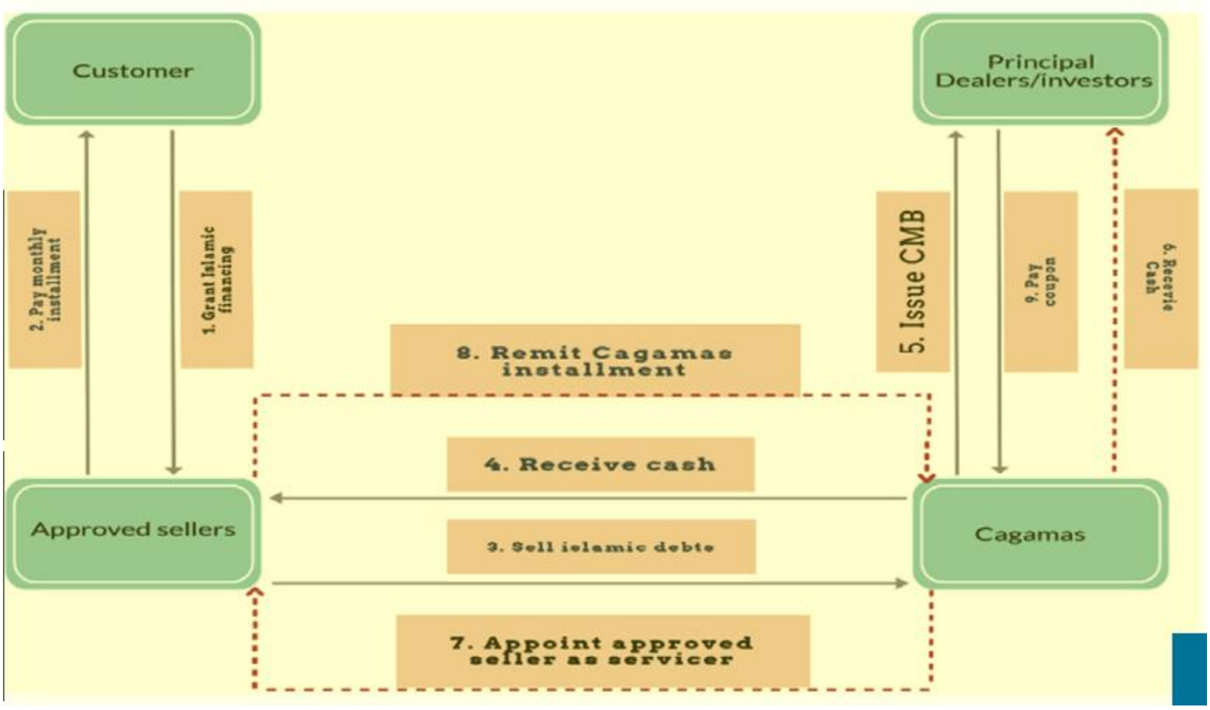
$$Proceeds = \frac{NV \times P}{100} + NV \times \left(\frac{C \times t}{36500}\right)$$

Cagamas Mudarabah Sukuk

The Sukuk was introduced to the market since 1994. They involve the purchase of Islamic housing financing and Islamic hire purchase from some Islamic financial institutions that offer Islamic house financing and Islamic hire purchase products. Mudarabah is the underlying concept of this Sukuk. Bay al-dayn is also applied in the Sukuk, which is to purchase the housing debt from financial institutions whereas Mudarabah concept is used to issue the

CMB. Under this agreement, the Sukuk holders and the Cagamas will share profits according to the profit-share ratio that has been agreed upon in the agreement.

The structure of the Sukuk starts when Cagamas Berhad purchased housing debts, let's say, amounting to RM 30 billion from Bank Islam Malaysia Berhad. The agreement pertaining to the purchase of housing debt will be sealed between Cagamas Berhad and Bank Islam Malaysia Berhad. Upon receiving the RM30 billion Islamic housing debt, Cagamas Berhad will issue Islamic bond/Sukuk worth RM30 billion to financial institutions that offer Islamic banking.



1) The process starts when the approved seller (let's say, Bank Islam Malaysia Berhad, BIMB) provides financing to customers
2) The customers will then pay the financing amount to the bank via an instalment payment
3) BIMB sells the Islamic housing debt to Cagamas Berhad
4) Cagamas pays cash to BIMB
5) Cagamas issues CMB to Sukuk holders
6) Sukuk holders invest in CMB
7) During the post-sale period, Cagamas appoints BIMB as the servicer
8) Cagamas remits the instalments from BIMB
9) The investors receive the coupons

Critical Assessment of Mudarabah Sukuk

Mudarabah Sukuk issuances have become less popular in the capital market for the past few years. According to the IFDI 2021, only about 10% of global Sukuk occurred in 2021. The Sukuk seem particularly advantageous for the Islamic banks rather than the investors. It is because the Sukuk assets could be falling below the par value which would likely lead to a reduced pay out at maturity. Nevertheless, there are different structures of Mudarabah Sukuk available in the market which were not the evidence to the above disadvantage.

Mudarabah Sukuk is an equity-based Sukuk structure where profits and losses are shared between the partners. Besides that, investment from a Shariah viewpoint does not allow a fixed return as well as the guaranteed principal amount at maturity to the investors.

However, several instruments fixed the periodic returns over the Sukuk and guaranteed the principal amount of the Sukuk holders. The periodic returns were often fixed. In the case the actual profits realised were less than the promised returns, the originator provided funding, whereas when there were excess profits or surplus, the originator took it as an incentive. This characteristic seems against the nature of the Mudarabah concept as the originator bore losses and the periodic returns to the Sukuk holders were fixed, regardless of the performance of the underlying project.

Besides that, in the matter of CMB, as far as the Shariah issue is concerned, debates about bay al-Inah (sale and buyback between two parties) are ongoing. The loopholes and conflicts in Mudarabah Sukuk have led us to recommend market players to issue a new and fresh contract of Sukuk, such as a partnership contract Sukuk. The Sukuk market is experiencing an increase in the issuance of sale-based contract Sukuk. It could be a good time for the market players to consider a partnership contract Sukuk given its strong development potential.

Conclusion

Sukuk is one of the Shariah-compliant financial instruments in the Malaysian capital market. The growth of the Sukuk in Malaysia has shown impressive development over the decades. In addition, Sukuk show grow positive trend internationally. Each country uses different types of contracts in their Sukuk. In Malaysia, various types of contracts are involved in the practice of Sukuk such as Ijarah, Mudarabah, Musharakah, Wakalah, Ijarah or hybrid structures based on combinations of Shari'ah contracts and others.

The domestic Sukuk market in Malaysia continues to serve as an important and attractive platform for government and corporate entities to raise long-term funds for various economic, business and infrastructure development needs. Sukuk market provides customised solutions to government and corporate issuers through various Sukuk structures. Despite the rapid growth of other financial instruments, we expect the growth movements of Sukuk to outpace as this instrument provides opportunities to beat a wider investor. The Sukuk structures are backed by real economic activity and have the ability to tap a broader investor base from both the Islamic and conventional spectrum including foreign investors.

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