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(AIJBES)**www.gaexcellence.com/aijbess**RISK DIMENSIONS IN SUKUK STRUCTURES:
A CONCEPTUAL FRAMEWORK OF UNDERLYING
SHARIAH CONTRACTS**

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Abstract:

The growth of the sukuk market in Malaysia has increased the need for a comprehensive understanding of risk characteristics associated with different Shariah-based structures. However, existing sukuk risk studies classify risks into general categories without sufficiently explaining how risk exposures differ according to the underlying Shariah contracts. This study addresses this conceptual gap by examining the contract-specific risk dimensions embedded within sukuk structures in Malaysia. Grounded in Islamic Contract Theory (*Fiqh al-Mu'amalat*), Agency Theory, and the Risk-Sharing Paradigm of Islamic economics, this conceptual study analyses the contractual characteristics and risk exposures of major Shariah contracts used in Malaysian sukuk, including ijarah, musharakah, mudarabah, murabahah, wakalah, istisna', and hybrid structures. Hence, the study proposes the Shariah Contract-Specific Risk Categories (SCSRC) framework, which maps Shariah contracts with their corresponding risk profiles and mitigation mechanisms. The findings demonstrate that sukuk risk is fundamentally contract dependent. The study further highlights the importance of contract-specific mitigation strategies, including strengthened Shariah governance, enhanced disclosure practices, asset segregation, and appropriate credit enhancement mechanisms. The proposed SCSRC

framework is expected to contribute to Islamic capital market literature by providing a structured approach for assessing sukuk risk from a Shariah contract perspective. It provides a practical reference for regulators, issuers, Shariah advisors, rating agencies, and investors to enhance risk assessment, strengthen governance, and improve sukuk structuring, thereby supporting the sustainable development of Malaysia's sukuk market. This study contributes to SDG 9 by supporting resilient financial infrastructure, promoting innovation in sukuk structuring, and strengthening the sustainability of Malaysia's sukuk market through contract-specific risk assessment.

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Islamic Capital Market, Risk Exposure, Shariah Contract, Sukuk Risk, Sukuk Structure



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Introduction

Malaysia is a leading player in the global Islamic capital market, contributing approximately 60 percent of global sukuk issuance as of November 2024 (IFSB, 2023; StashAway Malaysia, 2025). Over the past three decades, its sukuk market has evolved into a well-established ecosystem comprising sovereign, corporate, infrastructure, and Sustainable and Responsible Investment (SRI) sukuk. The market is supported by a comprehensive regulatory framework through the Securities Commission Malaysia (SC), including the Guidelines on Sukuk, the Guidelines on Islamic Capital Market Products and Services, and rulings issued by the Shariah Advisory Council (SAC) (SC, 2024). According to AAOIFI (2021), sukuk represent undivided ownership in tangible assets, usufructs, services, or investment activities, distinguishing them from conventional bonds, which represent debt obligations. Since sukuk are structured based on underlying Shariah contracts, each structure exhibits unique contractual characteristics and corresponding risk exposures (Mahadewi, 2024). For example, wakalah sukuk offers greater structural flexibility, while ijarah sukuk relies more heavily on the creditworthiness of the underlying lessee, resulting in different risk profiles (Malaysian Rating Corporation (MARC), 2022).

Recent studies have examined sukuk risk from different perspectives. Mohd Noor et al. (2024) found that Malaysia's sukuk market is highly responsive to macro-financial stability, while Alhammadi, Archer, and Aloumi (2024) examined sukuk risk from the issuer's perspective. However, existing studies generally classify sukuk risk into broad categories, such as credit, market, liquidity, operational, and Shariah non-compliance risk, without systematically differentiating risk according to the underlying Shariah contract (Alhammadi et al., 2024; Hasan, Ahmad, & Parveen, 2019). This represents an important conceptual limitation because

different Shariah contracts inherently generate different risk characteristics. For instance, murabahah sukuk primarily faces credit and Shariah compliance risk, whereas musharakah sukuk is more exposed to equity-related capital risk arising from its profit-and-loss sharing arrangement. Likewise, agency risk is more prominent in wakalah sukuk than in ijarah sukuk. The importance of contract-specific risk assessment is reflected in several Malaysian and international sukuk cases. The insolvencies involving Menara ABS Berhad, MEX II Sdn. Bhd., and Serba Dinamik Holdings Berhad demonstrate how contractual structures may contribute to governance and structural weaknesses (Mohd Shahid et al., 2025). Similarly, the Dana Gas dispute illustrates how Shariah non-compliance associated with contractual arrangements can create legal uncertainty and affect market confidence (Ali, Hasan, & Sharofiddin, 2022). Despite increasing scholarly interest in sukuk risk, there remains no comprehensive theoretical framework that systematically classifies risk according to the principal Shariah contracts used in the Malaysian sukuk market (Rifat, 2025). Existing studies primarily focus on macroeconomic determinants (Mohd Noor et al., 2024), issuer-oriented risk (Alhammadi et al., 2024), or general Shariah-compliant risk management (Heravi & Sharofiddin, 2025), without developing a contract-specific risk taxonomy.

Nevertheless, although previous studies have acknowledged that sukuk structures influence risk exposure, existing literature remains fragmented in explaining how specific Shariah contracts generate distinct risk characteristics. For instance, Alswaidan et al. (2017) examined sukuk risk based on broad structural classifications, while Razak et al. (2019) analysed the relationship between sukuk contracts, structures, and pricing mechanisms. More recent studies have further explored sukuk risk from issuer perspectives and individual sukuk structures (Alhammadi & Archer, 2024; Hussain et al., 2024). However, existing studies generally do not provide a comprehensive framework that systematically maps different Shariah contracts to their corresponding risk categories and mitigation mechanisms within the Malaysian sukuk market.

This limitation is significant because different Shariah contracts inherently determine different ownership rights, liability arrangements, profit entitlement, and risk-sharing obligations among contracting parties. Consequently, sukuk structures based on different contracts may generate distinct risk exposures that require different mitigation approaches. For example, murabahah sukuk are primarily associated with credit and Shariah compliance risks due to their debt-based characteristics, whereas musharakah sukuk involve greater equity and business performance risks arising from profit-and-loss sharing arrangements. Similarly, wakalah sukuk may face higher agency and performance risks, while ijarah sukuk are more closely associated with asset ownership and residual value risks. Hence, understanding sukuk risk requires a contract-specific perspective rather than a general risk classification approach.

Therefore, this study proposes the Shariah Contract-Specific Risk Categories (SCSRC) framework, which classifies sukuk risks based on their underlying Shariah contracts. Grounded in Shariah principles and supported by contemporary financial theory, the framework links each contract type to its respective risk profile and mitigation mechanisms. It is expected to complement the guidance issued by the Securities Commission Malaysia (SC), Bank Negara Malaysia (BNM), and the Shariah Advisory Council (SAC), while offering a structured approach for risk assessment, disclosure, and pricing to issuers, investors, regulators, and researchers. Ultimately, the framework contributes to strengthening transparency, governance, and risk management in Malaysia's Islamic capital market, in line with Sustainable

Development Goal 9 (SDG 9) by promoting resilient financial infrastructure, innovation, and sustainable economic development.

Literature Review

Sukuk has remained the predominant Islamic capital market instrument despite the concurrent availability of partnership-based contracts. According to Rifat (2025), sukuk refers to Shariah-compliant financial certificates that are structured to achieve economic outcomes similar to those of conventional debt securities while adhering to Islamic legal principles. Furthermore, sukuk structures have been meticulously constructed in accordance with Islamic law (Muhammed et al., 2022). Sukuk appears in variety of types, each one with specific features.

In certain sukuk structures, the issuer purchases an asset and then sells sukuk certificates that represent ownership shares in that asset in which many of current sukuk issuance are asset-based rather than asset-backed, which that the originators retain the legal title (AAOIFI, 2025).

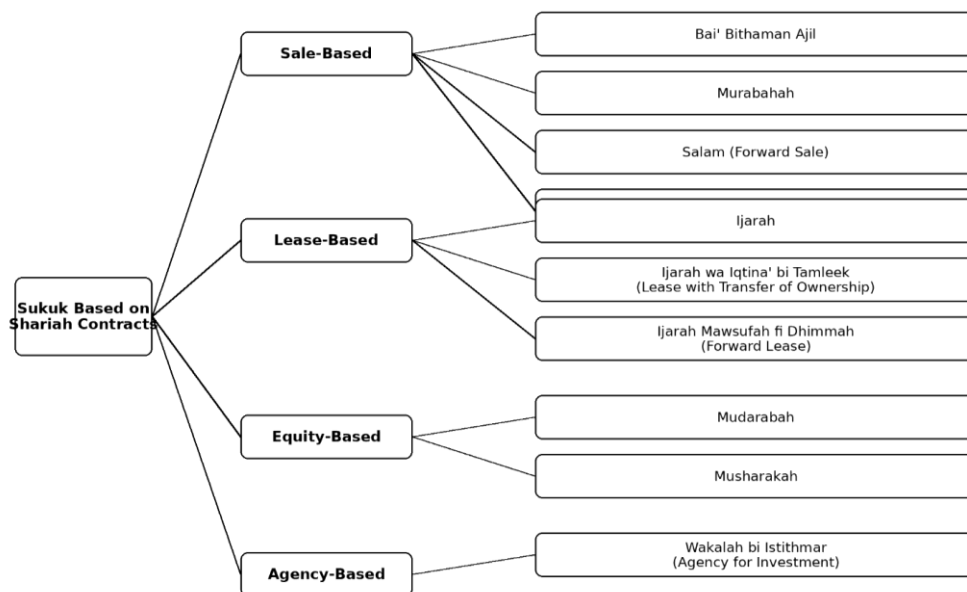


Figure 1: Sukuk Structures based on the Underlying Shariah Contracts

Source: Adapted from the Securities Commission Malaysia (2009).

In addition, sukuk structures promote Islamic finance principles involving asset ownership, risk-sharing, and the fulfilment of contractual obligations. According to SC (2009), sukuk are structured using variety of underlying Shariah contracts either individually or in combination, such as sale-based, lease-based, equity-based, and agency-based agreements.

On the contrary, based on the underlying Shariah contract, Muhammed et al. (2022) and Noriza et al. (2022) highlights that ijarah, Musharakah, murabahah, mudharabah, wakalah, istisna', and hybrid structure are the predominant structures used in corporate and sovereign sukuk issuances in Malaysia where the sukuk issuer, the SPV, and the investors have different legal

responsibilities, economic relationships, and risk distributions depending on the form of contract.

Ijarah is defined as a leasing contract in which the usufruct of an asset is transferred by the lessor to the lessee for a specified period in exchange for agreed rental payments (AAOIFI, 2021). In a ijarah sukuk structure, this arrangement is typically operationalised through a sale-and-leaseback mechanism, whereby the lessee sells an asset to a special purpose vehicle (SPV), which in turn issues sukuk certificates representing proportional ownership to investors (Rifat, 2025). The SPV subsequently leases the asset back to the lessee, and the rental payments generated under this lease serve as the basis for periodic distributions to sukuk holders. At maturity, the lessee commonly repurchases the asset through a purchase undertaking. According to MARC (2022), ijarah sukuk investors generally hold beneficial ownership rather than full legal title, such that recourse in the event of default is largely dependent on the lessee's contractual commitments rather than direct enforcement over the underlying asset. This structural feature has important implications for risk allocation within the instrument.

Musharakah is a partnership-based contract in which two or more parties contribute capital to a joint venture and agree to share profits and losses according to pre-determined ratios (AAOIFI, 2024). In sukuk *Musharakah* structures, certificates represent proportional ownership interests in the underlying partnership assets. A widely applied variant, diminishing *Musharakah* (*Musharakah mutanaqisah*), is commonly utilised in property and infrastructure financing, enabling one partner to gradually acquire full ownership over time. Alhammadi, Archer, and Aloumi (2024) argue that the equity-based nature of *Musharakah* sukuk introduces more complex governance considerations for originators, particularly in managing Shariah non-compliance risk alongside default risk and the competing interests of shareholders and creditors. In Malaysia, the Shariah Advisory Council (SAC) of SC (2023) has also issued guidance on restructuring mechanisms for sukuk *Musharakah*, reflecting the contractual and governance complexities inherent in this structure (Izzaty, 2024).

Mudharabah is a profit-sharing contract in which the capital provider (*rabb al-mal*) supplies funding while the entrepreneur (*mudharib*) undertakes managerial responsibility. Profits are distributed according to an agreed ratio, whereas financial losses are borne solely by the capital provider, except in cases of negligence or misconduct (AAOIFI, 2024). Empirical findings by Noriza et al. (2022) indicate that *mudharabah*-based sukuk are relatively less prevalent in Malaysia compared to other structures, largely due to the absence of capital guarantees, which increases exposure to potential capital loss and reduces its attractiveness among risk-averse institutional investors. In addition, Heravi and Sharofiddin (2025) observe that *mudharabah* sukuk is associated with a relatively higher degree of displaced commercial risk, rendering it more sensitive to fluctuations in market expectations and return stabilisation practices within the Malaysian Islamic finance environment.

Murabahah is a cost-plus-profit sale contract where the seller discloses to the buyer the original acquisition cost of the goods or asset being sold plus an agreed-upon profit margin MARC (2022). Commodity *murabahah* (*tawarruq*) has emerged as one of the predominant structures for liquidity management and financing purposes in Malaysia. However, *murabahah* sukuk continue to face significant shariah compliance issues related to the structure of sale transactions. Despite its widespread adoption, concerns regarding Shariah compliance remain relevant due to the contractual and structural requirements. Earlier structured of *murabahah* financing involving *bay' al-'inah* which arise debate among Shariah scholars, leading to the

regulators to place greater emphasis on compliance matters (Noriza et al., 2022). Subsequently, the Shariah Advisory Council (SAC) of Bank Negara Malaysia (2020) highlighted the importance of ensuring that murabahah arrangements are structured in accordance with Shariah principles. Ali, Hasan, and Sharofiddin (2022) further note that the close resemblance between permissible and impermissible sale arrangements makes murabahah sukuk particularly vulnerable to Shariah non-compliance risk.

Wakalah is an agency contract under which a principal (*muwakkil*) authorizes an agent (*wakeel*) to act on behalf of the principal (MACB, 2022). This shariah contract gained prominence after the global financial crisis due to its flexibility in accommodating a wide range of assets and financing needs. Although wakalah sukuk are generally regarded as adaptable and practical, maintaining Shariah compliance throughout the sukuk lifecycle remains a challenge (Izzaty, 2024). Hussain et al. (2024) identified Shariah non-compliance risks arising during the pre-issuance, operational, and post-issuance stages. These findings suggest that existing disclosure practices and risk management measures may not always sufficiently address the broader Shariah governance requirements associated with these instruments.

Istisna' is a contract used for the manufacture or construction of an asset according to agreed specifications, with delivery taking place at a future date (AAOIFI, 2021). It is commonly used in infrastructure development and large-scale project financing through sukuk. Given the nature of construction projects, risks related to project completion and timely delivery are particularly significant. Mohd Shahid et al. (2025) observe that weaknesses in risk mitigation arrangements, especially inadequate performance guarantees, have contributed to several Malaysian sukuk default cases. The case of MEX II Sdn Bhd illustrates how delays and project-related challenges can affect the overall performance of istisna'-based sukuk structures.

Moreover, hybrid sukuk combine two or more Shariah contracts, such as wakalah-ijarah or murabahah-istisna', within a single structure to achieve specific financing objectives (Noriza et al., 2022). While this structure offers greater flexibility and allows issuers to tailor sukuk structures to different funding requirements, it also increases the complexity of the transaction. The involvement of multiple contracts may create additional challenges in terms of Shariah governance, legal documentation, regulatory compliance, and enforcement. Mohamed, Hassan, and Lahsasna (2022) argue that these challenges become more pronounced in jurisdictions where sukuk-specific legal and insolvency frameworks are less developed. As a result, hybrid sukuk may face higher levels of legal and operational uncertainty compared to structures based on a individual Shariah contract.

Risk in Sukuk

Recent studies have examined sukuk risk from both theoretical and practical perspectives. Among the risks unique to Islamic finance, Shariah non-compliance risk (SNCR) is widely regarded as one of the most significant because it arises when a sukuk structure, transaction, or operational process fails to comply with Shariah principles, potentially resulting in legal disputes, reputational damage, and the invalidation of contractual arrangements (Alhammadi et al., 2024; Mohd Shahid et al., 2025). In addition, equity investment risk is inherent in partnership-based contracts such as musharakah and mudharabah, where investors directly share the risks and returns of the underlying business activities (Mahadewi, 2024). Reflecting the significance of these risks, Shariah non-compliance risk and default risk as among the most critical risks faced by sukuk issuers and originators, emphasizing the need for strong corporate

governance to ensure effective risk management (Md Zain & Shafii, 2018). Empirical evidence further suggests that both macro-financial conditions and contractual structures influence sukuk risk. At the contractual level, Heravi and Sharofiddin (2025) concluded that sukuk risk exposure is largely determined by the underlying Shariah contract adopted, while Hussain et al. (2024) identified inconsistencies between prescribed Shariah requirements and the actual disclosure and risk management practices in wakalah sukuk documentation.

Several high-profile sukuk defaults further demonstrate the practical implications of contract-specific risks. Mohd Shahid et al. (2025) analysed the defaults involving Menara ABS Berhad, MEX II Sdn. Bhd., and Serba Dinamik Holdings Berhad, concluding that inadequate liquidity management, weak governance practices, and regulatory inconsistencies were the primary contributing factors. The study also highlighted the importance of distinguishing between asset-backed and asset-based sukuk, as asset-backed structures generally provide stronger investor protection through direct recourse to the underlying assets. Similarly, Ali et al. (2022) examined the Dana Gas sukuk dispute and found that Shariah non-compliant contractual arrangements, insufficient legal standardisation, and governance inconsistencies significantly contributed to the default and heightened market uncertainty.

Islamic Contract Theory (*Fiqh al-Muamalat*)

Islamic Contract Theory (*Fiqh al-Mu'amalat*) provides the primary theoretical foundation for the proposed Shariah Contract-Specific Risk Categories (SCSRC) framework. The theory is based on the three essential pillars (*arkan*) of a valid Islamic contract, namely mutual consent (*sighah*), the contracting parties, and the subject matter of the contract, together with the fulfilment of specific contractual conditions (*shurut*) (Ahmad et al., 2024; Hussain et al., 2025). Guided by the objectives of Maqasid al-Shariah, particularly the protection of wealth (*hifz al-mal*) and justice, the theory requires that financial contracts allocate rights, obligations, and risks fairly among contracting parties (Mohamed et al., 2022).

In sukuk, the underlying Shariah contract determines ownership rights, liabilities, and the allocation of risks and returns (Alhammadi & Archer, 2024). Unlike conventional bonds, where investors are primarily exposed to credit risk, sukuk investors bear risks arising from the contractual structure and the underlying assets or business activities (Nawaz, 2025). This is consistent with the Islamic legal principles of *al-ghurm bi al-ghunm* (gain accompanies risk) and *al-kharaj bi al-daman* (entitlement to return accompanies liability), which establish that financial returns must be supported by the assumption of risk and responsibility (IFSB, 2024; Nawaz, 2025).

Accordingly, different Shariah contracts produce different risk profiles. For example, ijarah sukuk involve asset ownership and residual value risk, musharakah and mudarabah sukuk are exposed to equity and partnership risks, murabahah sukuk primarily face credit risk, wakalah sukuk involve agency risk, istisna' sukuk are exposed to construction and completion risk, while hybrid sukuk combine multiple risk exposures (Alhammadi & Archer, 2024). Therefore, Islamic Contract Theory provides the theoretical justification for classifying sukuk risks according to their underlying Shariah contracts, which forms the foundation of the proposed SCSRC framework.

Accordingly, different Shariah contracts generate distinct sukuk risk profiles due to variations in ownership rights, liability structures, profit entitlement, and risk-sharing arrangements. For instance, ijarah sukuk are associated with asset ownership and residual value risks, musharakah and mudarabah sukuk involve equity and partnership risks, murabahah sukuk are primarily exposed to credit risk, wakalah sukuk involve agency and performance risks, istisna' sukuk are subject to construction and completion risks, while hybrid sukuk may incorporate multiple risk exposures due to their combined contractual structures (Alhammadi & Archer, 2024).

Table 1 presents the relevance of Islamic Contract Theory to contract-specific sukuk risks by demonstrating how the Shariah principles governing contractual rights and obligations influence the risk exposure associated with different sukuk structures. The allocation of ownership, liability, and risk-bearing responsibilities embedded within each Shariah contract determines the nature of risks assumed by investors (Alhammadi & Archer, 2024; Salim & Hassan, 2023). Therefore, the sukuk risk profiles can be theoretically explained through the contractual arrangements established under Fiqh al-Mu'amalat, where different contracts generate distinct patterns of risk allocation and exposure (Nawaz, 2025; IFSB, 2024).

Table 1: Relevance of Islamic Contract Theory to Contract-Specific Sukuk Risks

Fiqh al-Mu'amalat Concept	Definition	Relevance to Sukuk Risk	References
<i>Al-Ghurm bi al-Ghunm</i> (Gain accompanies risk)	A party is entitled to profit only when exposed to the possibility of loss or risk.	Explains why Sukuk investors must bear underlying asset, business, or investment risks before earning returns. Particularly relevant for Musharakah and Mudarabah Sukuk.	Alhammadi and Archer (2024); Nawaz (2025); IFSB (2024).
<i>Al-Kharaj bi al-Daman</i> (Return accompanies liability)	The right to receive income is linked to assuming responsibility and liability for the asset.	Explains why Ijarah Sukuk holders are entitled to rental income only because they bear ownership-related risks and obligations.	Nawaz (2025); IFSB (2024)
<i>Milkiyyah</i> (Ownership)	Ownership confers both rights and obligations over assets.	Determines who bears risks associated with asset impairment, destruction, and value fluctuation. Critical in distinguishing asset-based and asset-backed Sukuk.	AAOIFI (2023); IFSB (2024).
<i>Daman</i> (obligation to bear risk)	Contracting parties bear liabilities according to their contractual roles and obligations.	Explains allocation of losses in Mudarabah, Musharakah, Ijarah, and Istisna' Sukuk.	Alhammadi and Archer (2024); IFSB (2024).
Risk-Sharing	Commercial transactions should	Explains why equity-based Sukuk carry greater	Alhammadi and Archer

	involve genuine risk-sharing among parties.	business and operational risks than debt-based Sukuk.	(2024); IFSB (2024).
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Agency Theory

Agency theory was introduced by Jensen and Meckling (1976) that explains the conflicts that arise in principal and agent relationships when one party (the agent) is delegated to act on behalf of another (the principal) under conditions of information asymmetry. In Islamic finance, this study has been extended by Alhammadi et al. (2024) to examine risk dynamics within sukuk structures. In *mudharabah* sukuk, the *mudharib* functions as the agent responsible for managing the investment on behalf of the investor-principals, while in *wakalah* sukuk, the *wakeel* assumes a similar agency role in executing investment activities. These structures inherently give rise to classical agency problems, particularly moral hazard, where the agent may prioritise self-interest over the interests of investors, and adverse selection, where principals face limitations in accurately assessing the competence and reliability of agents prior to contract formation (Nugraheni et al., 2024). Such agency-related risks are structurally embedded within these sukuk arrangements, thereby necessitating robust contractual provisions and governance mechanisms to mitigate potential inefficiencies. Consistent with this, Alhammadi et al. (2024) emphasise that effective governance frameworks are critical in addressing agency conflicts and ensuring the sustainability and resilience of sukuk originator structures in Islamic capital markets.

Risk-Sharing Paradigm of Islamic Economics

The foundation of Islamic economic applied the principles of *al-ghurm bil ghum* (liability accompanies entitlement to gain) and *al-kharaj bil daman* (return accompanies risk-bearing) establish that in Islamic finance, risk and return must be intrinsically related (Abdullah, 2023). Heravi and Sharofiddin (2025) suggests that risk serves as a main factor between lawful profit and *riba* which making risk analysis inseparable from Shariah analysis. This paradigm distinguishes equity-like sukuk (*Musharakah*, *mudharabah*) from asset-leasing sukuk (*ijarah*) and debt-like instruments (*murabahah*), with each carrying fundamentally different risk allocations between issuer and investor (Setiawan & Suwandaru, 2024).

The Shariah Contract-Specific Risk Categories (SCSRC) Framework

This study proposes the Shariah Contract-Specific Risk Categories (SCSRC) framework based on the three theoretical foundations outlined previously as well as the literature reviewed. The SCSRC framework is developed under the premise that the risk profile of a sukuk issuance is directly influenced by the specific type of Shariah contract which forms the basis of its structure. Thus, the analytical sequence employed in developing the SCSRC framework is constructed in Figure 2. The proposed framework is underpinned by three fundamental propositions. First, the underlying Shariah contract determines the risk profile of a sukuk, as each contractual structure gives rise to distinct risk characteristics. Second, risk mitigation mechanisms should be tailored to the specific Shariah contract, recognizing that strategies effective for one contract may not be suitable for another. Third, regulatory oversight should adopt a contract-specific approach by aligning Shariah governance, disclosure requirements, and rating methodologies with the unique characteristics of the underlying contractual

arrangement. This ensures that risk assessment and regulatory practices more accurately reflect the nature of each sukuk structure.

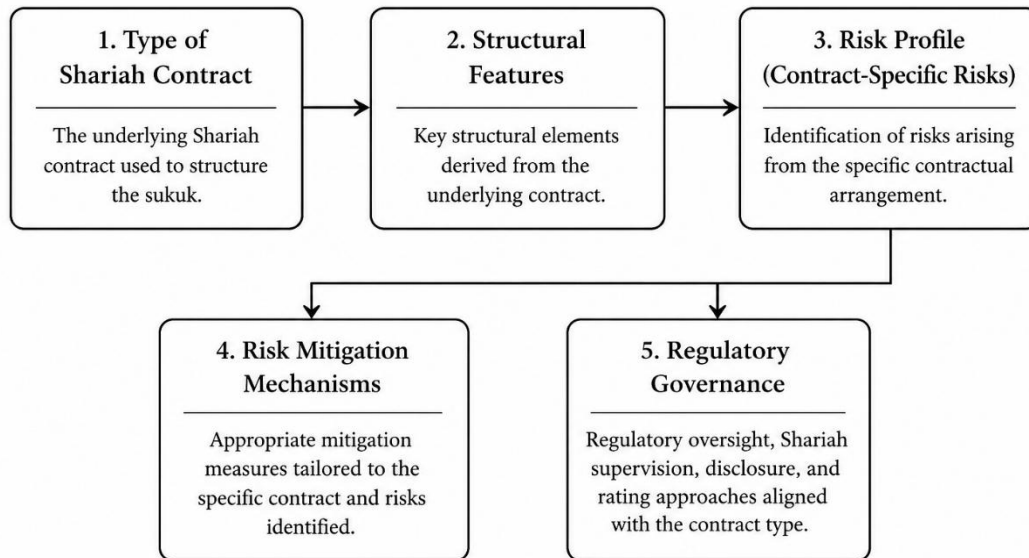


Figure 2: The Proposed Shariah Contract-Specific Risk Categories (SCSRC) Framework

Risk Categories by Shariah Contract

Table 2 presents the proposed Shariah Contract-Specific Risk Categories (SCSRC) framework, which links the seven Shariah contracts used in Malaysian sukuk issuances with their structural characteristics, contract-specific risk exposures, and corresponding mitigation mechanisms.

The framework provides a systematic approach to assessing sukuk risk by recognizing that different Shariah contracts inherently generate distinct risk profiles.

Table 2: The Risk Categories of Sukuk by Shariah Contract

Shariah Contract	Structural Feature	Primary Risk Profile	Risk Mitigation Mechanism
Ijarah	Asset sale-leaseback to SPV; periodic rental payments; purchase undertaking at maturity	Asset ownership risk; residual value risk; maintenance risk; legal enforcement risk in default	Purchase undertaking; maintenance reserve account; credit enhancement; Shariah-compliant step-in rights
Musharakah	Equity co-ownership in project; profit/loss sharing; diminishing buyout provisions	Equity risk; capital loss risk; valuation risk; profit manipulation risk; partner governance risk	Musharakah management agreement; independent Shariah audit; profit cap; SAC-approved restructuring
Mudharabah	Capital provision by rabb al-mal; entrepreneurship by mudharib; profit-share ratio agreed upfront	Moral hazard; information asymmetry; no capital guarantee; displaced commercial risk	Milestone-based disbursement; mandatory disclosure covenants; performance benchmarks; Shariah audit
Murabahah	Cost-plus deferred sale; commodity murabahah (tawarruq); fixed repayment schedule	Credit/default risk; commodity delivery risk; Shariah non-compliance risk (bay' al-inah)	Collateral security; independent commodity broker; Shariah advisor pre-approval; credit rating
Wakalah	SPV as principal; issuer as wakeel managing an investment portfolio	Agency risk; portfolio management risk; performance risk; Shariah non-compliance at ongoing stage	Wakeel performance benchmark; reserve account; fiduciary obligation; SC Malaysia compliance monitoring
Istisna'	Forward construction/manufacturing contract; asset delivered at future date	Completion risk; cost overrun risk; delivery risk; title transfer uncertainty	Performance bond; escrow mechanism; step-in rights; independent project monitor
Hybrid	Combination of two or more Shariah contracts (e.g., wakalah-ijarah)	Compounded risk profiles; structural complexity risk; cross-contract enforcement risk	Contractual hierarchy clauses; comprehensive legal opinion; SAC and SC Malaysia dual approval

Source: compilation based on AAOIFI (2021), SC Malaysia Guidelines on Sukuk (2024), MARC Ratings Berhad (2022), Alhammadi et al. (2024), Hussain et al. (2024), and Mohd Shahid et al. (2025).

In Musharakah sukuk, the partnership-based structure exposes investors to risk profiles similar to those found in equity participation. Capital loss risk is inherent, as financial losses are shared among partners in proportion to their capital contributions. Valuation risk also arises from the need to periodically assess the value of the underlying venture or assets, which directly influences profit allocation and redemption values. Furthermore, profit manipulation risk may occur when the managing partner exercises discretion in reporting or allocating profits, creating opportunities for moral hazard and information asymmetry (Heravi & Sharofiddin, 2025). The governance complexities associated with this structure are reflected in the SAC of the SC resolution on the restructuring of Musharakah sukuk, which highlights issues relating to the treatment of existing Musharakah contributions as capital in subsequent issuances (SC, 2023). These considerations demonstrate that partnership-based sukuk structures are particularly exposed to governance and valuation-related risks.

Mudarabah sukuk has a unique risk profile that can be attributed mainly to the way the sukuk's capital and management responsibilities are distributed among parties to the sukuk agreement. As per the mudarabah arrangement, the capital provider (*rabb al-mal*) is responsible for providing capital to the sukuk, whereas the manager of the sukuk (*mudarib*) is responsible for managing the investments (Mahadewi, 2024). In line with Shariah principles, the capital provider is barred from receiving any guaranteed return on their investment and cannot receive any predetermined return on their investment; thus, the majority of investment risk is borne by the investor (Heravi & Sharofiddin, 2025). A second type of risk associated with this structure is moral hazard risk, since the *mudarib* does not bear any financial risk for investment loss (unless it is negligent, engaged in misconduct, or breached the sukuk agreement), there is an incentive for the *mudarib* to make riskier investment choices. A third type of risk arising from this structure is information asymmetry risk. Due to the inability of investors to effectively monitor the *mudarib*'s operational decision-making processes and business performance, investors have little insight into how well the *mudarib* is performing (Setiawan, 2024). According to Noriza et al. (2022), these are some of the structural characteristics that can help explain why there have been so few adoptions of mudarabah sukuk in Malaysia. Investors in Malaysia could lose money on their investment and are likely to be uncertain as to what the final return will be. Therefore, agency-related risks will continue to be a significant characteristic of the mudarabah structure and will require proper governance and disclosure systems to mitigate them (, 2022).

The ijarah structure generates several asset specific risks related to the ownership of the asset. The primary risk associated with the ijarah structure is the asset ownership risk, in which the SPV, and therefore the sukuk holders, are the legal owners of the asset throughout the sukuk tenure. Thus, should an impairment occur to the physical or legal status of the asset, it would negatively impact the position of both the SPV and the sukuk holders. Therefore, the legal enforcement risk is regarded as an inherent feature of ijarah sukuk due to the contractual and asset-backed nature of the structure (Alhammadi & Aloumi, 2024). The effectiveness of legal documentation, regulatory oversight, and risk mitigation mechanisms embedded within contractual agreements is therefore crucial in safeguarding the rights and interests of sukuk holders.

In contrast, Musharakah sukuk are exposed to risks similar to those associated with equity-based investments. Capital loss risk arises because losses are allocated among partners according to their respective capital contributions, in accordance with the principle of profit-and-loss sharing in Islamic finance (Radzi & Shaharuddin, 2018). Furthermore, valuation risk

may emerge due to fluctuations in the value of the underlying assets or ventures, which can influence both the determination of returns and the redemption value of the sukuk (Ahroum & Achchab, 2017). Furthermore, Musharakah sukuk are exposed to profit manipulation risk, which may arise when the managing partner misreports or improperly allocates profits generated from the underlying investment. This risk is comparable to earnings management practices in conventional equity investments, where information asymmetry between managers and investors may lead to the misrepresentation of financial performance (Iqbal & Mirakhor, 2011). Furthermore, the resolutions of the Shariah Advisory Council (SAC) of the Securities Commission Malaysia regarding the restructuring of Musharakah sukuk highlight several governance and structural concerns, including the treatment of existing Musharakah contributions as capital in future sukuk issuances, thereby underscoring the importance of robust governance and monitoring mechanisms in mitigating agency-related risks (Securities Commission Malaysia, 2023).

Mudharabah sukuk expose investors to a distinct set of risks arising from the Shariah prohibition on capital guarantees and predetermined returns. Under a mudharabah arrangement, the *rabb al-mal* (capital provider) bears the risk of capital loss, while the *mudharib* (entrepreneur) is not liable for such losses unless they result from negligence, misconduct, or breach of contractual obligations. This unique risk-sharing structure may give rise to moral hazard risk, as the *mudharib* has limited financial exposure to investment losses, potentially reducing incentives for prudent management and increasing the likelihood of actions that may not fully align with the interests of investors (Iqbal & Mirakhor, 2011; Hassan & Lewis, 2007). Therefore, mudharib may be encouraged to engage in excessive risk-taking activities. Another type of investor-side risk created by mudharabah sukuk is information asymmetry risk. Information asymmetry risk results from the investor's limited knowledge of the mudharib's business operations. Noriza et al. (2022) identify these two structural risk characteristics as factors contributing to the relatively low popularity of mudharabah sukuk in Malaysia. They note that the sukuk assets may decline in value below par and that the structure benefits the issuer over the investor.

Whereas murabahah sukuk are primarily exposed to credit risk arising from the obligor's deferred payment obligations. In *tawarruq*-based arrangements, commodity risk may also arise, as the validity of the transaction depends on the genuine existence, ownership, and transfer of the underlying commodities. Furthermore, Shariah non-compliance risk remains a significant concern in murabahah structures, particularly when contractual arrangements resemble prohibited elements such as *riba* or *bay' al-'inah*. Ali et al. (2022) argued that structural deviations from the fundamental requirements of murabahah transactions may compromise the Shariah legitimacy and legal integrity of sukuk issuances. This concern is further reflected in the rulings of the Shariah Advisory Council (SAC) of Bank Negara Malaysia at its 199th meeting, which emphasised the need for strict adherence to Shariah requirements in murabahah-related arrangements to preserve transactional validity and market confidence (Bank Negara Malaysia, 2020).

Moreover, wakalah sukuk involve a principal-agent relationship that gives rise to agency and portfolio management risks. Agency risk stems from the discretion granted to the wakeel in managing the investment portfolio, potentially creating conflicts between the interests of the agent and those of investors. Additionally, portfolio management risk may result from ineffective asset selection, excessive concentration, or underperformance of the underlying assets (Ghezal et al., 2022). The shariah non-compliance risk in wakalah sukuk may arise

throughout the pre-issuance, operational, and post-issuance stages, suggesting that existing mitigation mechanisms may not adequately address the full spectrum of compliance-related challenges (Mohd Noor, 2024). Consequently, stronger governance frameworks, monitoring mechanisms, and disclosure requirements are necessary to ensure the effective management of wakalah-based sukuk structures.

Istisna' sukuk are exposed to project-specific risks due to their dependence on future construction or manufacturing activities. Among the key risks associated with this structure are completion risk, cost overrun risk, and delivery risk, which may adversely affect project viability and investor returns. Evidence from recent sukuk default cases demonstrates that inadequate project governance and ineffective risk mitigation mechanisms can significantly increase the likelihood of financial distress. In particular, the MEX II Sdn. Bhd. sukuk default highlights how project delays, governance weaknesses, and insufficient risk management practices contributed to greater risk exposure among sukuk holders (Mohd Shahid et al., 2025).

Similarly, hybrid sukuk, which combine multiple Shariah contracts within a single structure, exhibit more complex risk characteristics due to the interaction of different contractual arrangements. The complexity of these structures may create ambiguity in the allocation of rights, obligations, and risk responsibilities among stakeholders (Saied et al., 2024). Furthermore, cross-contract enforcement risk may arise when courts and regulators are required to interpret multiple interconnected agreements, particularly during restructuring or default situations (Ali et al., 2022). The increasing application of hybrid sukuk structures has therefore raised concerns regarding legal uncertainty, variations in Shariah interpretation, and regulatory harmonisation across jurisdictions. Accordingly, effective governance mechanisms, comprehensive Shariah review processes, and strengthened regulatory oversight are essential to maintaining the resilience and credibility of hybrid sukuk issuances (Mohamed et al., 2022; Setiawan & Suwandaru, 2024).

The distinct risk characteristics observed across different sukuk structures highlight the importance of adopting a systematic approach that links risk assessment with the underlying Shariah contract. Therefore, the proposed Shariah Contract-Specific Risk Categories (SCSRC) framework is developed based on three theoretical perspectives: Islamic Contract Theory (Fiqh al-Mu'amalat), Agency Theory, and the Risk-Sharing Paradigm. Islamic Contract Theory provides the contractual foundation by explaining how different Shariah contracts determine ownership rights, liabilities, and risk-bearing obligations. Agency Theory contributes the governance perspective by addressing principal-agent relationships, information asymmetry, and moral hazard concerns. Meanwhile, the Risk-Sharing Paradigm provides the economic rationale for the allocation of risks and returns among contracting parties. Collectively, these theories explain the emergence of contract-specific sukuk risks and support the framework's emphasis on risk identification, mitigation mechanisms, and regulatory governance.

Discussion

A comparative analysis of the Shariah Contract-Specific Risk Classification (SCSRC) framework suggests that sukuk risks fall within a range of risk exposures determined by the nature of the underlying Shariah contract. Sukuk issued under mudharabah and Musharakah contracts are associated with relatively higher risk exposure because investors directly participate in the profits and losses of the underlying venture. This reflects the fundamental Shariah principle that the right to earn returns is inseparable from the obligation to bear risk.

(Setiawan & Suwandaru, 2024). Unlike profit-sharing sukuk structures, murabahah sukuk offer relatively predictable returns derived from predetermined profit margins. However, their resemblance to conventional fixed-income instruments may increase exposure to Shariah non-compliance risk if the underlying contractual requirements are not strictly observed. Ijarah sukuk, on the other hand, occupy a middle ground between equity-based and debt-based structures, generating stable rental income while exposing investors to asset-related risks, including ownership, enforceability, and recovery risks that may become particularly significant during periods of financial distress or default (Saied et al., 2024). The variation in risk characteristics across sukuk structures has important implications for both pricing and credit assessment. Despite differences in contractual foundations and risk allocation mechanisms, Malaysian credit rating agencies have traditionally placed considerable emphasis on the creditworthiness of issuers and obligors when evaluating sukuk instruments.

The heterogeneity of risk embedded within various sukuk structures necessitates differentiated approaches to pricing and credit evaluation. However, notwithstanding the contractual and structural distinctions among sukuk instruments, Malaysian rating agencies have traditionally relied primarily on assessments of issuer and obligor creditworthiness when determining sukuk ratings. (MARC, 2022). Although this approach enhances the comparability of sukuk ratings, it may not adequately reflect the diverse risk exposures arising from different Shariah contractual arrangements. Consequently, certain structural risks associated with profit-sharing sukuk may be underestimated, while the extent of asset protection in asset-based sukuk may be overstated. Adopting a contract-specific rating framework informed by the SCSRC classification could therefore improve the accuracy of risk evaluation and promote more efficient pricing by providing a clearer representation of the risks embedded within each sukuk structure. Empirical evidence from Malaysian sukuk default cases further supports the relevance of the SCSRC framework. The sukuk cases of Menara ABS Berhad, MEX II Sdn. Bhd., and Serba Dinamik Holdings Berhad illustrate how contract-specific risks may materialise in practice and adversely affect sukuk performance (Mohd Shahid et al., 2025). In the case of MEX II Sdn. Bhd., the findings highlight the relevance of completion risk and cost overrun risk within *istisna'* sukuk structures, where insufficient risk mitigation mechanisms and project execution delays ultimately resulted in financial distress and losses to investors. Similarly, the Serba Dinamik Holdings Berhad case underscores the impact of governance weaknesses, information asymmetry, and alleged financial misrepresentation, all of which are closely aligned with agency and moral hazard risks commonly associated with profit-sharing sukuk structures. Furthermore, the internationally Dana Gas dispute provides empirical evidence of the materialisation of Shariah non-compliance risk, particularly in relation to legal contestation and restructuring outcomes in sukuk markets. As emphasised by Ali et al. (2022), disputes over the Shariah validity of contractual arrangements may generate legal uncertainty, weaken investor protection, and undermine overall market confidence in sukuk instruments. Collectively, these cases underscore the importance of adopting a contract-specific approach to sukuk risk assessment. Recognising the distinct risk characteristics embedded within different Shariah contracts can contribute to more effective governance, improved regulatory oversight, enhanced credit evaluation practices, and more accurate risk pricing in the Islamic capital market.

Implications

The SCSRC framework carries significant regulatory implications for the development of sukuk markets. First, while the Securities Commission Malaysia (SC) Guidelines on Sukuk are

comprehensive, they primarily emphasise general risk disclosure requirements without explicitly mandating contract-specific risk disclosures. This represents a regulatory gap, which the SCSRC framework identifies as requiring further attention. The introduction of enhanced, contract-specific disclosure standards requiring issuers to explicitly identify and disclose risks associated with the underlying Shariah contract that would strengthen investor protection and enhance market transparency. Second, the Shariah Advisory Council (SAC) of the SC continues to refine its resolutions in response to evolving market practices. The 2023 resolution on Musharakah sukuk restructuring, along with ongoing deliberations on hybrid sukuk governance, reflects the adaptive and dynamic nature of Shariah governance within the Malaysian Islamic capital market (SAC, 2023). Third, the AAOIFI Governance Standard No. 17, provides an important international benchmark for contract-sensitive Shariah governance, which may serve as a reference point for Malaysian regulatory harmonization (AAOIFI, 2024). From an institutional perspective, the SCSRC framework proposes a structured basis for contract-specific due diligence, particularly among institutional investors. For equity-based sukuk such as Musharakah and mudharabah, risk assessment should resemble equity investment analysis, with particular emphasis on governance quality, transparency in profit calculation, and agency risk management. For issuers and Shariah advisors, the framework underscores the importance of designing risk mitigation mechanisms that are both commercially viable and Shariah-compliant, and which are tailored to the specific contractual structure employed. At the operational level, effective implementation of the SCSRC framework requires coordinated action among key stakeholders. Regulators are encouraged to develop contract-specific risk guidelines in addition to existing general sukuk frameworks, while rating agencies should refine their methodologies to incorporate Shariah contract-based risk differentiation rather than relying predominantly on issuer creditworthiness. Similarly, Shariah advisory councils and advisors should integrate contract-specific risk assessment tools into their review processes to enhance governance effectiveness and Shariah compliance assurance (Hussain et al., 2024).

Conclusion

This paper set out to develop the Shariah Contract-Specific Risk Categories (SCSRC) framework for sukuk in Malaysia, anchored on the seven principal Shariah contracts employed in Malaysian sukuk structures, namely *ijarah*, *Musharakah*, *mudharabah*, *murabahah*, *wakalah*, *istisna*, and hybrid arrangements. Drawing on agency theory, Islamic contract theory, and the risk-sharing paradigm of Islamic economics, the study demonstrates that sukuk risk is fundamentally contract-contingent, whereby the nature of the underlying Shariah contract serves as the primary determinant of the sukuk's risk architecture. Each contract type exhibits a distinct risk profile, structural configuration, and corresponding risk mitigation mechanism, which cannot be sufficiently captured through a generic, uniform risk classification approach. The theoretical contribution of this study is twofold. First, it develops a unified cross-contract risk taxonomy for sukuk market in Malaysia. Second, it integrates Shariah principles with contemporary financial theories, particularly agency theory and the risk-sharing paradigm. Thus, providing a multidisciplinary foundation for future empirical research in Islamic finance. The practical contributions of this study include the provision of a structured analytical framework for sukuk risk assessment applicable to investors, issuers, and Shariah advisors; a conceptual basis for enhancing contract-specific regulatory disclosure requirements; and a foundation for the development of contract-sensitive sukuk rating methodologies. However, the study acknowledges several inherent limitations, particularly in

relation to its conceptual nature and the need for empirical validation of the proposed framework in future research.

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