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ASSESSING AND PRICING ISLAMIC SUKUK: AN OVERVIEW

Muhammad Saeed Iqbal¹ and Sofi Mohd Fikri²

^{1,2} School of Islamic Banking and Finance, Universiti Utara Malaysia

* Email: iqbaliub4@gmail.com and mohdfikri@uum.edu.my

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Abstract

Introduction to the Problem: Islamic sukuk conforms to Shariah guidelines. As a result, they are appealing pricing vehicles for Islamic financial institutions, Shariah-governed reserves, and Takaful Islamic insurance companies, which are prohibited from investing in conventional insurance policies that provide interest or riba.

Purpose/Objective Study: A growing number of Muslims with substantial net worth believe their real estate should follow Shariah. This paper describes and explains the tools for evaluating and assessing Islamic Sukuks.

Design/Methodology/Approach: Islamic Sukuks are financial instruments that follow Islamic laws, such as prohibitions against interest and gambling. They are used to determine the value of real estate to ensure it meets certain Shariah requirements. The tools for evaluating and assessing Islamic Sukuks include Islamic law, financial analysis, and real estate valuation.

Findings: An outstanding finding in the Islamic Sukuk study was the recognition of the significance of Islamic Sukuk estimation and assessment. This study is expected to help fill a gap in existing guidelines for Islamic Sukuk literature. Additionally, both professionals and academics will benefit from it. The findings could provide some ideas regarding the implementation of the strategy (Shariah boards, CEOs of Islamic financial institutions).

Paper Type: Research Article

Keywords: Islamic Sukuk; Shariah; Assessing; Pricing; KIBOR.

INTRODUCTION

One of the main problems with Islamic sukuk is that their return is often determined by reserves in US dollars rather than the KIBOR (Usmani, 2009). Consequently, there is a loan charge used primarily for valuation



Kampus 4
Universitas Ahmad Dahlan
Jl. Ringroad Selatan, Tamanan
Banguntapan, Bantul
Yogyakarta 55191
e-mail : ihtifaz@uad.ac.id

purposes. Shari'ah academics say controlling riba is contentious (Usmani, 2002). This means that Islamic sukuk are subject to regulations different from those of other financial instruments, which can lead to investors being charged excessive fees. Furthermore, more regulation is needed to make it easier for potential investors to assess the risks of investing in Islamic Sukuk.

Islamic sukuk challenges financial institutions because they are often viewed as ordinary resources rather than financial assets, as they are essentially risk assessments. Investing participants are more likely to invest in a security with a predictable structure than one that is difficult to comprehend. Thus, sukuk development is intriguingly legal; they are distinguished by Shariah compliance, but no economic growth has occurred (Wilson, 2008). The lack of economic growth is likely due to Islamic sukuk's lack of liquidity. This is because they are not traded on public exchanges. In addition, the Islamic sukuk's lack of transparency makes it difficult to evaluate them accurately, further impairing their growth (Ahmed et al., 2014; Ahmed et al., 2015). Risk-assessing organizations are willing to examine Islamic sukuk so that investors can obtain confirmation from the industry leader, Standard & Poor's, or the organization responsible for evaluating Middle Eastern institutions. A professional assessment organization for Islamic sukuk has been established by the IDB. This organization has significant experience analyzing Islamic Sukuk in Pakistan (Najeeb et al., 2017; Ahmed et al., 2022; Paltrinieri et al., 2019).

In addition, it addresses financial and legal issues related to the structure and issuance of sukuk, which are securitized financial instruments. These reflections and data are used as the basis of our investigation to assess the typical approach to sukuk structures and the risks underlying them. The literature also distinguishes between legal and regulatory factors. This distinction emphasizes the costs rather than the benefits of Sukuk issuance from investors' perspectives. The assessment addresses two prominent challenges related to legislative and regulatory matters: the need for harmonization with Shari'ah and the crucial role in overcoming non-standard laws and standards. Similarly, it explores the necessity of establishing a robust and universally accepted framework for Islamic accounting standards. This framework can be adopted for the issue of Sukuk. For more reliable financial statements, improving and establishing an optimal accounting standard collectively is necessary. The absence of standardization hinders Sukuk issuance in non-Islamic countries. Literature suggests that sukuk can provide various worldwide partners with benefits in alternative forms of business engagement. Nevertheless, the mere act of harmonization and standardization does not enhance the effectiveness of Sukuk markets, particularly with Iranian Ijārah sukuk, which are based on leasing contracts (Rahman et al., 2017).

ASSESSING OF ISLAMIC SUKUK

Assessing Islamic Sukuk requires a thorough valuation of several requirements to ensure compliance with Shari'ah guidelines. Assessment contains:

- i. Islamic sukuk must follow Shari'ah laws, which prohibit interest, investment, and uncertainty. A self-independent Shari'ah supervisory board controls Islamic sukuk formation and records to ensure compliance.
- ii. Islamic Sukuk are protected by tangible assets such as real estate structure projects or properties that provide a solid establishment. This suggests that they have a foundation resource sustaining them. The core assets offer investors security.
- iii. The financial stability of Islamic sukuk security is critical in assessing its ability to observe its responsibilities to Islamic sukuk investors. The Islamic sustainability, productivity, and income level of the guarantor are important components when assessing Islamic sukuk reliability.
- iv. Islamic Sukuk supporters should review possible risks correlated with the causing assets. Additionally, market uncertainties, operational risk, and credit risk are assessed as part of this Assessment.

PRICING STRUCTURE OF ISLAMIC SUKUK

Pricing of Islamic Sukuk is determined based on different significant factors involving:

- i. Different conventional securities that propose fixed interest payments, Islamic Sukuk investors contribute to the profit produced by important assets. The assessment structure interprets the assumed return on financing and possible gains from the determination.
- ii. Identified risk linked with Islamic Sukuk requires affecting the pricing structure. Increased credit possibility can result in a higher rate of return or increased ratio of advantages shared with inventors as a return for the increased risk.
- iii. Islamic sukuk is also affected by economic situations and demand and supply issues. If there is a significant demand for Islamic sukuk, guarantors may be able to price their Islamic sukuk at a lower return. Otherwise, if inventory exceeds demand, promoters may need to provide more attractive incentives to attract financial clients.
- iv. The Islamic Sukuk growth period also affects its pricing. In general, longer moods are linked with higher returns due to increased risk and chance over an extended period of time.

THEORY OF ISLAMIC SUKUS SECURITIES

As a result of Islamic finance, Muslims have lost several opportunities that may have provided them with a typical, respectable return with a typically secure interest rate. According to Tariq et al. (2007), a significant portion of speculative opportunities depend on land exchanges or securities exchanges with high levels of unpredictability. Since Islamic law prohibits interest-bearing bonds and fixed wages, sukuk (Islamic bonds) are an alternative. Conventional bonds are based on obligations, whereas Sukuk is based on resources. Sukuks were developed as one of the primary strategies to raise money in global capital's commercial sectors through acceptable designs that adhere to Shariah (Wilson, 2008). Sukuks are similar to conventional bonds in that they are traded on public markets and backed by an asset. However, the critical difference is that Sukuks are structured, so there is no interest or fixed payment. Instead, investors are paid a share of the profits generated by the asset, and the payment is based on the asset's performance.

Sukuk, also called Islamic bonds, Islamic trust authentications, or Islamic obligations security, is an Arabic term for securities or bonds organized following Shariah rules (M. AL-Bashir, 2008). It is structured to comply with Islamic laws, including prohibitions on charging interest and speculation. As a Sharia-compliant investment vehicle, sukuks provide investors with a low-risk investment opportunity.

Furthermore, Sukuk is a safeguard that conforms to Islamic Shariah regulations and requirements for theories, which prohibit interest payment and charging (Ahmed et al., 20019). According to Ahmed et al. (2019), Sukuk refers to a series of recommendations that deal with the distribution of assets in asset liability, accessibility, and organizations or in the asset-liability of specific projects or speculative ventures. Sukuk adheres to Islamic Shariah principles by providing an alternative financing approach that avoids interest. Furthermore, it motivates investors to engage in endeavors that will positively impact society as a whole. This is more than benefiting the individual investor.

Similarly, Sukuk is an asset that is recognized, flexible, consistently generates income, and has Shariah-compliant trust certifications. To issue Sukuk, entities such as businesses, governmental bodies, financial institutions, and charitable foundations must include resources in their accounting reports to activate monetary assets. Verifying the availability of adequate funds is the initial and pivotal stage in generating Sukuk information. Shariah principles say asset accumulation should not be limited to obligations associated with Islamic financial arrangements such as Istisna or Murabahah (Ahmed et al., 2019; Ahmed and others, 2018). The rationale for this is that Sukuk are investment instruments, and investors need assurance that the funds are safe and readily available for their intended purpose. Investors must ensure that the Islamic financial agreement strictly complies with Shariah rules.

Shariah Standard No.17 describes Investment Sukuk as "declarations of equivalent worth addressing unified shares of responsibility for resources, access, and governments, or for resources of a specific task or extraordinary speculation action. However, this is valid after receipt of the Sukuk value, the end of the membership term, and the completion of the work. Sukuk varieties most commonly used include Musharakah Sukuks, Ijarah Sukuks, Murabahah Sukuks, Istisna Sukuks, and Mudarabah Sukuks, as well as combinations of several of these types if possible(Alswaidan et al., 2017). They are structured to allow investors to invest funds while providing an income stream for the issuer. Sukuks can also be issued to provide liquidity for issuers, as they can be sold on the secondary market.

As defined by the Islamic Financial Services Board (IFSB), "Sukuk (plural of sakk), commonly referred to as Islamic bonds, are recommendations with each sakk addressing a relative unified proprietorship right in significant resources, or a pool of transcendently prominent resources, or an undertaking. Shariah guidelines and norms stipulate that these resources can be used for specific trading or work activities (Katterbaue et al., 2022). A Sukuk is a financial instrument that offers investors a return on their capital and provides the issuer with a source of debt financing. It is structured to comply with the Islamic Shariah, which prohibits interest charges and investors from profiting from using someone else's money. Instead, Sukuks are based on the concept of risk-sharing, where investors share the risk of loss and gain from the issuer's activities.

According to Malaysia Obligation Protections and Sukuk Market sources, sukuk can be defined as equal worth declarations focused on a single revenue (corresponding to the financial backer's revenue) as responsibility for fundamental resources (both substantial and immaterial), usufructs, services, or interests. Sukuk is supported by resources under this concept. A Sukuk holder can achieve a higher level of financial security than with conventional obligation bonds. Sukuk holders can benefit from their ability to pool resources and diversify risk (Mnif et al., 2020).

In addition, Sukuk can be structured following innovative applications of Islamic principles and standards. On the other hand, ordinary obligation safeguards reflect credits or obligations on which interest is paid. Sukuks are structured similarly based on the resources that generate revenue. In some respects, these safeguards are similar to those associated with normal obligations. It is concealed income from these resources that provides the source of revenue for the benefit installment on the Sukuk. Sukuks are similar to ordinary obligations, which use resource income to pay the benefit installments. However, Sukuks differ from ordinary obligations because they are structured differently to provide greater clarity and transparency for investors (Uddin et al., 2022).

According to the Malaysian Protections Commission, Islamic protections (Sukuk) are “any protections provided following Shariah standards and ideas supported by the Shariah Attention Committee (“SAC”) of the SC, as defined in Reference section 1 (and therefore Addendum 1 (B): Record or endorsement which demonstrates the quality of a resource” (SC Malaysia, 2004 Para 1.05 and SC Malaysia, Lexis Mexis, 2009). The SAC is a committee of legal experts appointed by the Securities Commission Malaysia to review the applications of Islamic protections. These legal experts ensure that the protections adhere to the Islamic standards of Shariah and provide adequate protection for investors. At first, we analyzed the instruments in the Sukuk issue to perform a meticulous probability analysis. The second step involved the establishment of a comprehensive framework and hierarchical structure. Establishing a highly effective Shariah framework is necessary in the third phase. In the fourth phase, they will assist the supervisor with guidance.

This study provides a comprehensive overview of the theoretical and empirical literature on Sukuk (Shariah-compliant bonds) from three perspectives: their underlying theory and characteristics, the operational challenges and structures involved in Sukuk, and the role of Sukuk in economic development. According to the article, most scholarly research into sukuk is in conference and seminar papers. This indicates that most sukuk literature is qualitative rather than quantitative. Despite a notable surge in research on sukuk, including journal articles, books, conference papers, reports, and magazines, the available supply still needs to be improved compared to other research on Islamic finance. The need for more progress in Sukuk research can be attributed to several factors. Firstly, the historical need for more reliable data is scarce. Secondly, there needs to be more scholarly organizations dedicated to Islamic finance matters and money. Thirdly, there needs to be more high-quality refereed journals that serve as reliable sources for Islamic finance research. Additionally, Shariah scholars need to pay more attention to Sukuk. Lastly, Islamic financial education needs a global standard and recognition for Islamic financial education (Uluyol, 2023; Hossain et al., 2018).

SUKUK AND LIQUIDITY MANAGEMENT

As a result, sukuk became the primary method by which IFIs gain access to liquid reserves. Shari’ah scholars consider the additional installment resulting from this transaction legitimate since it represents the result of an actual exchange transaction rather than the profit of a financial store. A critical mass of companies handling Islamic monetary organizations are prepared to manage assets in this manner. Due to this, changes were relatively high with low returns (Morea et al., 2017). This was because Sukuk was a relatively novel concept, and there was yet to be a large pool of investors willing to participate. Additionally, sukuk liquidity needed to be improved, making it difficult for investors to access liquid reserves.

Sukuk has provided executives with various additional liquidity options since its development. However, the Pakistan market may be manageable due to the size of the auxiliary exchanging the Bay, which is currently negligible due to the imbalance between demand and supply. In addition, Islamic organizations that purchase sukuk typically hold on to them until they are ready to sell them (Audiet al., 2021). This means that the supply of sukuk is quite limited, and any increased demand for sukuk could potentially send prices up and make it difficult for executives to access the liquidity they need.

ANALYSIS LINKED TO SUKUK

The review work for this analysis is based on the early period (1990-2012), which also looked at a few broad concerns relating to the Sukuk concept and development. This analysis provides an essential insight into the early period of the Sukuk concept and its development, as it helps to identify the main challenges, risks, and opportunities associated with Sukuk markets. These problems include fundamental analyses (early research) that have focused on interpreting and explaining the central notion of Islamic securitization and its relationship with the notion of Sukuk, the cycle, and necessary gatherings, as well as the perspectives and assessments of the researchers in this context. Moreover, the research focused on developing and designing updated procedures, equipment, and products. Several studies have focused on determining the most effective method to understand new things, obtaining customary items that adhere to Shari'ah regulations, or creating common bonds following Shari'ah. The aim was to ensure that Muslims can adhere to Shari'ah in their daily lives and access products and services that follow their religious values (Smaoui et al., 2017).

Several studies were conducted at the time that examined the variables that might prove helpful in the development of new financial products. In addition to these factors, the government's strategy provides greater freedom and the opportunity for players to choose commercial goods and services (Sial et al., 2022). It focuses on legal and Shariah issues in the middle. While Islamic law was examined in the early days of Sukuk concerns, more attention has been focused on the wake of the tremendous growth of the Sukuk market, in which several financial products have been introduced and altered agreements have been used. Studies have primarily addressed all issues from top to bottom at this stage.

We conducted connection and causality tests to determine the impact of industry performance on Sukuk returns. We observed two relapses to confirm if the industry's performance is indeed the main factor influencing Sukuk's returns. This is done by considering the effects of changes in the bond and equity markets (if any). The main focus is on an ARDL time-series model that examines the daily returns of a typical

business's sukuk portfolio and compares them to the market return of a similar business. The analysis also considers variable stationarity. We separately assessed the likelihood of ARDL relapse for nine industry-arranged sukuk portfolios. Our bound tests reveal that the positive outcomes of the models exceed the upper limit of the I (1) essential worth. This indicates the presence of cointegration in the model. The second regression analyses the industry-sorted Sukuk portfolio's average 30-day market momentum return. It compares it to the actual market momentum return of the industry during the same period. Board A demonstrates that the industry's overall performance plays a crucial role in determining the success of the industry-focused Sukuk portfolio. This finding is consistent across many industries and testing methodologies employed. The significant coefficients of the average industry market return (RIND) and momentum variables (MIND) in all industries and test models indicate that the impact of industry performance on sukuk return is not limited to the cash flow patterns of different types of Sukuk. This is further supported by the distinct results observed for the FCF and NCF sukuk portfolios in Panels B and C. Regardless, it is pertinent to observe that the performance of the overall security and value markets has a substantial impact on sukuk profits. This can be deduced from the coefficients of Equity, Bond, Equity, and Bond in all test models and across various industries. The time-series relapses seen in providing significant evidence of the prior findings about the connection and causality between the market performance of a Sukuk and the performance of the business to which the sukuk belongs (Umar et al., 2023; Billah et al., 2023 and Bhuiyan et al., 2020).

FACTORS AFFECTING ON SUKUK

State retail Sukuk is famous for several advantages, including investment security. This study aims to determine the impact of assets, sharia compliance risk, legal and regulatory risk, existing benefits, and different prices on Sukuk State availability. This study examined trade samples of Sukuk State Ijarah and Sukuk State Wakalah on the Indonesia Stock Exchange. However, state Sukuk availability is not influenced by existing assets and liabilities. In addition, the proposed examination focuses on the potential benefits of trading Sukuk State Ijarah and Sukuk State Wakalah on the Indonesia Stock Exchange. This is for State Sukuk investors and other stakeholders. State Sukuk serves as a domestic means of financing infrastructure projects and covering the budget deficit of the Republic of Indonesia Government (Alam et al., 2018; Kartiwi et al., 2008; Qamar et al., 2023).

As a result, public shares are the optimal investment group, rather than public securities, since they reduce risks, issuance costs, and marketing costs. Investors will take advantage of the extraordinary yields available on these Sukuk. The trading of Sukuk is the logical choice for

investors seeking a reasonable investment that will provide acceptable and Shariah-compliant returns (Khan et al., 2022). Sukuk offers investors the potential for higher returns due to the relatively low costs associated with their issuance and trading. Furthermore, Sukuk are also Shariah-compliant, making them an attractive option for investors looking for a halal investment. The analysis generally focuses on two factors that impact Islamic Sukuk in the following directions: 1. pricing structure. 2. Assessment of Sukuk.

IMPORTANCE AFFECTING ON SUKUK

Because Sukuk is a new instrument, it is natural to encounter some challenges compared to regular bonds. The assessment of Sukuk is one of its main concerns since the product is a new addition to the market and has yet to develop a practical tool to determine its price. According to (Rafay et al., 2017), the following challenges must be addressed:

- i. Due to the lack of comprehension on the part of the backers, Islamic securities must be evaluated following the standard market benchmark rate (such as KIBOR).
- ii. Due to a limited number of participants, there is low liquidity, a lack of market complexity, and no minimum quantity of issuances.
- iii. There is a lack of a regular expense approval mechanism to facilitate the dissemination of up-to-date information and impending challenges.
- iv. There is a lack of an evaluation tool based on gambling for Islamic currencies.
- v. Lack of mitigation measures to control and contain the risk of fluctuations in the market value of instruments due to changes in the benchmark rate.
- vi. There is a limit to the number of recorded resources that can be accepted as assurance.

In addition, Shari'ah regulations restrict trading obligations in response to the increasing number of Sukuk issued. Based on the ability of Sukuk contracts to be traded in an optional market using a variety of assessing methods, Meezan Bank (Borhan et al., 2018) has separated these contracts into two key categories:

- i. Sukuk that are tradable at market value, such as Sukuk Mudarabah, Sukuk Ijarah, and Sukuk Musharakah.
- ii. Sukuk can be transferred at face value, such as Sukuk Istisna and Murabaha.

A credit card assessment is a crucial factor in determining the price of conventional bonds, and it is also a critical factor in valuing Sukuks.

Since it is an interest-based benchmark, KIBOR is now the most used benchmark for calculating Sukuk benefits or rental returns. In terms of Shariah law, this needs to be revised. Sukuk valuation utilizes the contrast between offer and request costs (sometimes referred to as the offer-ask spread) in a manner comparable to bond valuation (Kantarc et al., 2018). However, KIBOR is an interest rate benchmark, and interest rate benchmarks are not Shari'ah-compliant. Therefore, the Sukuk's valuation cannot be based on KIBOR.

According to Nasreen et al. (2020), Sukuk bonds must use the correct annual loan fee distributions to financial supporters. It is generally accepted that Sukuk returns are derived from leases, benefits, or transactions involving real estate, equipment, or joint venture businesses. Because these leases, offers, or arrangements are not considered "interest" payments, they are structured to communicate what is equivalent to the correct yearly financing costs. The Sukuk assessment in the Islamic capital market is based on Shari'ah norms rather than conventional benchmarks such as KIBOR. Using such a test makes it more challenging to establish a mechanism for consistently valuing Sukuk to deal with Sukuk exchanges and establish an optional market that functions effectively. This is because the Shari'ah norms are subjective and open to interpretation, making it difficult to determine the fair market value of Sukuk. Additionally, the Islamic capital market is still relatively new, and there still needs to be more infrastructure to support it.

SUKUK ASSESSING

The Islamic Improvement Bank and the then-Pakistan Financial Bureau (now the State Bank of Pakistan) established the Islamic Worldwide Assessing Organisation (IWAO) in 2021 to impartially evaluate, dissect, and evaluate Islamic banks and instruments (Roslen et al., 2021). IWAO was created to ensure Islamic banks and instruments complied with Islamic financing norms and standards. It was intended to promote Islamic banking and to create a sustainable financial system.

Developing, implementing, and supporting existing Islamic interests in the burgeoning provincial Sukuk markets is crucial at the IWAO stage. The potential for IWAO to restrict Islamic money's moral authority based on reasonable interpretations of Fiqh Al-Muamalat is a minor snag in this process. In practice, it is effortless to disregard monetary regulations and the Shariah spirit when adopting Islamic financing. Additionally, it promotes highly flexible arrangements. The logical ability for the showing of the first resources, where the return depends on the dependability of the investor or the income provided by the first resources, as well as the position of the Sukuk when compared to other financial obligations of the guarantor, may pose additional risks for Sukuk from the perspective of conventional rating frameworks (Abdullah et

al., 2022). This is because Sukuk does not have the same structure as traditional bonds. Therefore, the default risk is much higher than that of traditional bonds. Furthermore, Sukuk's structure makes it difficult to accurately assess default risk, as the guarantor's position relative to other financial obligations can change dramatically.

Sukuk used a successful assessment strategy. Consideration is given to his assessment system. Sukuk's dependence on resources is in terms of wages derived from essential resources. Even though all exchanges are likely to involve significant risk shared between the lender and financial supporters, payment may also be resource-assembled based on the installment source through a repurchase arrangement. Yesuf et al. (2020) conducted a comparative analysis of the primary resources used to understand Sukuk principal repayment and material regulation. The analysts examined different types of Sukuk, encompassing Islamic securities, Islamic mutual funds, and Islamic insurance. It was found that Islamic insurance and mutual funds exhibited the highest level of resource dependence, while Islamic bonds demonstrated a comparatively lower level of resource dependency. The installment system greatly influenced Sukuk resource dependency, with repurchase agreements being the most resource-dependent.

This assessment can be used to confirm the Sukuk assessment in Pakistan. A credit assessment is intended to enhance the security of all covered obligations for Sukuk offerings in Pakistan. In Pakistan, credit evaluations are generally created by an independent third party, such as a credit assessment organization (CRA). CRA analyzes credit reimbursement accounts from all neighborhood banks nationwide to determine the likelihood of corporate entities failing to fulfill their financial obligations. The focus is placed on the commitment's repayment structure rather than the company sponsor's overall reliability. Instruments that can enhance or strengthen anything, such as guarantees, settled reserves, letters of credit, or other similar instruments, will be considered during the examination process. Therefore, a corporate entity may receive multiple rating categories for different obligations at different times (Laila et al., 2020).

This is because the obligation reimbursement structure is a crucial factor in determining the risk of a business backer. Suppose a company can consistently meet its obligations and reimburse its backers. In that case, it is less likely to be rated lower than a company with a more variable or uncertain obligation reimbursement structure. However, an assessment is not just a point of reference to highlight whether to buy, sell, or keep a security or if it is fair for a particular project. It may not include any evaluation by the assessing department (Hassan et al., 2021). Assessments can be subjective, and different departments may have different opinions. Pakistan is one of the few tiny nations worldwide that mandates credit rating agencies (CRAs) to assess security or Sukuk offerings (Wardani et al., 2020).

CONCLUSION

Globally, sukuk creates substantial funds that reach far beyond borders, exceeding domestic markets. This makes them the most robust segment of Islamic finance currently. Every country can enhance Islamic finance's prominence in contributing to worldwide economic expansion and monetary stability. This combines diligent efforts, progress, and a well-rounded development strategy. Two pressing concerns need to be addressed promptly to ensure the continued expansion of the sukuk structure and market. This necessitates close cooperation between Shariah scholars and financial experts. Through this collaboration, Islamic sukuk will adhere to Shariah principles. This will enhance the Islamic financial system's credibility. While pursuing legal and essential objectives, the primary objective of the sukuk market is to adhere to Shariah principles and get acceptance from international banks and institutions. This will also contribute to the real economy's advancement.

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