The Moderating Role of Shariah Supervisory Board on Sukuk Pricing Benchmark

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ABSTRACT

The primary objective of this research is to elucidate and describe the significance of the pricing benchmark on Islamic *Sukuk*, in addition to determining the potential moderating effects of *Shariah* Supervisory Board (SSB) on *Sukuk* pricing benchmark and *Shariah* disclosure relationships. The quantitative data were collected from the *Shariah* reports of the identified *Sukuk*. The population size in this study consists of 54 *Sukuk* in Islamic Financial Institutions in Malaysia, representing a full sample for seven consecutive years' period from 2005 to 2013. Secondary data was used and sourced from *Shariah* pronouncements on *Sukuk*. Using descriptive statistics, the existence and the extent of existence of *Shariah* disclosure on *Sukuk* in Islamic financial institutions in Malaysia was ascertained. The research found there is empirical evidence showing the moderating effect of *Shariah* supervisory board on relationship between pricing benchmark and *Shariah* disclosure on *Sukuk* in *Shariah* pronouncements.

Keywords: *Sukuk Pricing Benchmark, Shariah disclosure, Shariah supervisory board*

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1. Introduction

Islamic *Sukuk* have a main impact on different economic and banking operations where they have got an estimable position in capital and financial markets (Alabdullah, Ahmed, Salih, & Polat, 2017; Ahmed, Islam, & Alabdullah, 2014; Ahmed, Alabdullah, Islam, & Asmar, 2014). Today, *Sukuk* have been considered as the most successful financial instruments among the financial markets and also considered as one of the fastest industries in its growth in international financial landscape (Ahmed, Islam, & Ku Ariffin, 2015). *Shariah* [(2)] Scholars should be giving more attention to development of *Sukuk* structure to ensuring compliance of these *Sukuk* with *Shariah* requirements. *Sukuk* are one of the most popular and promising *Shariah*-compliant financing tools (Chermi, & Jerbi, 2015). One of the key challenges of Islamic *Sukuk* is that its return relies usually on benchmarking to the London Inter-Bank Offer Rate (LIBOR) on $US dollar funds (Ahmed, Islam, & Alabdullah, 2014). This, therefore, leads to an interest rate which is used only for pricing (Kantakji, 2012). However, Islamic banking and finance has been using conventional finance benchmarks, such as Euro Inter Bank Offer Rate (EURIBOR), Kuala Lumpur Interbank Offered Rate (KLIBOR), LIBOR, etc., to determine its own cost of funds, and consequently, its revenues to the financial investments (Omar, Azmi, Noor & Meera, 2010). However, such case is dealing with *riba*, which is a controversial issue among *Shariah* scholars (Usmani, 2002).

One of the very prominent issues to be debated is the legitimacy of *Sukuk* pricing (Ahmed, Alabdullah, Islam, & Asmar, 2014). Though the debate has been there for decades and very supportive arguments in favour of the existing pricing models have been presented by the *Shariah* scholars, the conflicts still persist due to different schools of thought and their mind-sets (Salman, 2014). The pricing benchmark has a significant role of *Shariah* compliant in effecting the *Sukuk* in general. It is an influential factor that has impact on the *Shariah*-compliant *Sukuk* as confirmed by several previous studies in the literature (See Kantakji, 2012, Usmani, 2009, Omar, el at., 2010, Al-Bashir, 2008).

Sukuk have penetrated the Islamic financial markets, which continues to remain a topic that researchers find a challenge to keep up with, in its diversified and multifaceted aspect (Ahmed, El-Morabit, & Islam, 2017). In spite of the fact that many had referred to *Sukuk*, in the context of conventional instruments, non-*Shariah* compliant *Sukuk* and new deviations in *Sukuk* structure will continue to be the motive force in the genuine expansion of the Islamic Financial Sector. Unlike conventional Bonds, *Sukuk* differ in terms of its structure, risk return mechanisms, and 'asset-backed' and 'asset-based' classifications, but most likely it is widely considered as a fund raising mechanism just like bonds (Alabdullah, Ahmed, Salih, & Polat, 2017; Usmani, 2002; kantakji, 2012). The researchers do not accept the argument of some contemporary scholars, referring to a high percentage of *Sukuk* applications, as they closely resemble conventional financial tools without scrutinizing and investigating this matter in all relevant aspects. Islamic *Sukuk* need to have their own *Shariah* boards to ensure its compliance with the *Shariah* principles, and such boards should be composed of *Shariah* experts (Ahmed, El-Morabit, & Islam, 2017). To

[(2)] Islamic law (Arabic: شريعة) is the religious law forming part of the Islamic tradition.

safeguard that Islamic financial institutions perform their operations according to the *Shariah* requirements, there should be a precise control in the financial institution represented by *Shariah* supervisory board (SSB) (Lahsasna, 2010). A *Shariah* Supervisory Board (SSB) normally consists of *fiqh muamalat* experts to guide their operations and transactions in accordance with the rules of *Shariah*. Therefore, SSB undoubtedly forms the most important and influential entity in any Islamic financial institution (Malik, 2010) to be *Shariah*-compliant and better containing legitimacy. Therefore, *Shariah* operation documents need to be reviewed and overseen by the *Shariah* supervisory board to provide the fatwa that lies in approving *Sukuk* that give expression for the legitimacy of mechanisms and structure of *Sukuk*. This is due to the fact that those documents are core matter to make *Sukuk* compliant to *Shariah* (Rahail, 2011). Thus, any negligence or even mistake might lead to difficulties in issuing the *Sukuk* as well as the probability to increase the *Shariah* compliance risks. Thus, the main objective of this paper is to focus on *Sukuk* pricing benchmark which is an essential element that has important impact on *Shariah* disclosure on Islamic *Sukuk*. Finally, the paper try to give empirical support to the potential moderating effects of SSB on pricing benchmark of *Sukuk* and *Shariah* disclosure relationships. The remainder of the paper is organized as follows: Section 2 contains a general Overview of *Sukuk*. Section 3 Mechanisms of Pricing Benchmark. Section 4 *Shariah* Supervisory Board. Section 5 describes the research method (data collection and sample), and the variables are described. In Section 6, the results of the empirical analysis are given. Section 7 summarizes the main findings and consequences and presents the conclusions

2. General Overview of *Sukuk*

Islamic finance has sometime lost some investment opportunities for Muslims that offer an expected good return with low risk (Tariq, & Dar, 2007). Most of the investment opportunities are based either on real estate transactions or on stock markets with high volatility (Ahmed, Islam, & Alabdullah, 2014). This is mainly since the interest-bearing bonds with fixed income are not permissible in Islamic *Shariah*, thus, *Sukuk* (Islamic bonds) can presented as one of the alternative solutions issue. *Sukuk* are asset-based securities while conventional bonds are debt-based securities (Alam, 2011). *Sukuk* were developed as one of the most significant mechanisms for raising finances in the markets of international capital through acceptable structures based on *Shariah* (Dusuki, 2010). Figure 1.1 allows several observations to be made. The global Sukuk market in 2010 reached US52.97 million, which was an increase of 50 percent in comparison to 2009 in which the total global market only reached US37.09 million in accordance to Islamic Finance Information Services (IFIS) sources. However, in 2014 the *Sukuk* issuance declined to $120.85 million from $138.17 million in 2013. Despite that, as forecasted, Malaysia continued to dominate the *Sukuk* issuance market in 2015 and remains as the global *Sukuk* market leader.

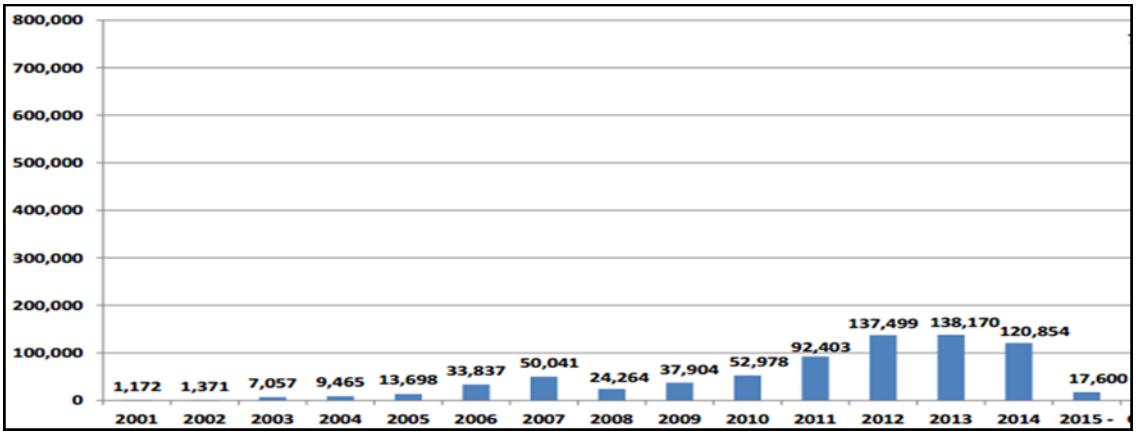

Figure 1.1: Total Global *Sukuk* Issuance 2006 – 2015
Source: International Islamic Financial Market (IIFM) *Sukuk* Database

A long time ago, the '*Sakk'* which cognates with the English root of the word *cheque,* could be defined as any document that represents a contract of transference of rights and obligations or revenues earned in accordance with the Islamic law, or *Shariah*. Empirical evidence showed that *Sukuk* (Islamic bonds), the plural form of *Sakk*, are a product broadly used during medieval Islam for transferring financial duties and obligations derived from trade and other business activities (Ahmed, Alabdullah, Islam and Asmar, 2014). The essence of *Sukuk* in the modern Islamic perspective depends on the concept of securitizing "asset monetization", which is achieved based on the process of issuing *Sukuk* "*taskeek*". Its great potential lies in transforming asset future cash flow within present cash flows. *Sukuk* may be issued on existing as well as specific assets, which would become available at a future date (AL-Maghlouth, 2009). According to De Vroede (1981), the word "check" in U.S. is associated with the British spelling of the word "cheque" and it appears that the modern Western word "cheque" appears to have been derived from the Arabic word Sakk (Heck, 2006). Sukuk could be defined as any document that represents a contract of transference of rights and obligations or revenues earned in accordance with the Islamic law, or *Shariah*. Empirical evidence showed that *Sukuk* (Islamic bonds), the plural form of Sakk, are a product broadly used during medieval Islam for transferring financial duties and obligations derived from trade and other business activities (Ahmed et al., 2014). The essence of *Sukuk* in the modern Islamic perspective depends on the concept of securitizing "asset monetization," which is achieved based on the process of issuing *Sukuk* "*taskeek*." Its great potential lies in transforming asset future cash flow within present cash flows. *Sukuk* may be issued on existing as well as specific assets, which could become available at a future date (Taher & Al-Hajjar, 2013).

Furthermore, the Accounting and Auditing Organization of Islamic Financial Institutions (AAOFI) defines the Investment *Sukuk* on the *Shariah* Standard No.17 as " *certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or in ownership of the asset of a particular project or special investment activity, however, this is true after receipt of the value of the Sukuk, the closing of subscription and the employment funds received for the purpose for which the Sukuk are issued* " (AAOIFI, 2012). Also, the AAOFI listed the *Sukuk* types that are mostly used as the *Musharakah*

Sukuk,Ijarah Sukuk, Murabahah Sukuk, Istisna Sukuk, Mudarabah Sukuk, and combination of some of these types if feasible (AL-Bashir, 2008).

The Malaysia Securities Commission defines the Islamic securities (*Sukuk*) as *"any securities issued pursuant to any Shariah principles and concepts approved by the Shariah Advisory Council ("SAC") of the SC as set out in Appendix 1 (and subsequently) Appendix 1 (B): A document or certificate which represents the value of an asset"* (SC Malaysia, 2004 Para 1.05 a & SC Malaysia, Lexis Mexis, 2009). However, first the steps involving in the issuance of *Sukuk* prepare a detailed feasibility study. Second, they set up a general framework and an organizational structure. Third, they work out an appropriate *Shariah* structure. Fourth, they arrange a lead manager. Fifth, they arrange agreed *Shariah* legal documentation. Sixth, they set up the special purpose vehicle (SPV) to represent the investors. Finally, they put *Sukuk* into circulation (LMC, 2008). The model of *Sukuk* security is derived from the conventional securitization process in which a special purpose vehicle (SPV) is setup to acquire assets and to issue financial claims on the assets. These financial assets claims represent a proportionate beneficial ownership to *Sukuk* holders (Al-Buolayan, 2006).

Globally, the business world has witnessed waves of crises, bankruptcies and collapses in large companies in several developed and developing countries. Such harmful crises have led to the collapse of a large number of global companies even those with good reputations in the business world (Chen, Lindeke, & Wyrick, 2010; Ongena, Smith, & Michalsen, 2003; Radelet & Sachs, 1998). Carmassi and Herring (2013) mentioned that these crises revealed that there is a lack, and thus a need for coherent business systems in global and large financial institutions.

3. Mechanisms of Pricing Benchmark

Pricing is one of the most important factors that impact the legitimacy of the *Sukuk* (Al-Amine, 2008; Wilson, 2008; Zulkhibri, 2015). Pricing is also a point of contention in relation to the issuance of Islamic *Sukuk* (Usmani, 2002). *Shariah* scholars and Muslim economists have not come up with an alternative to the interest rate as a readily available indicator of profitability (Al-Bashir, 2008). Hence the use of the London Interbank Offered Rate (LIBOR) as a pricing benchmark has become part of the practice of Islamic Financial Institutions (IFIs). The factors for computing the pricing benchmark ought to be free from interest rates, non-real economic activities and non-halal activities such as indices of financial derivatives instruments (Omar et al., 2010). However, in noting that while it is permissible to use LIBOR as a pricing benchmark, it is not correct to rely on it for a determination of returns (Kantakji, 2012).

The conventional benchmark like LIBOR has been used in IFIs as a reference guide, leading to long-term investment pricing (Mirakhor & Zaidi, 2007). It is generally accepted and recognized in the Islamic financial sector, without making any serious or deviant moves, to be free from usury-based benchmarks that do not reflect real investment behavior (Selim, 2008). The arguments made are based on a complete replication of conventional usury-based financial indicators, and the views of some scholars who align their views with the long lasting outlook of adhering to the control of Western practices to the financial markets, especially with the modern Islamic financial industry being in its infancy (Usmani, 2002; Kantakji, 2012).

Conventional interest-based financial institutions use interest rates for debts and charge the borrowers for the cost of the borrowed money as well as other risk factors reflected in the formula (Omar et al., 2010). This represents a behavior that has exhausted the economic cycle due to the imbalance among the parties of the investment process. As a result, the return is guaranteed to one side and the risk is transferred to the other, upon which the result will be of zero impact on the economy, with the likelihood that a loss will apply as well to the owners of the fund (Obaidullah, 2005). Both the conventional banks and the Islamic banks generally transfer the liability to the borrower and freeze their assets from further productive investment (Zahan, Ron, & Kenett, 2012). Moreover, both systems proactively share the use of the same index (LIBOR) as it is the most practical and commonly-used index, according to the widely spread belief. Conventional financial institutions justify themselves in applying a usury-based indicator, such as LIBOR, due to the adherent nature of usury-based structures in their system. Such an act is not justified for IFIs and cannot be excused based on the views of its proponents (Lane, 2006). Herwany & Febrian (2010) cautioned that, due to the absence of an appropriate *Sukuk* pricing model, the industry currently uses the same pricing benchmark (i.e. LIBOR) for both the issuance of conventional and *Sukuk* products.

In the existing literature there are a number of pertinent studies that have examined LIBOR. For instance, Wilson (2008) claimed for that for *Sukuk* pricing the use of LIBOR as the benchmark is not appropriate, in accordance with the Islamic scholars' opinion, and it was recommended that Corporate *Sukuk* ought to be benchmarked against the financial institutions' performance indicators. Wilson further added that share prices are not suitable as indicators as the share prices sit differently to *Sukuk* securities in relation to yielding a regular income which is fixed and debt and equity investment is unclear. Accordingly, a proposal which is suitable is to apply profit indicators or dividends that can be utilized to underpin a new type of *Sukuk* based on the structure of a partnership (Wilson, 2008). In addition, a monetary indicator such as Nominal GDP could be utilized for the pricing of a Sovereign *Sukuk*.

A study by Hayat and Kraeussl on the risk and return characteristics of Islamic Equity Funds (IEFs) between the years of 2000 - 2009 found that IEFs are underperformers compared to Islamic as well as to conventional equity benchmarks (Hayat & Kraeussl, 2011). This study which was done by analyzing pricing data from Bloomberg for 51 IEFs in Malaysia using Kuala Lumpur Composite Index (KLCI) as the conventional benchmark and the Kuala Lumpur *Shariah* Index (KLSI) as the Islamic benchmark, suggests that the financial improvements for Muslim investors could be improved by investing in index tracking funds rather than individual IEFs.

An immediate cessation by the IFIs of the practice of *Riba* is upheld by Usmani (2009). The argument put forward is advanced by the view that interest rates usage as a benchmark is undesirable for halal products [(3)]. Furthermore, the philosophy of an economy based on Islamic principles has not been promoted and, therefore, does not have an effect on the system of distribution.

An examination of the interactive linkages between *Sukuk* and the *Shariah* stocks in the Gulf Cooperation Countries (GCC) was undertaken by Aloui, Hammoudeh, and Hamida

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[(3)] Halāl (Arabic: حلال ḥalāl, "permissible"), also spelled hallal or halaal, refers to what is permissible or lawful in traditional Islamic law.

(2015). Their study found *Sukuk* and the *Shariah* stocks and the GCC markets are not mutually exclusive in that there are linkages between the two; however they are also regime-dependent. In other words the volatility in the *Shariah* stock market reacts in an asymmetrical way to events in the *Sukuk* markets. Crucially, this study provided support for the claim that a change in the GCC *Sukuk* price index can significantly impact the likelihood of transmission across the regimes.
Also ISRA (2013) utilized the Capital Asset Pricing Model (CAPM) to estimate the pricing model in order to ascertain whether a direct link exists between the market risk of projects or businesses and their required rate of returns. It has been established that the Islamic pricing model was more stable than the KLIBOR alternative. Ahmed et al., (2014) described the significance of the pricing mechanisms and rating on *Sukuk* as essential elements that have a significant impact on *Sukuk*. Their study found that the selected influencing factors need prompt solutions in order to achieve sustainability and development of the *Sukuk* market and the *Sukuk* structure. This requires a close cooperation among *Shariah* scholars and financial experts. Also an empirical study undertaken by Aloui et al. (2015) argued that the linkages between the *Shariah* stocks and *Sukuk* GCC markets are also regime-dependent and the *Shariah* stock market volatility reacts asymmetrically to events in the *Sukuk* market. Additionally, this study provided evidence for the assertion that changes in the GCC *Sukuk* price index have a significant impact on the probability of transmission across regimes. More specifically, in the Malaysian context, Ahmed et al. (2015) found that the pricing had a statistically significant and positive effect on the legitimacy of Sukuk in Malaysia because there is an influence from pricing on the structure and legitimacy that is applied by the IFIs.

The initial typical Islamic jurisprudence (*fiqh*) records indicate that pricing in Islam has been extensively deliberated and explained in the following records: *Adab al-hisbah* (al-Malqi, Abdullah al-Saqti Muhammad ibn Ahmad, 11th century); *Nihayat al-ratibah fi tolab al-hisba*h (Abd al-Rahman ibn Nasir, 589); *al-Hisbah fi Islam* (Sheikh al-Islam Ibn Taimiyyah); *Ma'alim al-qurbah fi ahkam al-hisbah*,(al-Qurashi, Muhamad ibn Ahmad al-Shafi'i, 729H); the book of *al-Turuq al-hukmiyyah fi al-siyasah al-syariyyah* (Ibn Qayyim al-Jawzi); *Ahkam al-suk* (Yahya ibn Umar al-Kanani, 213-289h) which was the initial manuscript placing a specific emphasis on the matter of pricing; followed by the book *al-Taysir fi ahkam al-tas'ir* (Ahmad ibn Said al-Majlidi, 1094H).

Among the existing works in Arabic on the mechanism of pricing and acceptability from the *Shariah* viewpoint along with government involvement in pricing are *Ahkam al Tas'ir fi al-Fiqhi al-* Islamic written by Muhammad Abu al Huda al Ya'kubi al Husni (2000); *Al-Ru'ya al-Islamiyyah li tas'ir al-sila' wa al-khadamat* written by Dr. Muhammad bin Ahmad bin Salih al-Salih (2001); *Jara'im al-tas'ir al-jabari* written by Mahmud Muhammad Abdul al-Zaini (2004) and Dirasat fi *takalif al-intaj wa tas'ir fi Islam* written by Dr. Auf Mahmud al-Kufrawi (1985), wherein the attention was on the revenue, cost and the computation of price and profit rates on the basis of the *Shariah* perspective. Among the modern works in English on pricing benchmark based on the *Shariah* perspective includes the Book of Indexation of Financial Assets an Islamic Evaluation (S.M Hasanuz Zaman, 1981), An Introduction to Islamic Finance (Usmani, 2009), and Pricing of *Murabahah* and *Ijarah* Product in Malaysia (Fitri, 2007). Another piece of contemporary relevant research was undertaken by Mirakhor (1996) and is titled the Cost of Capital and Investment in a Non-Interest Economy. However, *Shariah* scholars and Muslim economists have yet to identify an alternative to the interest rate as a readily available indicator of profitability (Kantakji, 2003; Al-Bashir, 2008). Hence in the absence of Islamic compliant benchmarks, the conventional usury-based benchmarks are adopted to determine *Sukuk* pricing (Selim, 2008). This view is justified in taking into consideration the early development stage of the modern Islamic finance (Usmani, 2002 & Kantakji & O'haj, 2010) which permits the use of conventional mechanism. Despite the justification, majority of studies claimed that the use of the conventional benchmark, the London Interbank Offered Rate (LIBOR) as a reference and guideline (Kantakji, 2003; Mirakhor & Zaidi, 2007) is undesirable from *Shariah* perspective. Therefore, this is a major challenge to Islamic financial instruments valuation which raises question on the legitimacy of *Sukuk* hence requires to be disclosed accordingly (Usmani, 2009; Wilson, 2008; Nanaeva, 2010; Herwany & Febrian, 2010; Aloui, Hammoudeh, & Hamida, 2015). Based on this literature, the following hypothesis has been developed: *H1: There is a positive relationship between pricing and the Shariah disclosure on Sukuk.*

Shariah Supervisory Board

In line with *Shariah* principles Islamic financial institutions are engaged in product development activities to cater for the needs of a wide range of parties. It is essential for these financial institutions to operate and innovate within the ambit of Islamic law (Ahmed, Islam, & Zuqibeh, 2013). Hence, the need for supervision is an integral part of any institution that deals by the name of Islamic economy. The safeguard to make Islamic financial institutions perform their dealings according to the *Shariah* comes when there is a legitimate control body in the bank (Lahsasna, 2010). It is vital for such financial institutions to form a *Shariah* Supervisory Board (SSB) consisting of *fiqh muamalat* experts to guide their transactions and operations in accordance with the *Shariah* principles. Malaysia and other countries have passed laws to govern the functions of *Shariah* board. Therefore, *Shariah* Board undoubtedly forms the most influential and important entity in any Islamic financial institution (Malik, 2010).

The role of *Shariah* Board members is to review the transactions and operations activities, supervise its development of Islamic business activities, and determine the compliance of these activities with *Shariah* principles (Ahmed, El-Morabit, & Islam, 2017). SSB has to carry their own independent audit relating to any of the transaction involving any element that is forbidden by Islamic law (Ahmed, Islam, & Al-Harthy, 2013). The *Shariah* boards have both consultative and supervisory functions. Since the *Shariah* scholars on the *Shariah* committee carry great responsibility, it is important that only high caliber scholars are appointed to the SSBs (Yean, 2009; Laldin, 2008; Lahsasna, 2010; Rahail, 2011).

Islamic financial institutions are required to establish operating procedures in order to ensure that neither investments nor business activities are undertaken without being approved by the SSB (Ahmed, Islam, & Zuqibeh, 2013). The management is required also to periodically report and certify to the *Shariah* board that the actual undertaken business investments conform to the forms are preapproved by the SSB (Lahsasna, 2010). Islamic financial institutions that offer instruments, tools, products and services complying with *Shariah* principles must, therefore, be governed by the *Shariah* board that acts as an independent SSB comprised of at least three *Shariah* scholars with specialized knowledge of the Islamic laws for operating, *fiqh al muamalat*, also knowledge of modern economics and business (Malkawi, 2014). They are responsible primarily to ensure that investments, business activities, services offered and other financial institution transection comply with the *Shariah* rules. The SSB is required to issue independently a Shariah report of the *Shariah* compliance (Malik, 2010).

According to DeLorenzo (2010), *Shariah* advice and supervision should be included at the earliest stages, if elements of the proposed business activities and contracts need to be modified to comply with *Shariah* rules and precepts. Moreover, once an activity is launched, *Shariah* supervision may take the form of ongoing monitoring through periodic audits. Such audits may be undertaken by document reviews, site visits, or consultation with management at regular times and intervals.

It is essential that all dealings and business activities must avoid Haram [(4)] and also should comply with the principles of Islamic law. For example, Muslims are required to deal in Halal business activities because "*Shariah* is a body of legal rules derived from Quran, the teachings of prophet Muhammad (PBUH) and interpretations of those teachings by *Shariah* jurisprudential scholars" (Masudi, 2005). In general, *Shariah* seeks to bring benefits to the community and the individual, and its laws are designed to protect these benefits and to facilitate the perfection and improvement of the conditions of human life on earth (Kamali, 2009). Almighty Allah says: *"We have not sent you but as a Mercy to the worlds" (21:107),* which means that Quran singles out Mercy as the most important purpose of the Prophethood of Muhammad (PBUH): This can also be seen in the Quran's characterization of itself as "a healing to the (spiritual) ailments of the hearts" and "a Guidance and Mercy" for the believers and mankind (10:57). Muslim scholars have, thus, considered Mercy to be the all-pervasive objective of the *Shariah*, which is considered in all intents and purposes to imply the benefit of interest (maslaha).

According to the AAOIFI Governance Standard for Islamic Financial Institutions (GSIFI) No. 1, an SSB is an independent body of specialized jurists in *Fiqh Muamalat*. AAOIFI has stated that an SSB shall consist of at least three members (AAOIFI, 2010). The role of the SSB covers five main areas: certifying permissible financial instruments through fatwa (ex-ante *Shariah* audit), verifying that operations comply with issued *fatwa* (ex-post *Shariah* audit), calculating and paying Zakat, disposing of non-*Shariah* compliant earnings, and advising on the distribution of income or expenses among stakeholders and investment account holders. The SSB issues a report to certify that all financial operations comply with the above-mentioned rules (Lahsasna, 2010).

The SSB plays a very important role since many institutions have their own separate committee of *Shariah*, and this will give and facilitate the public confidence of their operations. SSBs have direct relation to the investments and business activities (Ahmed, El-Morabit, & Islam, 2017). Scholars and index providers who defined the different *Shariah* strategies can be considered as major contributors as the most qualified *Shariah*

[(4)] Haram (Arabic: حَرَام ḥarām) is an Arabic term meaning "forbidden" or lawful in traditional Islamic law.

scholars, and this will show the importance to an organization to have an SSB (Derigs, & Marzban, 2009). It is an imperative that the SSBs consist of Muslim scholars, and their main objective is to check to ensure the banking practices are aligned or can be aligned with the principles of *Shariah* (Grassa, 2013). The SSB continues to evaluate banking practices through extensive meetings and discussions, whereupon the level of *Shariah* process of implementation in IFIs is expected to continue to improve.

In the existing body of literature a number of studies were found to support the above-mentioned discussion. For instance, AAOIFI, (2008) studied the observations and difficulties raised concerning *Sukuk* issuance. The study recognized that the SSBs' role is not merely to issue a fatwa on the permissibility of the *Sukuk* structure after having examined all the applicable contracts and documentation associated with the actual transaction, that their role is broader than that in that the SSBs have oversight of the actual process of implementation, and ensure that at every stage the operation complies with the guidelines and requirements of *Shariah*, as duly noted in the *Shariah* standards.

A study examined broadly any controversy and problems concerning *Sukuk*, and specifically the observations made by the *Shariah* Board of AAOIFI and its resolutions (Yean, 2009). The study determined that the SSBs have a more crucial role to undertake. Accordingly, the SSBs ought to be involved in the structure of the transactions, including providing guidance in the drafting, reviewing and approval of the documentation for compliance of *Shariah* transactions to ensure the fit of the documentation with the requirements of compliance with the desired outcome of consistency, certainty and transparency of the process of enforceability of these transactions.

In that regard a study, in the Malaysian *Sukuk* market context, examined the SSBs' role and the IFIs' practices prior to and after the issuance of *Sukuk*. The study claimed that *Shariah*-related challenges emerged directly after the issuance of *Sukuk* had taken place in that the practices may not adhere to the SSB fatwa. Indeed the study indicated that the majority of *Sukuk* customers sought a simple structure similar in nature to the conventional products with the minimal levels of liability, risk and cost.

A study undertaken by Casper (2012) examined the SSBs' functions and *Shariah* compliance on corporate governance in the context of institutions in Europe. Casper recommended that potential investors and holders of *Sukuk* ought to obtain independent advice and proposed that in examining whether products comply with the principles of *Shariah*, this can be done by consulting their own *Shariah* advisors or a comparable source which is reliable. As part of the process of discovery, an investor is often aware and acknowledges that the prospective yield of profit of a product which is *Shariah*-compliant might be at a lesser rate than that of the market standard. In this study there are two reasons for selecting the SSB method: The first was based on the literature where many researchers considered the SSB to have higher influence on Islamic *Sukuk*, while second was the lack studies on the relation between SSB and *Sukuk* (Ahmed, Islam, & Ku Ariffin, 2015; Laldin,2008; Lahsasna, 2010; Rahail, 2011). Based on this literature, the following hypothesis has been developed: H2: *The effect of pricing benchmark on Sukuk Shariah* *disclosure is strong when the collective knowledge and the decision-making of the Shariah Supervisory Board Members are stronger.*

Disclosure of *Shariah* Compliance

According to Sulaiman (2001), religion is generally considered a crucial part of some cultures. Particularly for Muslims, Islam affects the way in which Muslims conduct their lives, including their involvement in business activities. Hence, Islam's impact on accounting and economics is noticeable. Islam has more influence on accounting at the level of disclosure rather than the measurement of financial reporting, as the basic accounting measurement techniques are fundamentally similar to the conventional system (Baydoun & Willett, 1997). Consequently, from an Islamic perspective the emphasis will be on proper disclosure rather than the measurement techniques. The Islamic perspective of disclosure is based on two general requirements of Islamic accounting: the concept of social accountability; and the full disclosure concept (Baydoun & Willett, 1997, 2000; Haniffa & Hudaib, 2007).

The concept of the unity of God is an important concept in Islam. The belief that there is only one ultimate creator leads to the notion that the ultimate creator has absolute ownership and human beings are merely trustees in this world. As trustees, man is responsible for God's other creations, and will be accountable for his actions in the hereafter (Baydoun & Willett, 1997; Maali, Casson, Napier. 2006). Therefore, in Islam, man's accountability includes the accountability to the community and the environment. Thus, in Islamic accounting organizations, banks for example ought the society full disclosure of the financial reports that reveals the accountability of the bank. (Baydoun & Willett, 1997).

The social accountability concept in Islam has resulted in the concept of full disclosure, whereby the community has the right to know about the effects of the organizations' activities and operations on their society (Baydoun & Willett, 1997; Maali et al., 2006). Therefore, the concept of conservatism of information disclosure has no place in Islamic accounting in accordance with the findings of Alam (1998). Baydoun and Willett (1997, 2000) argued that full disclosure does not mean to disclose information to the last detail, but to disclose everything that is of importance to users. Similarly, Haniffa and Hudaib (2007) argued that the full disclosure of relevant and reliable information should assist external users in making both economic and religious decisions, in addition to assisting management in fulfilling their accountability to God and to society. Based on the social accountability and full disclosure concepts, users of the annual reports from *Shariah* approved companies may expect voluntary disclosure of relevant information, particularly Islamic-related information as discussed below. This information forms a basis for developing the Islamic items in the disclosure index.

Ibrahim, Wirman, Alrazi, Nor, and Pramono (2004) argued that the disclosure of *Shariah* compliance is one of the fundamental Islamic accounting objectives. Thus, this information should be disclosed voluntarily, even though it may not be required mandatorily. The information about *Shariah* compliance is similar to that in the *Shariah* Supervisory Board

(SSB) report in the case of IFIs. However, since some *Shariah*-approved companies do not have SSBs, the information on *Shariah* compliance is based on the Board of Director's declaration. *Shariah*-approved companies are presumed not to be involved in non-permissible activities or operations. However, should *Shariah*-approved companies be involved in prohibited activities, minimally (as allowed by the *Shariah* Advisory Council), it is the company's responsibility, based on social accountability and full disclosure, to disclose information about these non-permissible elements. This can help users understand how amounts generated from such activities are disposed, and to monitor a company's efforts to reduce involvement in such activities in the future. In addition, previous studies such as Haniffa and Hudaib (2007) and Maali et al. (2006) claimed that IFIs and their insights are very useful for improving disclosure in the *Shariah* Board's report of the Islamic financial tools. They mentioned that improving disclosure concerning *Shariah*-compliance is inevitable not only to distinguish amongst the Islamic financial products themselves but also with that of the traditional financial institutions (Ahmed et al., 2013).

4. The Sukuk Market in Malaysia

Presently, more efforts have been directed towards the development of the Sukuk market which has now increased to such a state that it encompasses in excess of fifty percent of the bond market in Malaysia (Ahmed, Amran, Islam, 2017). This situation has been made possible through the participation of international corporations and multilateral agencies that have raised substantial amounts of funds and invested in the Sukuk issuances outside Malaysia (Jobst, Kunzel & Mills, 2008). In lieu of *the* foreign participation, proportionally continuous innovation has been witnessed and an increasing number of issuances in foreign currency have occurred. Zeti Akhtar (2010) vowed that Malaysia offers international participation in the Islamic financial system, opening up an international gateway, leading to strengthening the link between the two important dynamic growth regions of Asia and the Middle East.

This cooperation involved Malaysia actively collaborating with the Islamic Financial Services Board (IFSB), the Islamic Financial Stability Forum (IFSF), the Islamic Development Bank (IDB), and the International Islamic Liquidity Management Corporation (IILMC). In addition, secondary trading in the Malaysian Sukuk market has increased the depth and liquidity of the market with the participation of more companies, including foreign-owned companies which continued to use this market for funding purposes (Bin Ibrahim & Wong, 2006). Naturally, a large number of corporate issuance serves to finance long-term funding needs. In practice, it helped to create an energetic secondary market due to the diversity and size of the Sukuk transactions, which possess an increasing value proposition that is appealing to investors out to vary their asset portfolios (Tariq, 2004).

Apart from that, the Malaysian Sukuk market has also developed sufficiently to innovatively and sophisticatedly handle the varied risk-return profiles and requirements of both issuers and investors (Wedderburn-Day, 2010). In order to encourage the participation of both local and foreign investors in the market, the propagation of new types of instruments with extended maturity profiles have been put into operation by the *Sukuk* issuers (Zin, Sakat, Ahmad, Bhari, Ishak & Jamain, 2011). In 2005, the Malaysian government threw in more support by liberalizing the market to allow for issuance of debt securities by foreign corporations and multilateral agencies in Ringgit denominated papers (Hamid, 2000). Subsequently, the issuance of debt securities was extended to foreign currency denominated issuances in 2007. As a result, many foreign corporations, multinational corporations and multilateral agencies began to raise funds and invest in issuances and originations out of Malaysia (Zin, Hashim, Khalid, Opir, and Sulaiman, 2011). This indirectly strengthened the Malaysian market and simultaneously forged stronger bonds with other international financial markets. On the whole, this illustrated the government's efforts to transform the Malaysian economy into a more diversified and private sector driven economy through the development of the *Sukuk* market in Malaysia (Zaid, 2011).

This diversification reflected the government's effort to transform a market dependent on its debt securities into long-term financing requirements for the private sector. This move has certainly boosted the market capitalization of the private sector in Malaysia. The debt securities and *Sukuk* market helped to meet the financing requirements from one-third, ten years ago, to almost three-fifths currently. More significant and liquid debt securities as well as *Sukuk* markets have directly helped to stabilize the financial system. Therefore, Malaysia has the world's largest *Sukuk* market with the total of *Sukuk* issues standing at 58.1 percent, or USD 308 billion of the total global outstanding amount at the end of 2015. Last year, the total global *Sukuk* outstanding was a little over $300 billion with Malaysia accounting for more than half of the total at $173 billion. Saudi Arabia came in second, making up 16.7 percent of the total global *Sukuk* outstanding.

Interestingly, Malaysia possesses the most developed *Sukuk* market in terms of total *Sukuk* issuance and also the introduction of innovative *Sukuk* structures which are competitive enough to attract more investors (Ab Majid, Shahimi & Bangaan, 2010). Furthermore, Malaysia aims to promote Malaysian debt security market and increase the capital market investment options offered. As a result debt securities and *Sukuk* has been listed on Bursa Malaysia under exempt regime by both listed and non-listed issuers for *Sukuk* that are issued, offered or subscribed in accordance with section 229(1) and section 230 (1) of the Capital Markets and Services Act 2007 (CMSA). This regime enables institutions and investors to enhance the transparency of *Sukuk* issued, as well as offering profiling opportunities for the instrument issuers. It allows any currency denominations by either listed or non-listed local or international entities but is subjected to the rules of Bursa Malaysia Listing Requirements which is comparable with other Exchanges that provide similar listing facilities. In short, the *Sukuk* market has developed into the most successful Islamic financial product in the financial industry and among the global finance sectors; it is one of the fastest-growing sectors (Zin et al., 2011).

The Institutional Theory

Meyer and Rowan (1977) stated that the institutional theory is a theory that is extremely useful because it helps give an explanation as to why an SSB reports the way in which it does. Institutional consistency, as mentioned by DiMaggio and Powell (1991), is a mechanism whereby practices of an organization are adopted by other organizations facing the same institutional pressures. Moreover, it has been demonstrated that this kind of consistency is based on the source from which such pressures are derived. Kasim (2012) explained that this consistency essentially has a relationship with organizational behavior with the regulative and political impacts for certain institutions like policies, and government regulators further to their regulations. Kasim also illustrated that simulation consistency uses the same set of practices used by successful organizations in order to reduce uncertainty and to normalize the consistency means of complying with the norms and expectations of professional bodies and society in general.

A research by DiMaggio (1998) explained that the institutional theory has much to contribute to the study of religious organizations, focusing on the idea of ritual, symbolic understandings and legitimacy. According to him, institutional theory is relevant and similar with the objectives of the religious organizations as normal business organizations tend to concentrate more on "rational actors", an image focusing on profit maximization. Osman, Alwi, Mokhtar, Ali, Setapa, Muda, and Rahim, (2015) studied the corporate image in Islamic banks based on the institutional theory. The study found that institutional image such as being Islamic, humble and trustworthy will lead towards other values and images of performance. Aziah Abu Kasim, (2012) utilized the institutional theory to underpin the examination of the disclosure of Shariah compliance as reported by the SSBs in the annual reports of takaful (cooperative system of reimbursement) companies in Malaysia. The findings of the study indicated a similarity in the reports of the Shariah Boards, not only in relation to the Bank Negara Malaysia guidelines but also with that of other takaful companies. Furthermore, the concept of isomorphism drawn from the institutional theory is useful and is used in the Shariah Board reports. Ahmed, et al., (2014) mentioned that the institutional theory is useful for the disclosure practices in the pronouncement of Shariah in IFIs. He noted two essential reasons. It relies on and uses the institutional theory because the concept of consistency is derived from such theory, as well as a clear similarity among all IFIs including the generation of reports by the Shariah Boards and guidelines from the central banks. Therefore, the current study relies on these two essential reasons, and uses the institutional theory to underpin the discussion on its findings because there is a clear similarity among IFIs including the pronouncements of the SSBs and the guidelines of the central banks, as well as the concept of consistency derived from such theories.

5. Methodology

This paper aims to investigate and detect *Shariah* disclosure on *Sukuk* in *Shariah* pronouncements. The study was conducted on population of the Islamic financial institutions in Malaysia. The quantitative data were collected from the *Shariah* reports of the identified *Sukuk*. The population of this study is the *Sukuk* issuance under the Exempt Regime in Bursa Malaysia. SC and BNM have been listed as *Sukuk* on the Bursa Malaysia list under the exempt regime in accordance with section 229 (1) and section 230 (1) of the Capital Markets and Services Act 2007 (CMSA). In order to enhance the level of transparency for investors, offers providing valuable profiling opportunities for issuers of the instruments are of significance. The population size in this study consists of 54 *Sukuk* approved by the SC and registered in the Bursa Malaysia, and this represents a full sample for eleven consecutive years for the period from 2005 to 2013. This period was chosen as the first available *Sukuk* data under exempt regime in Bursa Malaysia in 2005. Therefore, the entire population was able to be studied without having to take smaller samples for the analysis. SPSS (Statistical Package of Social Science) will be used in the analysis of the data. The primary source of the sample *Sukuk* is from the Bursa Malaysia required *Sukuk* reports and requirements (Announcements, Offering Memorandum, Principal Terms and Conditions, *Shariah* Pronouncement and Rating Reports) for internal and external users. Furthermore, for this research endeavor it comprised the 54 listed *Sukuk* reports under the exempt regime in Bursa Malaysia. Thus, the types of information available in relation to *Sukuk* legitimacy ought to be relatively consistent in nature.

5.1Variables Measurement

Dependent Variable: To measure *Shariah* disclosure on *Sukuk*, the current study used content analysis as a way for measuring *Shariah* disclosure, where the literature review shows that this way is employed in social disclosure (Abdul Rahman, Hashim, & Bakar, 2010; Maali et al., 2006; Gray, Kouhy, & Lavers, 1995).

Several previous studies were done to develop a relevant list of social information that must be disclosed by Islamic financial institutions. Yet, a few empirical studies have developed disclosure index (see appendix A) with *Shariah* compliant information, particularly for Islamic financial institutions (Haniffa and Hudaib, 2007; Maali et al., 2006; Muwazir et al., 2006).Therefore, the present research is the first to take in its account the using of three new parts as new structures that compose the SSB report: structure and mechanisms of *Sukuk* legitimacy; *Sukuk* documentation and the last lies in *Shariah* compliance. The nature of disclosure is categorized as either qualitative or quantitative, and the incidence of occurrence (i.e., number of sentences) is generally noted. The sentences count reveals the proportion of space allocated for a given element, since each 'information' is competing for its right of space in the *Shariah* reports. A *Sukuk* legitimacy overall index is calculated according to the total amount of information disclosed.

The proportion of the *Shariah* disclosure average is calculated from equation 4.1:

$$C = \frac{P(A)}{P(B)}$$

Where, C is the average of *Shariah* disclosure, P (A) is the number of sentences and P (B) is total of sentences for each *Shariah* report.

Pricing benchmark: The Islamic pricing is considered as the benchmark model to estimate the rate of any *Sukuk*, while considering any expected future cash flows, which is relative to invested capital. The future cash flows are supposed to take into account the economic conditions prevailing (i.e. growing or recession), and other prevailing factors (Kantakji, 2012). The *Shariah* reports contain the content on disclosures about *Sukuk* pricing, which are dependent on Islamic benchmarks (such as the Dow Jones or *Shariah* global equity) or are according to the rate of return or are based on non-Islamic benchmarks (LIBOR, KLIBOR etc). However, the current study contributes to measuring the pricing of *Sukuk* based on Islamic benchmarks or conventional benchmarks, which is disclosed in the *Shariah* report details.

Shariah Supervisory Board: (SSB) measurement is based on numbers of SSB committees members (Rahman, & Bukair, 2013). The common number of SSB members in an Islamic financial institution is three, which is in line with the AAOIFI standards. A greater number of members in an SSB or number of SSBs would provide more effective monitoring and more consistency with the principles of *Shariah*. According to Chen and Jaggi (2000), a larger size of the committee may reduce the possibility of information asymmetry. Therefore, a higher size of members of the committee may also reduce the ambiguity and the lack of information (Birnbaum, 1984). Such information needs to be disclosed in the annual report for shareholders to be more confident in dealing with Islamic financial institutions.

6. Result

6.1 Descriptive Statistics on *Shariah* Disclosure

Table 1.1 reports on Shariah disclosure on *Sukuk* in Islamic financial institutions. The percentage of *Shariah* disclosure was between 0.16-0.92 percent. There are 15 *Sukuk* that have Shariah disclosure between 0.16-0.38 percent, 13 *Sukuk* which have Shariah disclosure between 0.39-0.63 percent, 14 *Sukuk* which have *Shariah* disclosure between 0.64-0.73 percent, and only 2 *Sukuk* that have Shariah disclosure of 0.74-0.90 percent. Based on the content analysis, 72% of *Sukuk* issued in Malaysia between 2005-2013 conformed to *Shariah* principles. The rest, which stood at 28%, was found to have been lacking *Shariah* conformity.

Table 1.1: Statistics of *Shariah* Disclosure

Shariah Disclosure	Frequency	Percent
Valid .16 to .38	16	29.6
.39 to .63	12	22.2
.64 to .73	14	25.6
.74 to .92	12	22.2
Total	54	100.0

Descriptive Analyses of Pricing

Table 1.2 shows that out of the 54 selected *Sukuk*, 41 *Sukuk* (i.e. 75.9 percent) have *Shariah* Pricing compared to 13 *Sukuk* (24.1percent) with Non-*Shariah* Pricing. The descriptive statistic showed that most of the Islamic *Sukuk* in Malaysia has a *Shariah* majority of pricing.

Table 1.2: Pricing Benchmark

	Frequency	Percent

SH-PRICING	41	75.9
Non-SH PRICING	13	24.1
Total	54	100.0

6.2 Number of Members of *Shariah* Supervisory Board

Table 1.3 describes the percentage of Number of Members of SSBs in *Sukuk*. The descriptive statistic showed that only 11 *Sukuk* have one member of SSBs at 20.4 percent, while 9 *Sukuk* had 6 members of SSBs with 16.7 percent, 7 *Sukuk* have 2 members of SSBs at 13.0 percent, 6 *Sukuk* have 3 members of SSBs at 11.1 percent, 5 *Sukuk* had 8 members of SSBs at 9.3 percent, 4 *Sukuk* had 4 and 5 *Sukuk* at 7.4 percent, only ten *Sukuk* had 2 members at 3.7 percent, and 9 *Sukuk* had 9 members at 5.6 percent. This result is consistent with an empirical study done by Akhtaruddin, Hossain, and Yao, (2009) and Chaganti, Mahajan, and Sharma (1985) who mentioned that the SSBM board size can affect controlling, monitoring and the level of disclosure. A greater number of members in an SSB would provide more effective monitoring and more consistency with the rules and principles of *Shariah*. According to Chen and Jaggi (2000), a larger size of the board may decrease the possibility of information asymmetry. In addition, a higher number of members of the board may also reduce uncertainty and the lack of information (Birnbaum, 1984).

Table 1.3: Number of Members of *Shariah* Supervisory Boards

SSBMs	Frequency	Percent (%)
Valid 1	11	20.4
2	7	13.0
3	6	11.1
4	4	7.4
5	4	7.4
6	9	16.7
7	3	5.6
8	5	9.3
9	3	5.6
10	2	3.7
Total	54	100.0

Table 1.4 describes the percentage of the number of members in the SSB in the selected *Sukuk*. Results showed that only 19 *Sukuk* had an SSB with less than 3 members with percentage of 35.2 and 35 *Sukuk* had an SSB above 3 members with a percentage of 64.8. The descriptive statistic showed that a majority of the *Sukuk* in Malaysia has a number of members in SSBs above 3.

Table 1.4: Number of Member of SSB

SSBM	Frequency	Percent (%)
Less than 3	19	35.2
Above 3	35	64.8
Total	54	100.0

6.3 Descriptive Statistics of *Shariah* Disclosure on *Sukuk*

Table 1.5 reports on *Shariah* disclosure on *Sukuk* in Islamic institutions. The percentage of *Shariah* disclosure was between 0.16-0.92 percent. There are 15 *Sukuk* having *Shariah* disclosure between 0.16-0.38 percent; 13 *Sukuk* having *Shariah* disclosure between 0.39-0.63 percent; 14 *Sukuk* having *Shariah* disclosure between 0.64-0.73 percent, and only 2 *Sukuk* having *Shariah* disclosure 0.74-0.90 percent. The descriptive statistic showed that most of the *Sukuk* in Malaysia have a majority of *Shariah* disclosure. The positive association that the current study observed between pricing benchmmark and Shariah disclosure is consistent with the study of Ahmed et al. (2015), which found that Sukuk that uses a *Shariah* pricing benchmark generally has a high level of legitimacy. Likewise, this result is consistent with Nanaeva (2010) and Aloui et al, (2015), who claim that Islamic pricing benchmark is preferred to have high effect on *Shariah* compliant *Sukuk*. This finding demonstrates that *Shariah* pricing benchmark may be used as a tool of pressure on SSB to follow the higher *Shariah* compliant levels and consequently enhance *Sukuk* legitimacy. A study in Malaysian context done by Hayat and kraeussl (2011) showed evidence of a positive relationship between Islamic pricing benchmark and Islamic equity funds (IEFs). Another study by Ahmed et al., (2015) tested the relationship between pricing and legitimacy of *Sukuk*. The study also found a strong positive relationship between pricing and legitimacy. This finding is supported by Usmani (2009) who argued that the interest rates used as a benchmark is not in accordance to Shariah requirement, a claim that is echoed by Islamic scholars as well. Thus, it was recommended that corporate *Sukuk* ought to be benchmarked against the financial institutions' performance indicators instead.

Table 1.5: Statistics of *Shariah* Disclosure

	Frequency	**Percent**
Valid .16 to .38	15	28.1
.39 to .63	13	24.4
.64 to .73	14	26.2
.74 to .92	2	21.3
Total	54	100.0

6.4 Correlation Analysis

It determines how well the estimated equation actually describes the relationship. The correlation between the dependent and independent variables is shown in Table 1.6. The report showed that pricing has a high positive relationship with *Shariah* disclosure on *Sukuk* with values .745.

Table 1.6: Correlations between variables

	Pricing benchmark	*Shariah* Disclosure
Pricing benchmark	1	
Shariah Disclosure	.745**	1

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

6.5 Regression Analysis

In order to test hypothesis (H1) that postulated positive relationship between pricing benchmark and *Shariah* disclosure on *Sukuk*, there was one step of hierarchical regression equation that was carried out. In step one, the independent (predictor) variables were introduced to test their marginal effect on the dependent variable.

A report on Table 1.7 with R square value of .805 for *Sukuk* legitimacy, the R square (not adjusting R square) value is explaining 80.5% from independent variables (pricing benchmark) on dependent variable (*Shariah* disclosure).

Table 1.7: R Square of *Shariah* Disclosure

Model	*Shariah* Disclosure
R Square	.805
Sig F Change	.000

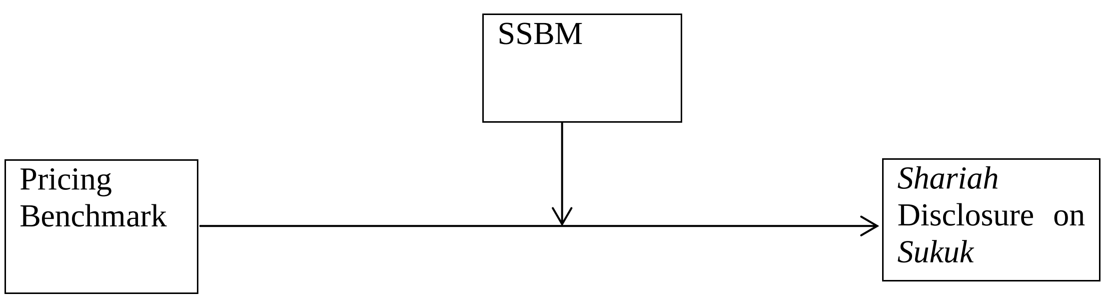

Figure 1: Research Model

Table 1.8 was found that pricing has a positive relationship with the *Shariah* disclosure, (pricing benchmark .246). The result showed that the pricing benchmark has a significant impact on *Shariah* disclosure where it was at $P<0.01$, $\beta=0.246$. It shows that the larger *Shariah* pricing the higher legitimacy of *Sukuk*. Therefore, hypothesis (H1) has been supported. This result gives support for the assertion that the *Sukuk* characteristics leads to the creation of *Shariah* disclosure on *Sukuk*. Thus, the higher the usage of *Shariah* pricing benchmark, the higher compliance with *Shariah* rule.

Table 1.8: Regression Result: Relationship between Pricing and *Shariah* Disclosure

Shariah Disclosure	
Standardized Coefficients	
Independent Variable	Beta
Pricing benchmark	.246

In this study the hypothesis that was set before the analysis shows acceptance for the variables proposed in this study, the hypothesis was supported.

7. Discussion

7.1 The Impact of *Sukuk* Pricing on *Shariah* Disclosure

Pricing is one of the most important factors that impacts the *Shariah* disclosure on the *Sukuk*. The pricing is another point of criticism against Islamic *Sukuk* (Usmani, 2002). *Shariah* scholars and Muslim economists have not come up with an alternative to the interest rate as a readily available indicator of profitability (Al-Bashir, 2008). Hence the use of LIBOR as a benchmark has become part of the practice in Islamic financial institutions. The factors for computing pricing benchmark should be free from interest rates, non-real economic activities, and non-halal activities such as indices of financial derivatives instruments (Omar, Azmi, Noor & Meera 2010). However, what shall be noted is that while it is permissible to use LIBOR as a pricing benchmark it is not correct to rely on it for determination of returns (Kantakji, 2012). Therefore, pricing of *Sukuk* will be an effect to structure of the *Sukuk* to comply more with rules of *Shariah* and increase the legitimacy of *Sukuk*. Thus, the influence of the *Sukuk* pricing on *Shariah* disclosure was studied. The findings of the study have supported this hypothesis with a relation between *Sukuk* pricing and *Shariah* disclosure indicated by the positive value in the results.

The results showed that 75.9 percent of *Shariah* disclosure based on Islamic pricing benchmark, while 24.1 percent based on non- Islamic pricing benchmark. This finding is consistent with Nanaeva (2010) and Aloui et al, (2015), who claim that Islamic pricing benchmark is preferred to have high effect on *Shariah* compliant *Sukuk*. This finding demonstrates that *Shariah* pricing benchmark may be used as a tool of pressure on SSB to follow the higher *Shariah* compliant levels and consequently enhance Shariah compliance on Sukuk. A study in Malaysian context done by Hayat and kraeussl (2011) showed evidence of a positive relationship between Islamic pricing benchmark and Islamic equity funds (IEFs). Another study by Ahmed et al., (2015) tested the relationship between pricing and legitimacy of *Sukuk*. The study also found a strong positive relationship between pricing and legitimacy. This finding is supported by Usmani (2009) who argued that the interest rates used as a benchmark are not in accordance to Shariah requirement, a claim that is echoed by Islamic scholars as well. This highlights that majority of the *Sukuk* pricing in Islamic financial institutions in Malaysia follow Islamic pricing benchmark. We can be considered a positive relationship between pricing and *Sukuk* legitimacy because there is influence from pricing on structure and legitimacy applied by the Islamic financial institutions. The more compliant with the *Shariah* principles whenever the pricing increase the legitimacy on *Sukuk* through the induction of audit *Sukuk* characteristics to ensure that *Sukuk* compliant with the *Shariah* principles.

7.2 The Moderating Effect of *Shariah* Supervisory Board (SSB)

Hierarchical regression analysis was performed to test the moderating effects of the *Shariah* supervisory board Members (SSBM) on the relationship between pricing benchmark and *Shariah disclosure*. The moderated regression technique was established by Baron and Kenny (1986). To test hypothesis (H2), a three-step hierarchical regression was conducted for each moderator. In the first step, the independent variables were entered, the moderating variable was entered in the second step, and lastly, interaction terms introduced into the equation to test the joint effect of the predictor and the moderator on the dependent variable. The interaction terms were calculated by multiplying the predictor by the moderating variables.

Furthermore, in order to find out whether a moderator is a pure or quasi-moderating, the current study followed the conditions cited by (Sharma et al, 1981). If the coefficient of multiplicative interaction term was significant and the coefficient of moderator variable effect was not significant, the moderator is a pure moderator. However, if the coefficient of both the multiplicative interaction term and the moderator variable are significant, the moderator is a quasi-moderator.

Consequently, each significant moderating effect will be illustrated graphically using a technique recommended by Al-Mawali, and Lam, (2016) to illustrate the nature of moderator effect. This process was carried out for testing the moderating effect of each of the two moderating variables on each relationship that links the five components of determinants with *Sukuk* legitimacy.

Furthermore, the current study splits each component of determinants into groups (low, high) by using the median percentile cut off point to show a significant effect, and *Shariah* supervisory boards into two groups (low and high) by using median. However, the following two subsections show the analysis for the two *Shariah* supervisory board dimensions, and summary of each moderator's effect was presented in the following subsequence to each analysis.

The analysis starts with the testing moderating effect of SSBM on the relationship between pricing benchmark and Shariah disclosure on *Sukuk* as shown in Table 1.9. An assessment on the beta coefficients for interaction terms shows that an SSBM moderates the relationship between only pricing and *Shariah* disclosure on *Sukuk*, the pricing at $p<0.05$, $\beta = .421$. The introduction of the terms made significant increases in model value (as indicated by significant F changes) and raises R square around 8%, and generally the model as a whole is significant ($F= 37.438$, $p<0.01$). However, SSBM shows no moderating effect between the pricing benchmark and *Shariah* disclosure on *Sukuk*. Therefore, this result indicated that hypothesis is not supported. This result implies that *Sukuk* that are governed by a greater number of SSB members are characterized by an adequacy of SSB ensuring disclosure and compliance that may encourage Islamic financial institutions to provide greater monitoring. SSB members must give more attention to their tasks and must audit all structure of *Sukuk* to identify *Shariah* risks. Thus, to increase the *Shariah* disclosure on *Sukuk* and to reduce Shariah risks, the role of Shariah advisors should be enhanced. In conclusion, *Sukuk* that has less *Shariah* disclosure with high number of SSB members are more likely to increase the legitimacy of the *Sukuk*.

Table 1.9 Moderating Effect of SSBM on The relationship between pricing benchmark and *Shariah* disclosure for *Sukuk*

Variables			**DV: *Shariah Disclosure***
	Step 1	**Step 2**	**Step 3**
	Std. Beta	**Std. Beta**	**Std. Beta**
Independent Variables			
Pricing	.246***	.228***	. 096
Moderator Variable			
SSBM		.181**	.599***
Interaction terms			
SSBM*Pricing			.421***
F Value	39.738***	37.248***	73.438***
R2	.805	.826	.907
Adjusted R2	.785	.804	.883
R2change	.805	.021	.081
F change	39.738	5.631	7.371

The SSB members should ensure that all *Sukuk* issuers of the Islamic financial institutions (management, shareholders, employees, suppliers, community and depositors) have full confidence in reading *Shariah* reports about *Sukuk* structure (Farook Hassanl & Lanis, 2011; Haniffa and Hudaib, 2007; Maali et al., 2006). Farook, Hassanl and Lanis (2011) mentioned that the existence of SSB in Islamic financial institutions will improve monitoring and controlling. The previous studies suggest that board size can affect monitoring controlling, and the level of disclosure (Akhatruddin, Hossain, and Yao, 2009; Mahajan Chaganti, and Sharma, 1985). Whilst there are no restrictions on the number of SSBM's, the perfect number should include members between three and seven (Rahman, and Bukair, 2013). The common number of SSBM's in Islamic financial institutions is three members, which is compatible with AAOIFI standards. A greater number of SSB members will provide more effective monitoring and consistency with the principles and rules of *Shariah*. Likewise, a higher number of members of the board will be willing to reduce the lack of information and uncertainty (Birnbaum, 1984).
SSB board's size is likely to affect its ability to audit and review all transactions and operations of *Sukuk* to ensure their structures are in compliance with the rules of *Shariah*.

In addition, the ability of SSB members to audit *Sukuk* that would affect the confidence of investors is much higher with more members on the board. With more members, the collective experience and knowledge of SSB will increase, and consequently, lead to greater *Shariah* disclosure for *Sukuk*. Therefore, this study found that more *Shariah* pricing may enhance the monitoring and contribute towards increased compliance and legitimacy of *Sukuk*. That is, the *Sukuk* having Islamic pricing benchmark and facing a high level of SSBM are more willing to increase their legitimacy and *Shariah* compliance in general.

8. Implication

The findings highlighted earlier lead to several implications. The discussion on these implications will be divided into two perspectives, namely theoretical and practical.

Theoretical Implications: First and foremost, the findings enrich the *Shariah* disclosure for *Sukuk* literature. Furthermore, this study added a new discussion, i.e. *Shariah* disclosure on the Islamic *Sukuk* with its relationship with pricing of Islamic *Sukuk*. Furthermore, it is a novel study since there are no previous studies, as to the author's knowledge that has covered this area from the Islamic finance perspectives.

This study would enlighten the Islamic *Ummah* and contribute to knowledge to provide clarification on the Islamic pricing benchmark for further investigations and with more detailed description of the *Shariah* compliance. Furthermore, this study contributes to both academic and practitioner individuals. The findings may have some policy implications whereby the policy is made (*Shariah* advisory council, Islamic financial institutions management).

The study is intended to increase public awareness for *Sukuk* pricing in the importance of *Shariah* compliancy not only in the form but also in substance. In addition, this study will be give more benefits for Islamic financial institutions in the sense that they should amend some of their regulatory frameworks to push the *Sukuk* market investors to move towards asset backed structure.

Practical Perspective: This study will be useful to financial institutions in taking into consideration the pricing benchmark that will enhance the Shariah compliance on *Sukuk*, since this implies that when factor is properly implemented with *Shariah* rules, the Sukuk Shariah disclosure will be improved. Thus, this improved Shariah disclosure will enhance the structures of *Sukuk* and consequently lead into an improved economy of the country in the long run. *Shariah* Supervisory Board (SSB) should promote importance and attention, and have increased the *Shariah* compliance to Islamic *Sukuk*. The committees of SSB in bank centrals must also look into the importance of increasing the *Shariah* compliance for *Sukuk* and apply it to the Islamic financial institutions. The importance of increase and subsequently attention of legitimacy will also act as guideline for the financial institutions in their *Sukuk* operations. The Islamic financial institutions that increase will know their *Sukuk* structure in conducting their *Sukuk* operations that should not conflict with the *Shariah* and affect the *Sukuk* holders.

9. Conclusion

This study has made a unique contribution to the body of literature concerning the influence of *Sukuk* pricing on the *Shariah* disclosure for *Sukuk* in population of Islamic financial institutions in Malaysia for the period 2005-2013. The results of this study have revealed that the level of *Shariah* disclosure on *Sukuk* in Islamic financial institutions in Malaysia is high in general.
Surprisingly, there is a positive relationship between *Sukuk* pricing with *Shariah* disclosure on *Sukuk*. This study found that there is empirical evidence showing the moderating effect of a *Shariah* supervisory board on relationships between pricing and *Shariah* disclosure for *Sukuk*.

This study tested a research model that conceptualized the influence of *Sukuk* pricing on *Shariah* disclosure for *Sukuk*. The research found that the selected *Sukuk* pricing influence legitimacy could be used as subjects of references in determining the existence of *Shariah* compliance on Islamic *Sukuk*. This is significant for at least three parties, i.e. investors, Islamic financial institutions and the relevant authorities' bodies, to strategize on containing the existence of the *Shariah* compliance in Islamic *Sukuk* by accordingly controlling the selected characteristics, hence producing Islamic financial institutions that are more compliant to the *Shariah*. The focus of the *Sukuk* market and be acceptable to international financial institutions, although these are valid and well needed objectives, but to be *Shariah* compliant first and foremost. This will also help in the growth of real economy.

The limitations of the current study could be discussed from few perspectives. Firstly, one of the limitations of this study is that it is dependent on *Shariah* pronouncements (*Shariah* reports) to examine the *Shariah* disclosure. Other studies may choose to review different types of reports that include disclosure information. Secondly, the sample size of this study is the *Sukuk* issuance listed on the Bursa Malaysia under Exempt Regime. Hence, future studies may choose to apply the research in other countries in Middle East, such as UAE, Saudi Arabia or Qatar. Thus, for future research there is a need to examine whether the same results can be achieved by examining these variables in different countries that have different Islamic accounting standards. It is recommended that future studies are undertaken with IFIs in other countries to compare the findings. Nonetheless, although the results of this study presented a reasonable structure for *Shariah* disclosure on *Sukuk*, there is need for more research in order to confirm these results in other contexts

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Appendix A: Categorization of the List of Items Included in the Classification Index (Legitimacy disclosure of *Sukuk*)

	Items	Sources			
	Structure and Mechanism of *Sukuk* Issue Based on the *Shariah* Principle	SC, (2011)	AAOIFI., (2012)	Maali *et al.* (2006)	Haniffa Hudaib (2007)
1	*Shariah* opinion on the lawfulness of the purchase of assets.	√	√	√	√
2	View of the *Shariah* Board on lease of assets.	√	√	√	
3	Present details of purchase, substitution and redemption undertaking.	√	√		
4	Appointment of a Servicing Agent	√	√		
	***Shariah* Ruling and Considerations (Important Highlights)**				
5	Financial Ratio Test (Islamic market index)	√	√		
6	Utilization of proceeds.	√	√		
7	Waiver of interest and exchangeable *Sukuk* features.	√			
8	*Wakalah* Agreement	√	√		
9	Business Activity Test (non *Shariah*-compliant) alcohol, tobacco, pork-related products, Conventional financial services (banking, insurance, etc.), weapons and defence, and entertainment (hotels, casinos/gambling, cinema, music, pornography etc.)	√	√	√	√
	***Shariah* compliant (Approval)**				
10	The view of the *Shariah* Adviser in relation to the prevailing circumstances, the structure and mechanism.	√	√		
11	Agreement of the *Shariah* Adviser to approve the documents for the *Sukuk* structure.	√	√		
12	The legal constraints under which the proposed *Sukuk* is being developed.	√			
13	View of the *Shariah* Adviser to develop the Islamic *Sukuk* issuance.	√			√
14	View of the *Shariah* adviser for the removal of *riba.*	√			