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Bonds in Islamic Economic Review

Abu Umar Faruq
E-mail: umar.ahmad@ubd.edu.bn

Universiti Brunei Darrussalam, Brunei Darussalam

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ABSTRACT

Bonds that are reviewed from fiqh principles are allowed as stated in the DSN MUI fatwa Number: 32/DSN-MUI/IX/2002 concerning Syari'ah Bonds, Number: 41/DSN-MUI/III/2004 concerning Syari'ah Ijarah Bonds and Number: 59 /DSN-MUI/V/2007 concerning Convertible Syari'ah Mudharabah Bonds. Bonds can be issued based on sharia principles by referring to the fatwa. This study aims to describe bonds in a review of fiqh rules and describe the differences between Islamic bonds and bonds. with qualitative research methods. This study found that the basic difference between Islamic bonds and conventional bonds is the application of interest that has been determined at the beginning of the transaction. In Islamic bonds, profit sharing is not determined at the beginning of the transaction, but what is determined is the percentage (nisbah) of future profits.

1. Introduction

The capital market is a market for various tradable financial instruments or long-term securities. From a sharia perspective, the capital market is a means for muamalah activities. Transactions in the capital market are permitted under sharia law as long as there are no transactions that conflict with sharia principles (Sulistyowati & Yasin, 2022). The Islamic capital market is a capital market that is run according to the concept of sharia, where every securities trade complies with the terms of the transaction under the Sharia basis (Sulistyowati & Yasin, 2022). The development of the capital market has had a positive impact on the Indonesian economy. The capital market has a very important role in a country(Fahlevi, 2019). The capital market provides an opportunity for the public to make investments, both short-term, medium-term, and long-term investments, while issuers find it easier to obtain funds from investors by issuing securities both equity and debt.

Portfolio investment is a fairly permanent option for investing funds, for investors who want low investment risk (Shaik et al., 2022). Besides having a low level of risk, portfolio investment can be liquid at a certain time. Among portfolio investment instruments, bonds (debt securities) are very safe and liquid instruments. Bonds are liquid, meaning that investment funds can be taken back along with additional profits (interest) from the agreed period of time. Bonds are very safe (safe), especially bonds issued by the state (Pirgaip et al., 2021). One of the investment instruments in the capital market is bonds. Bonds are a source of funding (financing) for the government and companies, which can be obtained from the capital market. Bonds are securities issued by the issuer (issuer) to investors (bondholders), where the issuer will provide a return in the form of coupons which are paid periodically, and the principal value (principal) when the bond matures.

The issuance (emission) of bonds can be viewed from two sides, namely from the side of the issuer/company and from the side of investors (Kant, 2021). Issuance of bonds from the issuer side is basically to obtain funds to support the company's activities because bonds are a relatively cheaper funding alternative compared to loans from other parties (Chiesa & Barua, 2019). Meanwhile, from an investor perspective, investment in bonds is the same alternative, because bonds provide fixed income in the form of interest coupons that are paid regularly at competitive interest rates and the principal is paid on time at a predetermined maturity.

several previous studies such as Cahyono et al (2022) examined the comparison of the performance of conventional bonds with Islamic bonds, Hanapi (2019) examined the application of Islamic bonds and sukuk in Indonesia and Amin (2021) examined the development of Islamic bonds in Indonesia. This article provides a different perspective from previous research, namely focusing on bonds in fiqh law and getting to know more deeply what are the differences between Islamic bonds and conventional bonds.

Bonds are long-term debt instruments that indicate that a company has borrowed a certain amount of money and promises to repay it in the future on predetermined terms. Predetermined terms are the maturity date, coupon interest rate, and interest payment term. This study uses qualitative research methods with content analysis techniques (Creswell & Creswell, 2017). aims to describe the principles of fiqh in bonds? And the difference between Islamic bonds and bonds.

2. Literature Review

One of the investment instruments in the (conventional) capital market is bonds. Bonds are long-term debt securities issued by issuers to bondholders with the obligation to pay interest for a certain period and repay the principal at maturity to the bondholders. Bonds are not under sharia provisions, so there is a need for bonds that can be issued under DSN sharia principles.

The basis used in issuing a fatwa on sharia bonds is as follows:

a. QS Al Maidah : 1

يَاأَيُّهَا الَّذِيْنَ آمَنُوْا أَوْفُوْا بِالْعُقُوْدِ . . .

"O you who believe, fulfill the contracts..."

b. QS Al Baqarah : 282

ٱلَّذِينَ يَأۡكُلُونَ ٱلرِّبَوٰاْ لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ ٱلَّذِي يَتَخَبَّطُهُ ٱلشَّيۡطَٰنُ مِنَ ٱلۡمَسِّۚ
ذَٰلِكَ بِأَنَّهُمۡ قَالُوٓاْ إِنَّمَا ٱلۡبَيۡعُ مِثۡلُ ٱلرِّبَوٰاْۗ وَأَحَلَّ ٱللَّهُ ٱلۡبَيۡعَ وَحَرَّمَ ٱلرِّبَوٰاْۚ فَمَن
جَآءَهُۥ مَوۡعِظَةٞ مِّن رَّبِّهِۦ فَٱنتَهَىٰ فَلَهُۥ مَا سَلَفَ وَأَمۡرُهُۥٓ إِلَى ٱللَّهِۖ وَمَنۡ عَادَ
فَأُوْلَٰٓئِكَ أَصۡحَٰبُ ٱلنَّارِۖ هُمۡ فِيهَا خَٰلِدُونَ

"Those who eat (take) usury cannot stand but are like the standing of a person who has been possessed by a devil because of (pressure) madness. Their situation is like that, is because they say (opinion), actually buying and selling is the same as usury, even though Allah has justified buying and selling and forbidding usury. Those who have received a ban from their Lord, then stop (from taking usury), then for him what he has taken before (before the prohibition comes); and his affairs (submitted) to Allah. People who return (take usury), then that person is the inhabitants of hell; they abide therein."

c. Hadith of the Prophet narrated by Tirmidhi from 'Amr bin 'Auf

اَلصُّلْحُ جَائِزٌ بَيْنَ الْمُسْلِمِينَ إِلاَّ صُلْحًا حَرَّمَ حَلاَلاً أَوْ أَحَلَّ
حَرَامًا وَالْمُسْلِمُونَ عَلَى شُرُوطِهِمْ إِلاَّ شَرْطًا حَرَّمَ حَلاَلاً أَوْ
أَحَلَّ حَرَامًا.

"Agreements may be made between Muslims except for agreements that forbid what is lawful or allow what is unlawful, and the Muslims are bound by their conditions except for conditions that prohibit what is lawful or allow what is unlawful."

d. Hadith of the Prophet narrated by Imam Ibn Majah from 'Ubadah bin al-Shamit, Ahmad from Ibn 'Abbas, Malik from 'Amr bin Yahya al-Mazini, al-Daraquthni, and others, from Abu Sa'id al-Khudri, the Prophet s.a.w. said:

لاَضَرَرَ وَلاَضِرَارَ.

"One must not endanger oneself or others."

e. Fiqh rules

اَلأَصْلُ فِي الْمُعَامَلاَتِ اْلإِبَاحَةُ إِلاَّ أَنْ يَدُلَّ دَلِيْلٌ عَلَى تَحْرِيْمِهَا

"Basically, all forms of muamalah are permissible unless there is an argument that forbids them."

اَلْمَشَقَّةُ تَجْلِبُ التَّيْسِيْرَ

"Difficulty can attract ease."

اَلْحَاجَةُ قَدْ تَنْزِلُ مَنْزِلَةَ الضَّرُوْرَة

"Needs can occupy an emergency position."

اَلثَّابِتُ بِالْعُرْفِ كَالثَّابِتِ بِالشَّرْعِ

"Something that applies based on custom is the same as something that applies based on syara' (as long as it doesn't conflict with shari'a)."

Based on the DSN-MUI fatwa No. 32 of 2002 concerning Sharia Bonds, that:

a. Based on general provisions:

    1) Bonds that are not justified according to sharia, namely bonds that are debt with the obligation to pay based on interest.

    2) Bonds that are justified according to sharia are bonds based on sharia principles.

    3) Sharia Bonds are long-term securities based on sharia principles issued by Issuers to Sharia Bondholders which require the Issuer to pay income to Sharia Bondholders in the form of profit sharing/margin/fees and repay the bond funds at maturity.

b. Under special conditions:

    1) Contracts that can be used in the issuance of sharia bonds include a. Mudharabah (Muqaradhah)/ Qiradh b. Musyarakah c. Murabaha d. Greetings e. Istishna f. Ijarah.

    2) The type of business carried out by the Issuer (Mudharib) may not conflict with sharia by taking into account the substance of the DSN-MUI Fatwa Number 20/DSN-MUI/IV/2001 concerning Guidelines for Investment Implementation for Sharia Mutual Funds.

    3) Investment income (yield) distributed by Issuers (Mudharib) to holders of Syariah Mudharabah Bonds (Shahibul Mal) must be clean from non-halal elements.

    4) Income (yield) obtained by Sharia Bondholders by following the contract used.

5) The transfer of sharia bond ownership follows the contracts used.

c. Dispute settlement, If one party does not fulfill its obligations or if a dispute occurs between the parties concerned, then the settlement is carried out through the Sharia Arbitration Board after no agreement is reached through deliberation (DSN MUI, 2002).

As an effect, bonds can be traded on the capital market. There are two types of bond markets. First, is the primary market, which is the market where bonds are traded when they are issued. One of the requirements of the provisions of the capital market is that bonds must be listed on the stock exchange to be offered to the public. Second, the secondary market, which is where bonds are traded after they are issued and listed on the stock exchange, will be traded Over the Counter (OTC), meaning that there is no physical trading place. Bondholders as well as those who want to buy them will interact with online trading or telephone.

Each bond has a different structure. Bonds consist of various classifications. Several types of bonds can be reviewed from the side of the issuer, the interest payment system, exchange rights/options, and the guarantee/collateral side (Fabozzi & Fabozzi, 2021).

a) Types of bonds by issuer:

1) Corporate bonds, namely bonds issued by companies, both in the form of state-owned enterprises and private companies.

2) Government bonds, namely bonds issued by the government.

3) Municipal bonds, namely bonds issued by local governments.

b) Types of bonds based on the interest payment system:

1) Zero coupon bonds, namely bonds that do not make periodic interest payments.

2) Coupon bonds, namely bonds with coupons that can be cashed out periodically by following the provisions of the issuer.
3) Fixed coupon bonds, namely bonds with a coupon rate determined before that period of time, based on a benchmark.
4) Floating coupon bonds, namely bonds with an interest rate determined before that period, based on a reference, namely the weighted average deposit interest rates of government and private banks.

c) Types of bonds based on exchange rights/ options:

1) Convertible bonds, namely bonds that give rights to bondholders to convert the bonds into several some many shares owned by the issuer.
2) Exchangeable bonds, namely bonds that give the right to bondholders to exchange company shares into several many affiliated company shares belonging to the issuer.
3) Callable bonds, namely bonds that give the issuer the right to buy back the bonds at a certain price throughout the life of the bonds.
4) Putable bonds, namely bonds that provide rights to investors who require the issuer to buy back the bonds at a certain price throughout the life of the bonds.
5) Serial bonds, namely bonds whose repayment method is carried out in stages according to the maturity date scheduled for a certain period until the entire bond is repaid.
6) Perpetual bonds, namely bonds that do not have a maturity date, cannot be redeemed, and must pay fixed interest income (annual bond).

d) Types of bonds based on collateral:

1) Secured bonds, namely bonds guaranteed by certain assets belonging to the issuer or by other guarantees from third parties.
2) Unsecured bonds, namely bonds that are not guaranteed by a certain wealth but are guaranteed by the general wealth of the issuer. (Rivai, Veithzal, dkk, 2007)

Sharia bonds are known as sukuk. The word sukuk can be easily traced to classical commercial Islamic literature. Sukuk comes from the Arabic "sak" (singular) and "sukuk" (plural) which have a meaning similar to a certificate or note. In its practical understanding, sukuk is proof (claim) of ownership (Fabozzi & Fabozzi, 2021).

Based on historical searches, the term Sukuk has been known since the Middle Ages, when Muslims used it in the context of international trade. Sukuk is used as a document showing financial obligations arising from trading and other commercial activities. Even several some many Western writers who are concerned with Islamic history, state that it is this sakk that is the root of the word "check" in Latin, which has become something that is commonly used in contemporary banking world transactions (Izhar & Munkin, 2021).

Among portfolio investment instruments, bonds (debt securities) are very safe and liquid instruments. Bonds are liquid, meaning that investment funds can be taken back along with additional profits (interest) from the agreed period of time. Bonds are very safe (safe), especially bonds issued by the state. In stocks, investors will get net profits which are divided in the form of dividends. In bonds, where investor funds are loan funds (debt), the party issuing the bond (the creditor) will pay off its obligations to the investor in advance, the obligation is in the form of payment of investment funds and interest. So the return (profit) from bonds is more competitive than the distribution of dividends on stocks (Djayusman, 2014).

The assets on which the Sukuk are based must not conflict with Sharia Principles in the Capital Market. Assets that form the basis of Sukuk as referred to in Article 2 may consist of:

1. Certain tangible assets (a'yan maujudat);
2. Benefit value of certain tangible assets (manafiul a'yan), both existing and future;
3. Services (al khadamat) that have existed or will exist;
4. Certain project assets (maujudat masyru' mu'ayyan); and/or
5. Predetermined investment activities (nasyath ististmarin Khashah).

Issuers conducting a Public Offering of Sukuk must comply with the provisions of the Financial Services Authority Regulation concerning the Application of Sharia Principles in the Capital Market, this Financial Services Authority Regulation, and other laws and regulations in the Capital Markets sector. Registration Statements in the context of a Public Offering of Sukuk must comply with laws and regulations in the Capital Markets sector governing Registration Statements, Public Offerings, and other related regulations, as well as this Financial Services Authority Regulation. (OJK, 2015)

The requirements that must be met by issuers to be able to issue Sukuk are as follows:

a. The main activity (core business) which is halal, does not conflict with the substance of Fatwa No. 20/DSN-MUI/IV/2001. This fatwa explains that the types of business activities that are contrary to Islamic sharia are:
    1) Gambling and game businesses are classified as gambling or prohibited trading.

2) Conventional financial institution business (usury) including conventional banking and insurance.
3) Businesses that produce, distribute, and trade unclean food and drinks.
4) Businesses that produce or provide goods or services that damage morale and are harmful.

b. The investment grade rating must be:
1) Having strong business fundamentals.
2) Having strong financial fundamentals.
3) Have a good image for the public.

c. Additional benefits if included in the Jakarta Islamic Index (JII) component. (Tjiptono Darmadji, 2006)

The parties involved in the issuance of sharia bonds (Sukuk) are as follows:

a. Obligor, namely the party responsible for the payment of compensation and the nominal value of the Sukuk issued until the maturity of the Sukuk
b. Special Purpose Vehicle (SPV), which is a legal entity established to issue Sukuk and has the following functions:
1. as a Sukuk issuer
2. act as a trustee (trustee) to represent investors
3. become the government's counterpart in asset transfer transactions.
c. Investors/Sukuk holders are Sukuk holders who have the right to compensation, margin, and nominal value of the Sukuk by following their respective participations.

Bonds (bonds) can be classified into several types, namely: according to the issuer, the coupon given, the guarantee (collateral), and others. In terms of the coupons/fees paid by the bonds, it can be divided into 2 (two), namely interest rate-based bonds (conventional) and sharia bonds. Interest rate bonds (conventional) are types of bonds where profit sharing is based on interest rates. There are 4 (four) types of bonds of this type, namely: fixed rate bonds, floating rate bonds, combination rate bonds, and zero coupons.

Sharia bonds are bonds whose profit/margin/fee sharing is based on sharia principles. What is meant based on sharia principles is that the management of funds from these bonds must avoid things that are prohibited in Islamic law (shariah) including free from interest which has been considered as usury. Sharia bonds consist of two types, namely: Mudharabah Sharia Bonds and Ijarah Sharia Bonds (Hafidzi & Luthfi, 2021).

Convertible Mudharabah Sharia Bonds (Convertible Mudarabah Bonds) are sharia bonds issued by Issuers based on Mudharabah principles to increase working capital needs, with the option that investors can convert bonds into Issuer shares at maturity. Terms of sharia bond (sukuk) mudharabah contract:

1. The contract used in the Sharia Mudharabah Convertible Bonds is a mudharabah contract by taking into account the substance of the DSN-MUI Fatwa Number 7/DSN-MUI/IV/2000 concerning Mudharabah Financing, DSN-MUI Fatwa Number 32/DSNMUI/IX/2002 concerning Sharia Bonds, DSN-MUI Fatwa Number 33/DSN-MUI/IX/2002 concerning Mudharabah Sharia Bonds.
2. Issuers in Convertible Sharia Mudharabah Bonds act as Mudharib, while Holders of Convertible Sharia Mudharabah Bonds act as Shahibul Mal. If the holder of a convertible sharia bond uses his right to convert the bond into shares of the issuer, the contract used is a Musyarakah contract, in which the

holder of the Convertible Mudharabah Sharia Bond acts as a shareholder (Hamil al-sahm).

Special provisions for sharia bonds (Sukuk) mudharabah:

1. The type of business carried out by Issuers may not conflict with sharia principles by taking into account the substance of the DSN-MUI Fatwa Number 20/DSN-MUI/IX/2000 concerning Guidelines
2. Investment Implementation for Sharia Mutual Funds and Number 40/DSN-MUI/X/2003 concerning Capital Markets and General Guidelines for the Application of Sharia Principles in the Capital Market Sector.
3. Investment income (yield) distributed by the Issuer (Mudharib) to Holders of Convertible Sharia Mudharabah Bonds (Shahibul Mal) must be clean from non-halal elements.
4. The profit ratio in Convertible Sharia Mudharabah Bonds between Issuers (Mudharib) and Holders of Convertible Sharia Mudharabah Bonds (Shahibul Mal) is determined by following the agreement, before the issuance (issuance) of the Convertible Sharia Mudharabah Bonds.
5. Distribution of income (yield) can be done periodically according to the agreement, provided that the maturity date is calculated as a whole.
6. Supervision of sharia aspects is carried out by the Sharia Supervisory Board or the Sharia Expert Team appointed by the MUI National Sharia Council since the issuance process of the Convertible Mudharabah Sharia Bonds begins.

7. Ownership of Convertible Sharia Mudharabah Bonds can be transferred to other parties as long as it is agreed in the contract. If an investor exercises the option to convert the bond into the issuer's shares, the price is determined at maturity and by following the current stock market price or an agreed-upon price.
8. If one party does not fulfill its obligations or if there is a dispute between the parties, then the settlement is carried out through the Sharia Arbitration Board or the Religious Court after no agreement is reached through deliberation. (DSN MUI, 2007)

3. Discussions

Mudharabah Syariah Bonds in figure 1, as a loan agreement letter that uses a mudharabah contract between the issuer/seller of the bonds (mudharib) and the buyer of the bonds (shahib al-mal), so that the bonds are a statement of debt from the borrower (bond issuer). The contract requires the issuer (seller) of the bond to make certain payments to the owner (buyer) of the bond (Cestau et al., 2019). These payments in sharia bonds are made based on the profit-sharing principle of the profits or income of the company/issuer of the bonds. So that the nominal amount of profit sharing paid to bond owners is not fixed, because payments to bond owners can only be made after the income of the bond issuer has been known.

The nominal amount of payment/revenue can only be known after the bond issuer's income is known, but the buyer/bond owner already knows the amount of the portion of income sharing or the ratio/ratio of the bond issuer's income at the beginning of the agreement/contract. Therefore, the size of the bond owner's income depends on the size of the income from the bond issuer, in other words, the profit or return from this type of bond is not fixed.

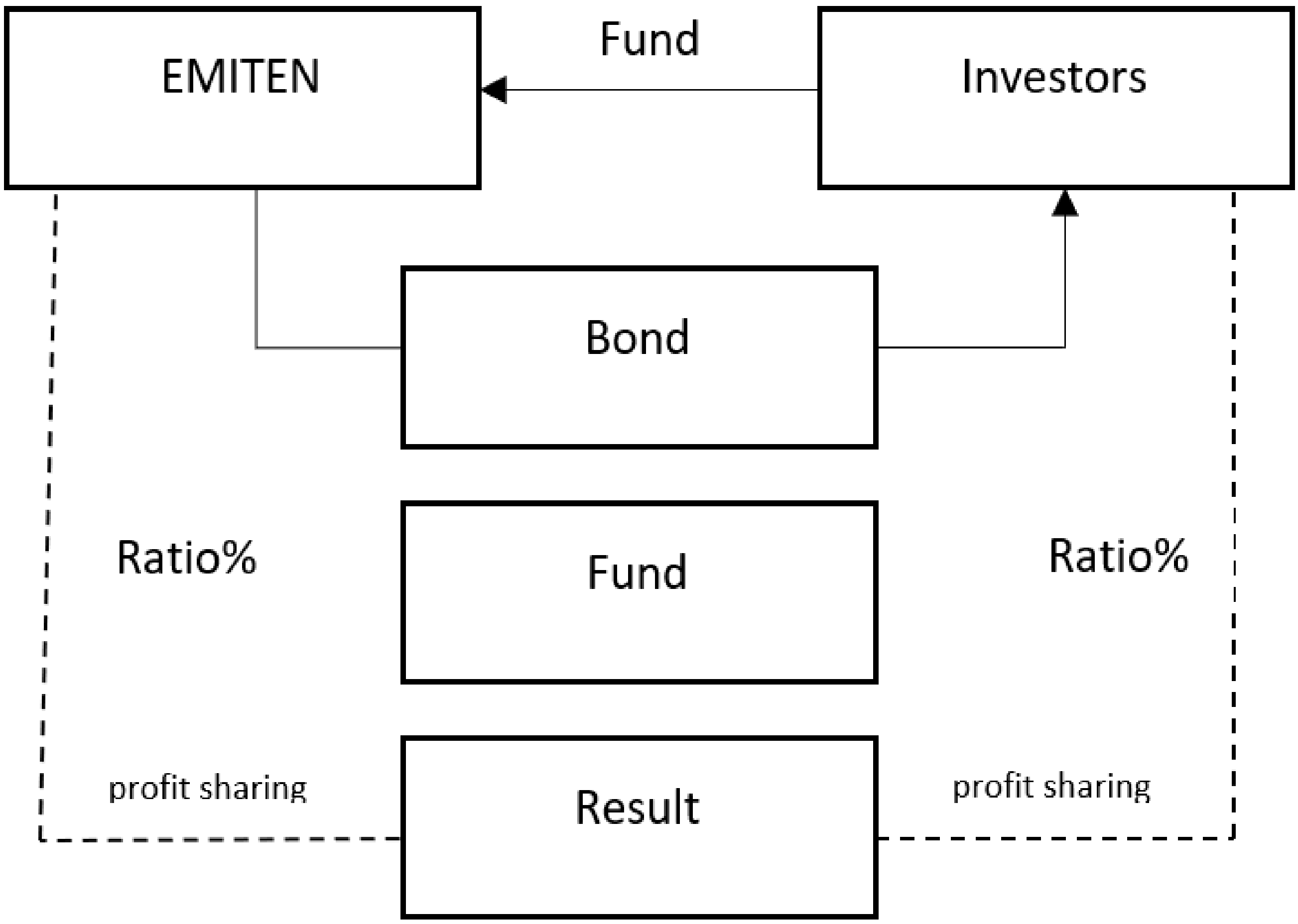

Figure 1. Mudharabah Sukuk (Islamic Bond) Scheme

Another thing that distinguishes between Islamic bonds and conventional bonds is that, for Islamic bonds, from the start, a source has been determined for payment of the bonds (Kareem et al., 2020).

In Ijarah Syariah Bonds, the funds used as capital are allocated to the procurement of new rites or the development of old rites, both movable and immovable rites or services (Kareem et al., 2020).

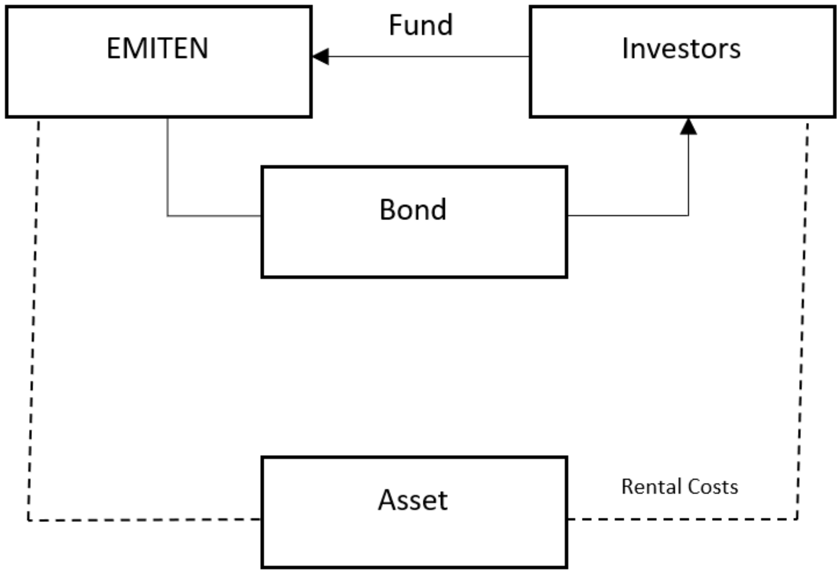

Figure 2. Ijarah Sukuk (Islamic Bond) Scheme

Based on figure 2. the description of sharia bonds and bonds (Sukuk), then in terms of return, it can be seen that: The return obtained by the bondholders has been determined from the coupon/interest amount, while the return obtained from the Sukuk comes from the margin/fee as well as the profit-sharing system based on assets or production. The profit-sharing scheme on Sukuk is very different from bonds, especially in terms of the certainty of returns originating from profit-sharing or interest earned by the owner of the funds. The return to be obtained from bonds can be expressed as yield. Prospective investors will consider the number of bond yields to measure the return to be received. This yield is determined based on the current yield and yield to maturity.

Current yield is calculated based on the number of coupons received for one year against the bond price, while Yield to maturity is the rate of return that investors will get if they hold bonds until maturity. The profit-sharing scheme on Sukuk is very different from bonds, especially in terms of the certainty of returns originating from profit-sharing or interest earned by the owner of the funds (Supriyanto, 2019). The return obtained from investment in Sukuk depends on the principle/contract of agreement used. If the mudharabah or musyarakah principle is used, then the return comes from profit sharing.

Return is determined based on the expected return because it depends on the performance of the income generated. Meanwhile, if the principle used is the Ijarah scheme, the return is in the form of a margin/fee (Soemitra et al., 2021). Likewise, for Sukuk with a Murabahah, Salam, and Istisna scheme as a form of buying and selling on a cost-plus basis scheme, the Sukuk will provide a fixed return to investors.

The difference between bonds and sharia bonds (Sukuk) in terms of pricing schemes, among others, bonds can be issued/offered at several possible prices:

1. At par (at par value), namely the price of the bond is equal to the face value of the bond
2. At premium (with a premium), namely the bond price is higher than the nominal value of the bond
3. At discount (with a discount), namely bonds sold at a price below the nominal value.

The selling price of these bonds is strongly influenced by the market interest rate at the time the bonds are offered. Meanwhile, Sukuk instruments are sold at the maturity par value on the primary market. The agreed price is by following the nominal price because the instrument is based on real assets or transactions. Funds or proceeds from the sale of Sukuk will be received by the company and investment returns will be received by investors. In principle, the issuer of Sukuk has a financial obligation to investors to return the principal plus profit sharing. (Purnamawati, 2015).

In terms of the transfer of bonds (bonds) between the buyer and the seller/issuer, this can only be done at maturity (Sari et al., 2022). At maturity, the bond buyer will get the nominal amount of the bond along with the interest or coupon. However, the transfer of bonds (bonds) can occur in the secondary market. Conventional bonds can be traded even before maturity. The owner (buyer) of the bond will benefit from the difference between the purchase price and the selling price of the bond. This means that bond owners can obtain bonds in the secondary market at a discount from the nominal value stated on the bonds.

In the transfer of Islamic bonds before maturity, there are two opinions, namely that this is a sale and purchase of the debt (money) which is prohibited in Islam, while another opinion states that this is a sale and purchase of assets that represent Islamic bonds in the form of underlying assets (Iggi, 2003).

The transfer or transfer of ownership of sharia bonds can be done in the following ways:

1. There is an agreement at the beginning of the contract between the issuer and the investor regarding the transfer of Islamic bonds before maturity.
2. There is a joint agreement between issuers, investors, and potential new investors in transferring the ownership of the bonds.
3. The prospective new owner knows his rights as the bondholder.
4. The agreement or agreement between the issuer and the initial investor remains valid even though there has been a change in investor/bondholder.
5. The existence of real assets as the underlying assets of the issuance of bonds.

If the bonds are to be transferred to a third party, the nominal value transferred is the same as the nominal value stated on the bond certificate (Djayusman, 2014).

4. Conclusion

Bonds under review of fiqh principles are permissible as stated in the DSN MUI fatwa Number: 32/DSN-MUI/IX/2002 concerning Syari'ah Bonds, Number: 41/DSN-MUI/III/2004 concerning Syari'ah Ijarah Bonds and Number: 59 /DSN-MUI/V/2007 Concerning Convertible Syari'ah Mudharabah Bonds. Bonds can be issued by following shari'ah principles by referring to these fatwas. The basic difference between Islamic bonds and conventional bonds is the application of interest that has been determined at the beginning of the transaction. In sharia bonds, profit sharing is not determined at the beginning of the transaction, but what is determined is the percentage (nisbah) of profits earned in the future.

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