Islamic Capital Market

WAQF ASSETS:
Development, Governance and the role of Islamic Capital Market

Suruhanjaya Sekuriti
Securities Commission
Malaysia

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**The example of those
who spend their wealth
in the way of Allah
is like a seed [of grain]
which grows seven spikes;
in each spike is a hundred grains.
And Allah multiplies [His reward]
for whom He wills.
And Allah is all-Encompassing
and Knowing.**

~ Quran 2:261

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Special Message

by HRH Sultan of Perak Darul Ridzuan and the Royal Patron for Malaysia's Islamic Finance Initiative

Bismillahir-rahmanir-rahim

In accordance with the saying of God's apostle narrated by Muslim, Prophet Muhammad (May prayers and peace be upon him), that *"At a man's demise, of all his deeds only three keep attached to him: a sustained charity, useful knowledge and a virtuous offspring invoking divine care for him".* The great scholar Imam Nawawi, in his exegesis of the *Hadith*, defined "sustained charity" as a religious endowment whereby legal claim is mortmain i.e. neither to be sold nor granted and never inherited no matter how much remains thereof.

In response to this, the development of *waqf* or endowment has been a long practised tradition in Islamic civilisation. The important role of *waqf* in the history of the development of Muslim societies has been well recognised. In the era of the Ottoman Empire, *waqf* as a social and economic tool flourished, supporting the numerous economic and social activities. *Waqf* was not only servicing society for basic necessities, it was then able to provide important and sustainable aspects of life including the acquisition of knowledge and skills through the establishment of various institutions such as public universities.

The subject of *waqf* has seen a revival, attracting interest across the globe in an effort to unlock the potential value of the vast pool of under-developed *waqf* assets. There have been concerted efforts among various stakeholder groups to revive the institution of *waqf,* in line with modern day development by integrating the *waqf* system with the financial world.

Consistent with *waqf* characteristic which is meant to be perpetual, *waqf* assets should ideally generate steady, if not increasing, flow of revenues or usufructs (benefits) to serve their objectives. More importantly, it should be able to provide sustainability to the wide-ranging activities that it is intended for. Efficient utilisation of these assets can also broaden and enhance social impact projects and socially responsible development in the context of public good. One of the outcomes will be a more inclusive society that would be able to enjoy better standards of living and at the same time achieving sustainability of the environment. Thus, fulfilling the *Maqasid al Shariah* (the objective of Shariah).

The best strategy in developing and empowering *waqf* is to integrate it into the Islamic finance system. Today, Islamic finance meets multiple roles in the economy and society, ranging from serving the needs and requirements of the community to being an integral component of a country's financial system. Contemporary financial applications that leverage on Islamic finance particularly Islamic capital market can facilitate and accelerate the development of *waqf* assets on a larger scale in order to achieve various social and economic outcomes.

There is much potential for *waqf* to grow and achieve its past glory. We can learn from the success of the philanthropic models and endowment funds in western countries. With the growth and resilience of Islamic finance, *waqf* should take full advantage by creating more sustainable financial models, without losing its religious objectives. Various stakeholder groups must share the same aspirations to bring *waqf* development to the next level, and collectively and responsibly commit to put into effect the necessary measures.

It is hoped that this book would provide a practical reference in understanding a new financial approach in developing *waqf* assets. I also wish to take this opportunity to commend the Securities Commission Malaysia which has initiated countless efforts in developing the Islamic capital market and the positive contribution towards developing the *waqf* industry. I am confident that this book will generate meaningful inspiration to all *waqf* stakeholders globally and valuable discussions for the development of *waqf* assets.

HRH Sultan Nazrin Muizzuddin Shah
Ibni Almarhum Sultan Azlan Muhibbuddin Shah Al-Maghfur-lah

October 2014

PREFACE

Throughout history, *waqf* had provided for many essential services to society such as health, education and municipal services. There has been renewed interest to revive the institution of *waqf* and unleash its potential to contribute more significantly towards economic and social development. Given the significant size of *waqf* assets in various jurisdictions across the world, it is therefore timely and perhaps even necessary to seek practical solutions and action plans to viably develop these assets. This in turn can help stimulate economic activities and position *waqf* once again as an important economic and social institution serving the needs of society.

With Islamic finance gaining traction across many parts of the world, the development of *waqf* could attract greater interest and participation as well as provide the catalyst for the Islamic finance industry. An integrated and holistic approach would contribute towards a more effective development of *waqf* that is able to demonstrate viability and have a meaningful impact on the welfare of the individual and society.

Waqf assets are well suited to the current environment because it can provide a feasible and unique value proposition for global investors looking for diversification and quality yields. To further realise its potential as an attractive investment opportunity, the development of *waqf* assets must be supported by a system that is efficiently managed and robust. A vibrant Islamic capital market is one of the avenues and would be able to support such development, fundamentally through the issuance of sukuk or any viable Shariah-compliant fund structures.

The Securities Commission Malaysia (SC) has taken on a number of initiatives to explore effective ways to revive the role of *waqf* in economic and social development through the Islamic capital market. One such initiative is the 5th SC–Oxford Centre for Islamic Studies (SC-OCIS) Roundtable on Islamic Finance, themed "Harnessing *Waqf* into a Bankable Social Financing and Investment Asset Class" held in March 2014. Various key issues surrounding the development of *waqf* assets and its potential were discussed among policy makers, senior industry practitioners, Shariah scholars and academia. Following on from the deliberations, participants encouraged the SC to lead further work and follow through on some of the recommendations proposed during the SC-OCIS Roundtable to spur greater development in the area of *waqf*.

This book is a realisation from the SC-OCIS Roundtable and serves as a guide for practitioners, religious bodies, institutions and other interested parties who wish to explore opportunities of developing *waqf* assets through the Islamic capital market and provides recommendations on governance best practices. Governance is an important component of an enabling environment that can bring about greater public confidence on the management of *waqf* assets and the industry as a whole. It is hoped that this book will further encourage all the stakeholders including *waqf* authorities, industry practitioners and financial institutions to work together to synergise efforts and to bring forth creative ideas, methods and initiatives for the development of *waqf* across the globe.

We would like to record our utmost appreciation to HRH Sultan Nazrin Muizzuddin Shah Ibni Almarhum Sultan Azlan Muhibbuddin Shah Al-Maghfur-lah, Sultan of Perak Darul Ridzuan, for kindly consenting to write the Special Message for this book. His Royal Highness' passion and guidance towards Islamic finance gives us the inspiration to excel further in our endeavours.

Securities Commission Malaysia

October 2014

ACKNOWLEDGEMENTS

Waqf Assets: Development, Governance and the Role of Islamic Capital Market was made possible by the collective effort of staff members of the Securities Commission Malaysia (SC). The development of *waqf* assets globally can present an opportunity for the Islamic capital market to play a greater role towards society. This *waqf* book, therefore, is a response to support and complement the various initiatives of developing and managing *waqf* assets. The *waqf* book directs its focus on leveraging in the Islamic capital market and provides guidance on matters relating to capital, capability and confidence.

Constructive input and ideas reviewed by members of Shariah Advisory Council of the SC (2012-2014) particularly Datuk Dr Mohd Daud Bakar, Assoc Prof Dr Aznan Hasan, Prof Dr Engku Rabiah Adawiah Engku Ali, Prof Dato' Mohamed Ismail Mohamed Shariff and Assoc Prof Dr Azman Mohd Noor are fully appreciated.

This publication has benefited from the invaluable materials, comments, views and assistance rendered by SC staff members throughout its production. Special mention is accorded to the senior management of the SC for their guidance and advice in providing direction for the publication of this book. Many thanks go to: Product Evaluation and Shariah departments, Islamic Capital Market business group; Markets & Products Department, Market Development; Advisory Department, General Counsel and Corporate Affairs Department.

The co-ordination and production of this book were led by the Development Department, Islamic Capital Market business group.

CHAPTER 1

CONTEMPORARY WAQF AND ISLAMIC FINANCE

“… a modernised *waqf* structure that is both transparent and responsive can rival other Islamic and conventional financial instruments, capable of contributing towards economic growth and development”.

~ Tan Sri Dr Mohd Irwan Serigar Abdullah, Secretary General of Treasury, Ministry of Finance, speech delivered at the Roundtable Discussion on Managing Waqf Properties in Malaysia, Kuala Lumpur, January 2014.

Chapter 1

CONTEMPORARY WAQF AND ISLAMIC FINANCE

Waqf is an endowment initiative that is managed in accordance with the Shariah and plays a prominent role in the Islamic economic system. The concept started off as a simple endowment during the time of Caliph Umar al Khattab (RA), but it was only during the time of the Ottomans that through innovations, *waqf* management became more clarified and, in a way, regulated. The concept and structure of *waqf* changed into self-sustaining business models that generated income utilised not just for upkeep and maintenance of the assets or properties, but also other philanthropic activities.

In recent times, we have witnessed interesting developments in the area of *waqf*, some of which exhibits innovative and practical solutions in terms of forms, structures, operating models and Shariah pronouncements. Cash *waqf* and corporate *waqf* are among the contemporary forms of *waqf*. Cash *waqf* or cash endowment is a form of liquid asset that can be channelled immediately towards certain investment objectives, and the dividends or capital gains derived can be utilised to meet the desired aims under the *waqf* charter.

Corporate *waqf* takes a form of corporate vehicle where liquid assets such as stocks or securities are endowed, thereby enabling the *waqf* institutions to benefit through the flow of dividends and these monies may be used to fund various charitable projects or initiatives. We have also witnessed instances where the promoter of cash *waqf* and corporate *waqf* leveraged on the capability of professional fund managers for the management of their *waqf* funds to generate returns.

The industry also saw some structural institutional changes within the *waqf* system with the establishment of a separate *waqf* entity from that of the religious body, with this entity being helmed by professionals. In the aspects of scholarly reasoning, religious institutions in certain jurisdictions have pronounced the practice of *istibdal* – a substitution of a *waqf* asset with another asset that enables the overall benefits and value to be subsequently enhanced, paving the way for a more flexible route to the development of *waqf* assets.

While *waqf* had been an integral part of Islamic countries' social and economic system, its present development is hampered by the absence of a comprehensive and complete ecosystem including the lack of legislation, governance, professionalism, the issue of misperception and more importantly, the availability of funding.

The pace for reforms on existing legislations and regulations for *waqf* could be accelerated to provide a conducive environment for growth. Strengthening governance and professionalism in *waqf* institutions will create trust and confidence thereby generating vibrancy within the system. This can be supported by the practice of accountability and transparency to create opportunity for quality improvement and value to the institution of *waqf*.

Sitting on the other end is Islamic finance where the global industry is forecast to grow exceeding US$2 trillion and it now has the scale to support other segments of the Islamic economic system including *waqf*. As Islamic finance is centred on ethics and the real economy, it should be an ideal platform for *waqf* to leverage onto especially in respect of meeting *waqf's* capital requirements, professional management and sustainability needs.

Islamic finance, for instance, is an avenue for *waqf* institutions to outsource its activities in terms of securing professional management of its relevant *waqf* assets riding on the basis that these Islamic intermediary institutions are duly governed, regulated and supervised. As more investment firms look at this opportunity, it will definitely add a new dimension especially in the area of Islamic fund management. The *waqf* system will in effect offer promising prospects for the growth of the Islamic finance industry, including Islamic capital market.

On the other hand, the availability of funding is one of the key components for the development and maintenance of *waqf* assets. One of the main sources of funding has always been through cash donation. Nevertheless, the monies collected are seldom sufficient which explains the generally dilapidated state of *waqf* assets. Given this impediment, *waqf* should consider other avenues to meet its funding need. One alternative is the Islamic capital market where various instruments and institutions are available to serve this need.

CHAPTER 2

INNOVATING DEVELOPMENT OF WAQF ASSETS THROUGH ISLAMIC CAPITAL MARKET

Efficient utilisation of *waqf* assets can also broaden and enhance social impact projects and socially responsible development within the country. One of the outcomes will be a more inclusive society that enjoys better standards of living and sustainability of the environment.

~ HRH Sultan Nazrin Muizzuddin Shah, special address delivered at the 5th SC-OCIS Roundtable, March 2014

Chapter 2

INNOVATING DEVELOPMENT OF WAQF ASSETS THROUGH ISLAMIC CAPITAL MARKET

Innovation is an important element that can be used to promote the development of *waqf*. Innovation requires concerted efforts by many parties and acceptance of new ideas. As the development of *waqf* assets may require huge amounts of capital, innovation can take the form of new ways of financing which depart from the traditional methods of financing from financial institutions.

The availability of Islamic capital market products can be used to raise the needed capital while professional services provided by Islamic capital market intermediaries (e.g. asset managers licensed by the supervisory authorities) can be harnessed to efficiently manage *waqf* assets. These licensed intermediaries have resources and expertise in assessing, developing and managing the *waqf* assets thereby creating opportunities for larger economic returns to the community. By leveraging on these available avenues, *waqf* institutions can broaden and enhance social impact projects as well as sustainable and responsible development within the country.

There are various products and services available in the Islamic capital market to meet the demand and preferences of both Islamic and conventional stakeholders. These products can facilitate the development of *waqf* assets either for raising capital or for investment purposes which will be explained further in this chapter.

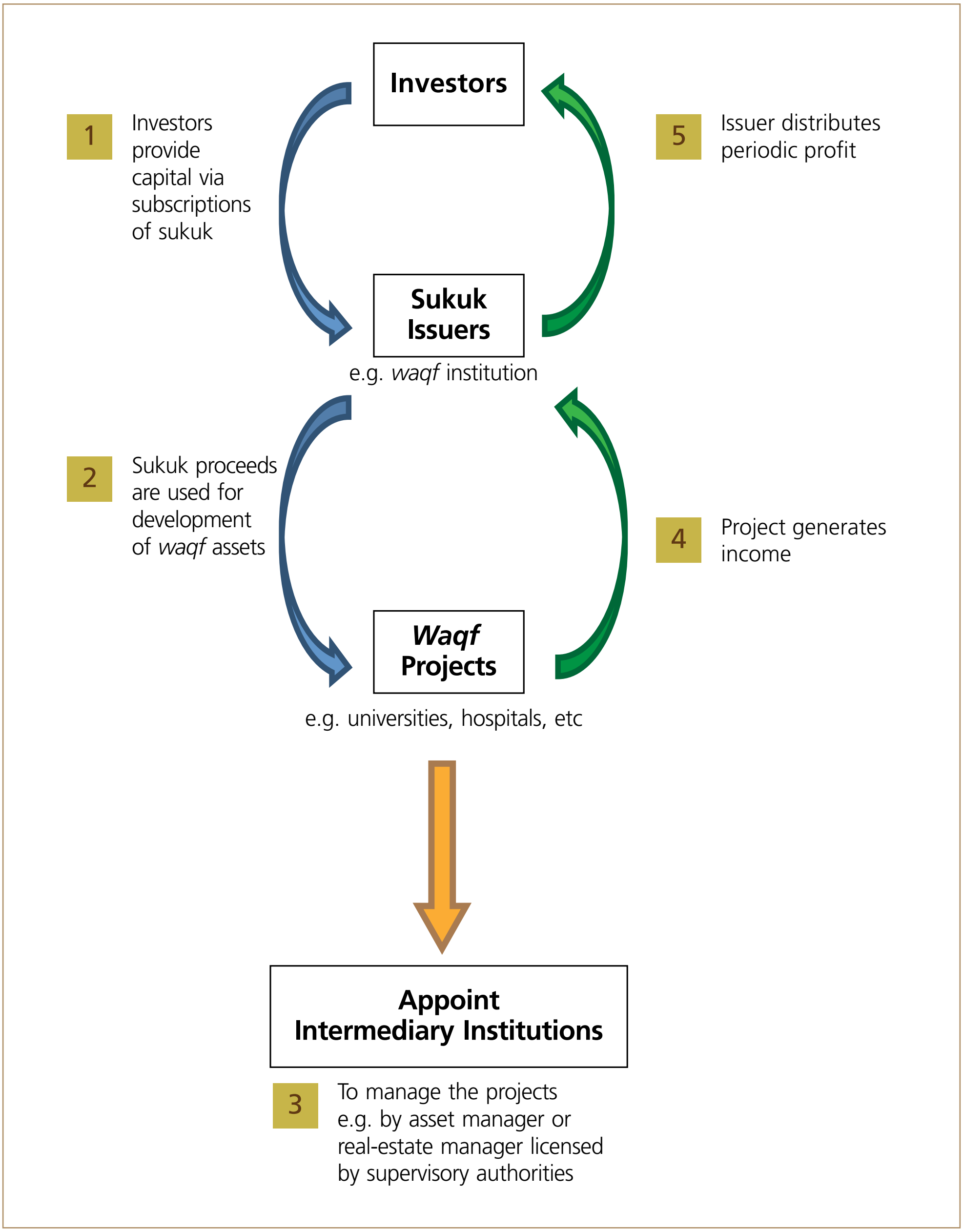
2.1 RAISING OF CAPITAL THROUGH SUKUK

The Islamic capital market is one of the main components of the capital market in certain jurisdictions. It functions as a parallel market to the conventional capital market, and plays a complementary role to the Islamic banking system in broadening and deepening the Islamic financial markets. The core proposition of Islamic finance draws from its inherent features and the values that it brings to the economy, and the tremendous potential that it offers in supporting sustainable economic growth and in safeguarding financial stability. These core propositions are derived from the Shariah, which dictates that Islamic financial transactions must be supported by underlying productive activities. This Shariah ruling ensures a close link between financial transactions and the real economy while the embedded Shariah principles serve as a built-in mechanism against unproductive elements in financial transactions.

Waqf institutions can opt to explore raising capital for the development of their *waqf* projects through issuance of sukuk. Sukuk are widely used instrument in the Islamic capital market to finance specific economic activities in accordance with Shariah principles. Sukuk have flexible characteristics in which they can be structured to meet the medium to long-term financing requirements. Thus, sukuk may be issued for various purposes to satisfy the issuer's commercial needs, such as for the purpose of financing working capital and capital expenditure requirements, vis-à-vis the investors' (sukukholders) investment and risk appetite. Diagram 1 provides an overall picture of how capital raising from sukuk issuance could be used for the development of *waqf* assets.

Diagram 1

Raising capital through sukuk issuance for the development of waqf assets



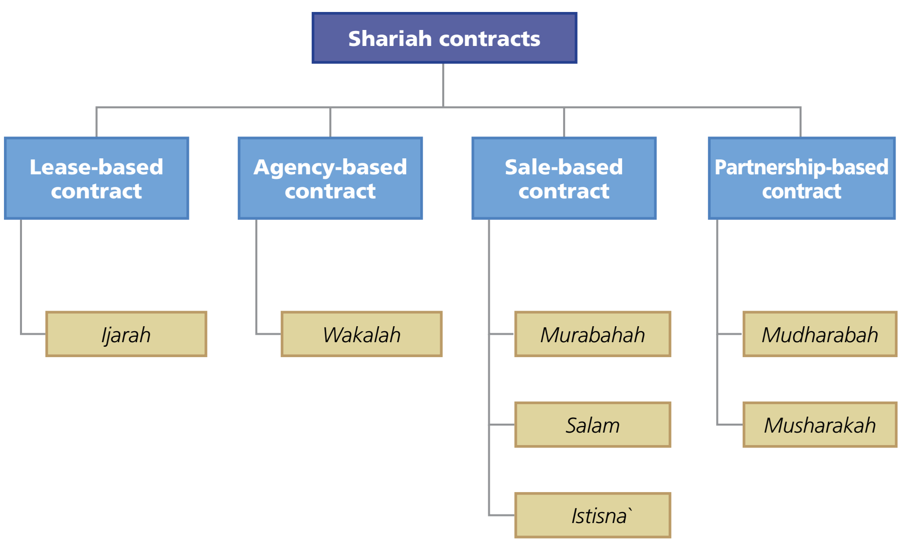
Source: SC

Sukuk, the plural of "*sakk*", is the Arabic term for Islamic securities or Islamic bonds. The literal meaning of sukuk is certificates. Technically, it refers to certificates of equal value which evidence undivided proportionate ownership or investment in the assets using Shariah principles and concepts. The investors may receive profit or income from the cash flow generated from the assets or investment in the asset in the form of periodic distributions. The returns may be fixed or variable depending on the mechanisms applied.

Sukuk are structured based on various Shariah contracts to create financial obligations and relationships between issuers and investors. Generally, the common underlying Shariah contracts used in structuring sukuk are lease-based, agency-based, sale-based and partnership-based as shown in Diagram 2. The definition for each of these Shariah contracts is available in Table 1.

Diagram 2

Underlying Shariah contracts for sukuk structure



Source: SC

Table 1
Shariah contracts in sukuk transactions

Shariah contract	Definition
Ijarah	A contract whereby a lessor (owner) leases out an asset to a lessee at an agreed lease rental for a predetermined lease period. The ownership of the leased asset shall always remain with the lessor.
Wakalah	A contract where a party authorises another party to act on behalf of the former based on agreed terms and conditions as long as he/she is alive.
Murabahah	A contract that refers to the sale and purchase of an asset whereby the cost and profit margin (mark-up) are made known.
Salam	A sale and purchase contract whereby payment is made in cash at the point of contract but the delivery of the asset purchased will be deferred to a pre-determined date.
Istisna`	A purchase order contract where a buyer requires a seller or a contractor to deliver or construct the asset to be completed in the future according to the specifications given in the sale and purchase contract. The payment term can be as agreed by both parties in the contract.
Mudharabah	A contract made between two parties to enter into a business venture. The parties consist of the *rabb al-mal* (capital provider) who shall contribute capital to finance the venture, and the *mudharib* (entrepreneur) who will manage the venture. If the venture is profitable, the profit will be distributed based on a pre-agreed ratio. In the event of a business loss, the loss shall be borne solely by the *rabb al-mal*, unless the loss is due to the negligence or mismanagement of the *mudharib* in managing the venture.
Musharakah	A partnership arrangement between two or more parties to finance a business venture whereby all parties contribute capital either in the form of cash or in kind for the purpose of financing the said venture. Any profit derived from the venture will be distributed based on a pre-agreed profit sharing ratio, but a loss will be shared on the basis of capital contribution.

Source: SC

2.1.1 Exploring Viability of Sukuk Structures for Waqf Development

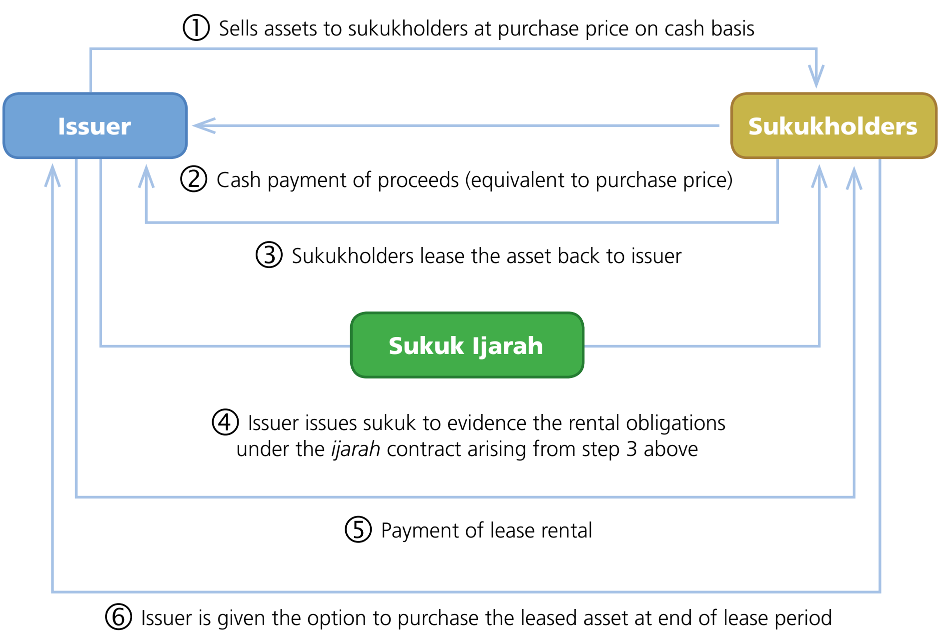
The issuance of sukuk is supported by various structures which are permissible under Shariah.

The following exemplifies several types of sukuk structures based on different categories of Shariah contracts. These sukuk structures could be explored and may be used as a basis for innovative financing for *waqf* development.

Sukuk ijarah

Sukuk *ijarah* refers to certificates of equal value evidencing the certificate holders' undivided proportionate ownership of the leased asset and/or usufruct and/or services and rights to the rental receivables from the said leased asset and/or usufruct and/or services. Diagram 3 below illustrates the basic transaction structure of sukuk *ijarah*.

Diagram 3
Basic transaction structure of sukuk ijarah



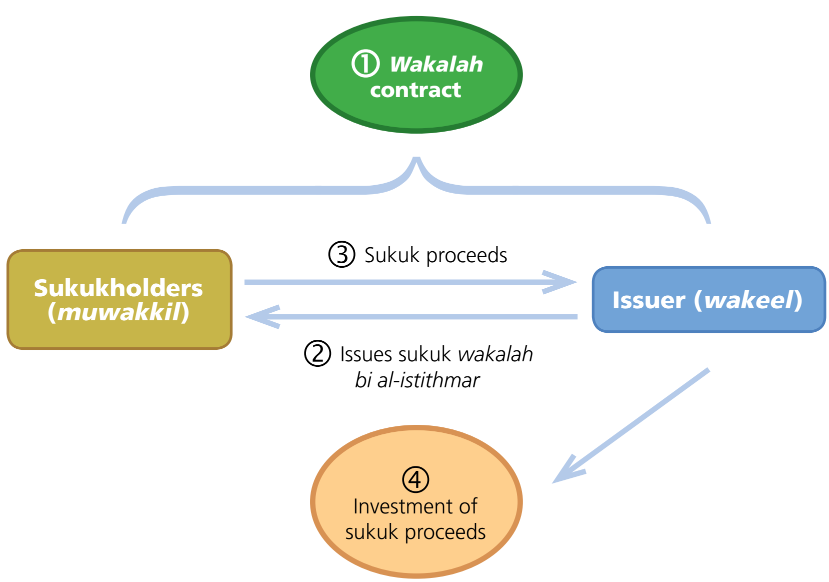
Source: SC

In a sukuk *ijarah* transaction, the issuer who is in need of financing will first sell its asset to the sukukholders for the financing amount. The sukukholders effect payment to the issuer. The same asset is then leased back to the issuer for a lease rental. The periodic lease rental will constitute the periodic distribution to the sukukholders. The issuer will then issue the sukuk *ijarah* to the sukukholders who are also the lessors. At end of lease period, issuer has an option to purchase the leased asset.

Sukuk wakalah bi al-istithmar

Sukuk *wakalah bi al-istithmar* refers to certificates of equal value which evidence undivided proportionate ownership of the certificate holders in the investment assets pursuant to their investment through the investment agent or *wakeel*. Diagram 4 illustrates the basic transaction structure of sukuk *wakalah bi al-istithmar*.

Diagram 4
Basic transaction structure of sukuk wakalah bi al-istithmar



Source: SC

In the above structure, the sukukholders and the issuer enter into a *wakalah* contract, whereby the issuer is appointed as *wakeel* and acts according to the terms and conditions determined by the sukukholders. As *wakeel*, the issuer is entitled to receive a management fee. The sukukholders as *muwakkil*, appoint the issuer as their *wakeel* to invest their money/fund in Shariah-compliant activities or projects.

The issuer then issues sukuk *wakalah bi al-istithmar* to the sukukholders. Proceeds from the sukuk issuance will be used by the issuer for investments in the Shariah-compliant activities or projects.

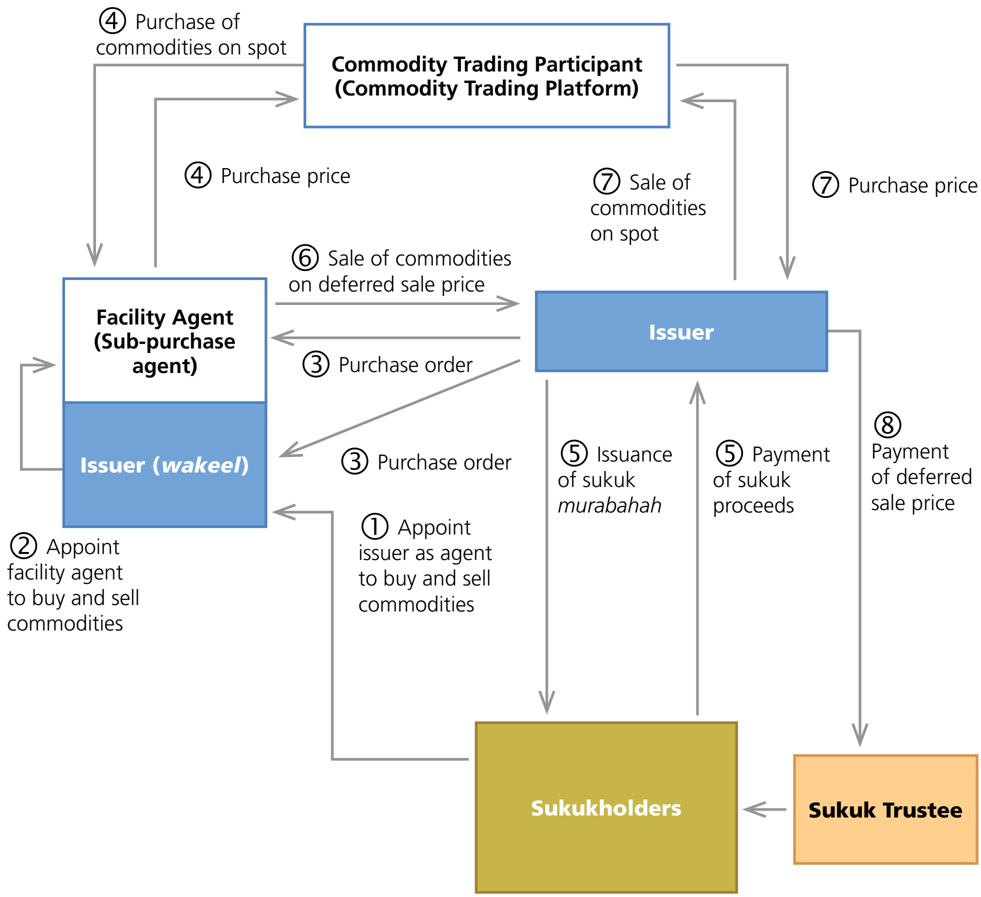
Sukuk murabahah

Sukuk *murabahah* refers to certificates of equal value evidencing the certificate holder's undivided proportionate ownership of the asset, including the rights to receivables arising from the underlying contract. Diagram 5 illustrates a typical sukuk *murabahah* (via *tawarruq*[1] mechanism) transaction structure.

1 *Tawarruq* (tripartite sale) – purchasing a commodity on a deferred price and then selling it to a third party for cash

Diagram 5

Basic transaction structure of sukuk murabahah (via tawarruq mechanism)



Source: SC

In this arrangement, the issuer will be appointed as agent (*wakeel*) for the sukukholders to buy and sell Shariah-compliant commodities. The *wakeel* will then appoint a facility agent (as its sub-purchase agent) to buy and sell the commodities. The issuer will issue a purchase order to the *wakeel* and the facility agent whereby the issuer will irrevocably undertake to purchase the commodities from the sukukholders at a price equivalent to the purchase price and a mark-up (profit) payable on a deferred payment basis (deferred sale price).

The facility agent will purchase the commodities from commodity vendor(s) in the commodity trading platform [through a Commodity Trading Participant (CTP)] at a purchase price on a spot basis (equivalent to the proceeds of the sukuk *murabahah*). Subsequently, the issuer shall issue the sukuk *murabahah* to the sukukholders evidencing the sukukholders ownership of the commodities and all such rights thereto (including all rights against the issuer under the purchase order as well as the rights to the deferred sale price once the commodities are sold to the issuer).

Proceeds received from the issuances of the sukuk *murabahah* shall be used by or deemed to have been used by the facility agent to pay the purchase price of the commodities. Thereafter, the facility agent as instructed by the sukukholders shall sell the commodities to the issuer at the deferred sale price. Upon completion of such purchase, the issuer (acting as purchaser) shall sell the commodities in the commodity trading platform (through a CTP) for a cash consideration equal to the purchase price on a spot basis.

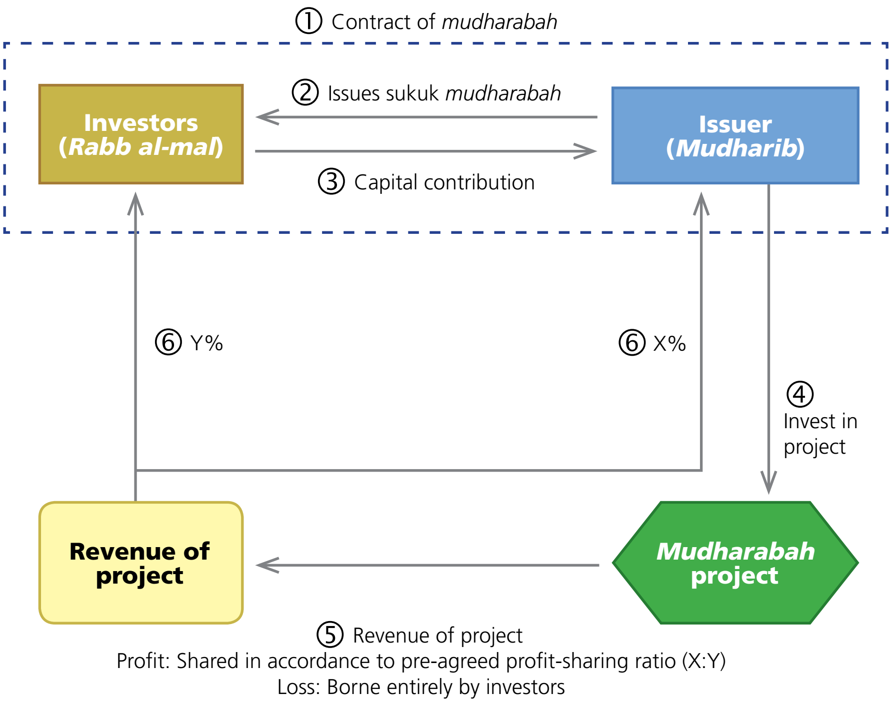
During the tenure of the sukuk *murabahah*, the issuer shall make payment of the deferred sale price periodically to the sukuk trustee (acting for the sukukholders amounting to its obligation to pay the deferred sale price to the sukukholders).

Sukuk mudharabah

Sukuk *mudharabah* refers to certificates of equal value evidencing the certificate holder's undivided proportionate ownership in the *mudharabah* venture. Diagram 6 illustrates the basic transaction structure of sukuk *mudharabah*.

Diagram 6

Basic transaction structure of sukuk mudharabah



Source: SC

In a sukuk *mudharabah* structure, the issuer will first invite investors to participate in the *mudharabah* contract. The issuer will act as the entrepreneur or *mudharib* while the investors will be the capital provider or *rabb al-mal*. The *mudharabah* sukuk is issued by issuer to evidence the proportionate capital contribution by the investors to the *mudharabah* and their subsequent right in the *mudharabah* project or investment activities.

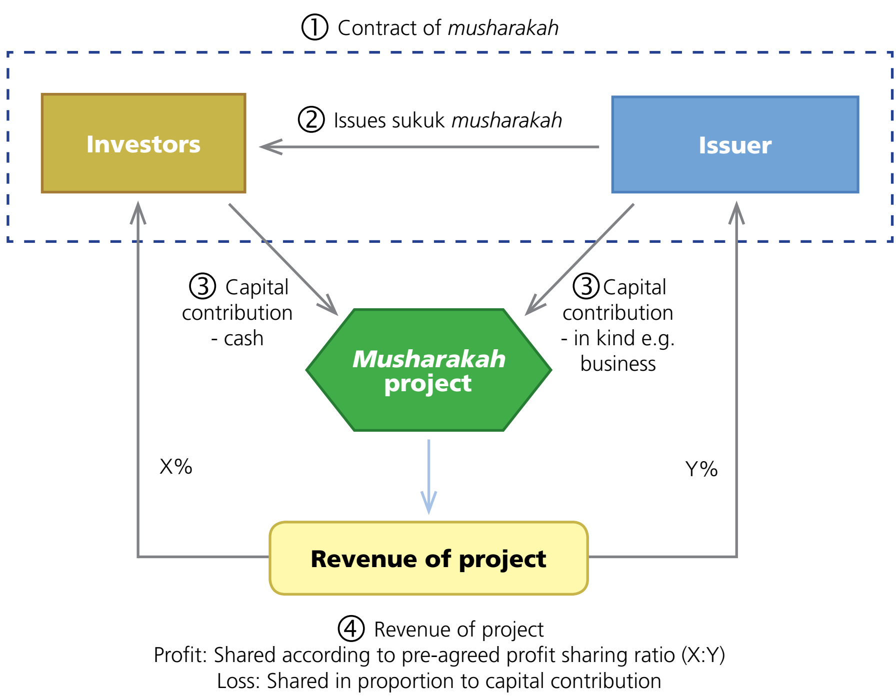
The issuer as *mudharib* will then invest the *mudharabah* capital into an agreed project. Normally, the *mudharabah* project would already have identifiable projected cash flow, and this allows the issuer to indicate an expected rate of profit to the investors upon initial issuance of sukuk *mudharabah*. The expected rate of profit should be calculated based on a pre-agreed profit sharing ratio that is tentatively applied to the projected return of the project.

If the project generates profit, the issuer will apply the profit sharing ratio and pay the profit share of the investors as periodic coupon distribution. However, if the project suffers a loss, it will be borne by the investors except when the loss is caused by the negligence or mismanagement of the *mudharib*.

Sukuk musharakah

Sukuk *musharakah* refers to certificate of equal value evidencing the certificate holder's undivided proportionate ownership in the musharakah venture. Diagram 7 illustrates the basic transaction structure of sukuk *musharakah*.

Diagram 7
Basic transaction structure of sukuk musharakah



Source: SC

In a *musharakah* sukuk transaction, both the issuer and the investor will contribute to the capital of the *musharakah* project. The *musharakah* project is normally managed by either the issuer or a third party as the case may be.

Similar to a *mudharabah* arrangement, if the project generates profit, the issuer will apply the profit sharing ratio and pay the profit share of the investors as periodic coupon distribution. However, for *musharakah*, if the project suffers a loss, it will be shared by both the issuer and investors on the basis of their capital contribution.

Alternatively, a *musharakah* sukuk transaction may also be structured in the form of partnership among the investors only whereby the investors will contribute capital for the purpose of investment in the issuer's business, as the *musharakah* project. The investors will appoint the issuer as their agent to manage the *musharakah* project. This is likened to the *wakalah* concept.

2.1.2 Shariah-related Considerations in the Structuring of Sukuk

The use of *waqf* assets as underlying assets in the structuring of sukuk may attract salient Shariah-related considerations as listed in Table 2. These Shariah-related considerations may be subjected to *fatwa* issued by the relevant religious authorities regarding the permissibility of certain sukuk structures.

Assets, other than *waqf* assets can also be used as underlying assets in the course of structuring sukuk. In this instance , the proceeds from this sukuk issuance can be utilised for financing *waqf* development.

Table 2

Salient Shariah-related considerations in the structuring of sukuk

- ***Waqf* assets as underlying assets in sukuk structuring**
  Whether *waqf* assets can be used as underlying assets in sukuk structuring based on the various Shariah principles?

- **The principle of perpetuity in *waqf***
  Whether a "temporary" sale of *waqf* asset under a sale and lease-back *ijarah* structure is permissible with the presence of binding purchase undertaking?

- **Income derived from *waqf* assets as collateral**
  Whether it is permissible to use income derived from the *waqf* assets as collateral for purposes of raising financing?

- **Application of *istibdal* (substitution of *waqf* asset)**
  In cases where the application of *istibdal* is permissible, questions arise as to whether the remaining proceeds from the disposal of *waqf* assets (where part of the proceeds are used to acquire new *waqf* assets) can be used as capital contribution in a sukuk structure.

2.1.3 Demonstration Effect of Waqf Development Involving the Issuance of Sukuk

Waqf development involving the issuance of sukuk is not entirely new to the market. There have been successful sukuk issuances for the development of *waqf* assets in several jurisdictions e.g. Singapore and Saudi Arabia. These issuances demonstrate how sukuk, being a Shariah-compliant capital market instrument, can be innovatively structured to support the financing for the development and redevelopment of *waqf* assets into viable income-generating properties. Today, these *waqf* assets have proven to be highly successful in supporting the objective of providing the needs of society.

Sukuk musharakah for the development of an old mosque in Bencoolen Street, Singapore[2]

In Singapore, sukuk *musharakah* was introduced for developing commercial building on *waqf* land. This initiative was spearheaded by Warees Pte Ltd (Warees), a subsidiary of the Islamic Religious Council of Singapore or Majlis Ugama Islam Singapura (MUIS).

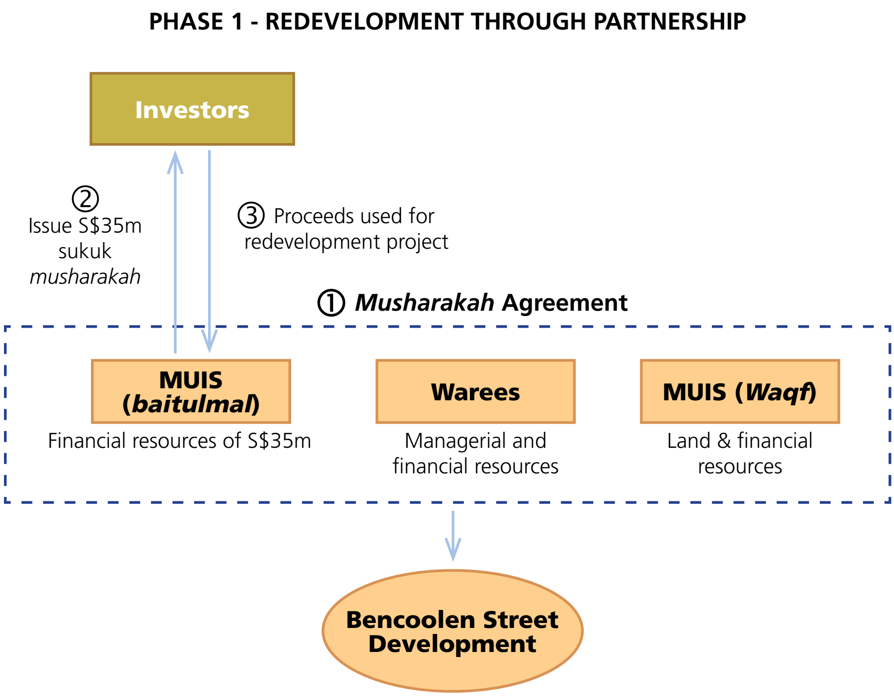
Between 2001 and 2002, Warees successfully developed two pieces of *waqf* lands in Singapore through the issuances of sukuk *musharakah* in which US$60 million was raised. One of these was the redevelopment of an old mosque into a multi-storey complex comprising a modern mosque, a 3-storey commercial building, and a full-service 12-storey apartment block with 84 units in Bencoolen Street in 2002. The financing of the project was done through the issuance of S$35 million sukuk *musharakah*. The *musharakah* was a joint venture among three parties i.e. MUIS (*baitulmal*), Warees and MUIS (*waqf*). The sukuk were fully subscribed by institutional investors. The structures of this sukuk issuance pertaining to the redevelopment through partnership and distribution of return are described in Diagram 8.

Mosque at Bencoolen Street, Singapore. Before and after.

[2] *Waqf Prospects and Challenges*, KFH Research Ltd, May 2013

Diagram 8

S$35 million Sukuk Musharakah by MUIS

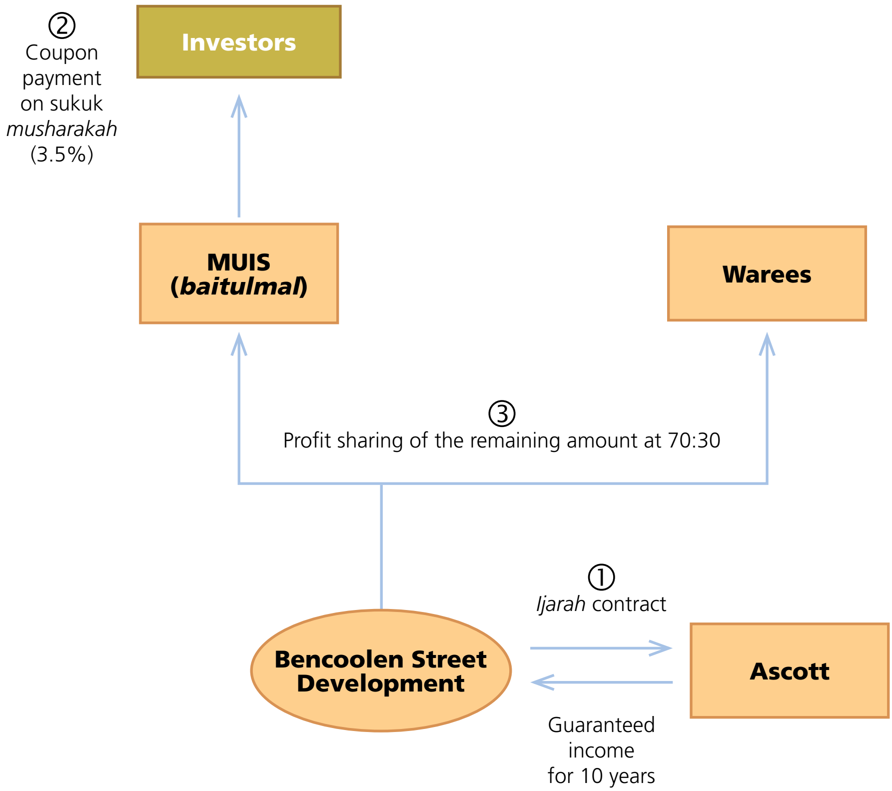


Source: Presentation by Dr Shamsiah Abdul Karim, at the 5th SC-OCIS Roundtable, Kuala Lumpur, March 2014.

Notes:

1. MUIS (*baitulmal*), Warees and MUIS (*waqf*) entered into a *musharakah* agreement.
2. Sukuk *musharakah* was issued to the investors.
3. Proceeds from the issuance were used for the redevelopment of Bencoolen Street Project.

PHASE 2 – DISTRIBUTION OF RETURNS



Source: Presentation by Dr Shamsiah Abdul Karim, at the 5th SC-OCIS Roundtable, Kuala Lumpur, March 2014.

Notes:

1. Ascott Investments Pte Ltd (Ascott) signed a 10-year *ijarah* to lease the apartments of the Bencoolen Street Project.
2. Investors received an annual profit of 3.5% from the rental income.
3. The remaining profit amount is shared between MUIS (*baitulmal*) and Warees based on 70:30 profit-sharing ratio.

Sukuk al-Intifa`a *for the development of Zamzam Tower, Makkah*[3]

In Saudi Arabia, the issuance of sukuk *al-intifa`a* (timeshare) has been successfully implemented to develop one of the apartment towers near the Grand Mosque in Makkah. In this transaction, a construction and real estate company, Munshaat Real Estate Projects Co. (Munshaat) was awarded with a 24-year lease to construct one of the seven towers (Zamzam Tower) on the land adjacent to the Grand Mosque, which is owned by the King Abdul Aziz Waqf for the Two Holy Mosques (The Waqf).

In this transaction, the developer, Munshaat was granted the lease over the *waqf* land. The sukuk issuance was for the purpose of financing the construction cost of the said tower. This was achieved via a forward lease contract *(ijarah mawsufah fi dhimmah)*. Under the forward lease, Munshaat leased the asset under construction to the sukukholders (for 22 years) who paid the lease rental in advance in one lump sum.

Due to restriction on ownership of non-Saudis of real property right in Makkah, the sukukholders would enjoy the usufruct of the assets after its construction based on time-sharing slots. The time-sharing rights under the forward lease were evidenced by the issuance of sukuk al-*intifa`a*. The advance lease rental (sukuk proceeds) was used by Munshaat to pay for the 24-year lease rental on the *waqf*, and the construction costs of Zamzam Tower.

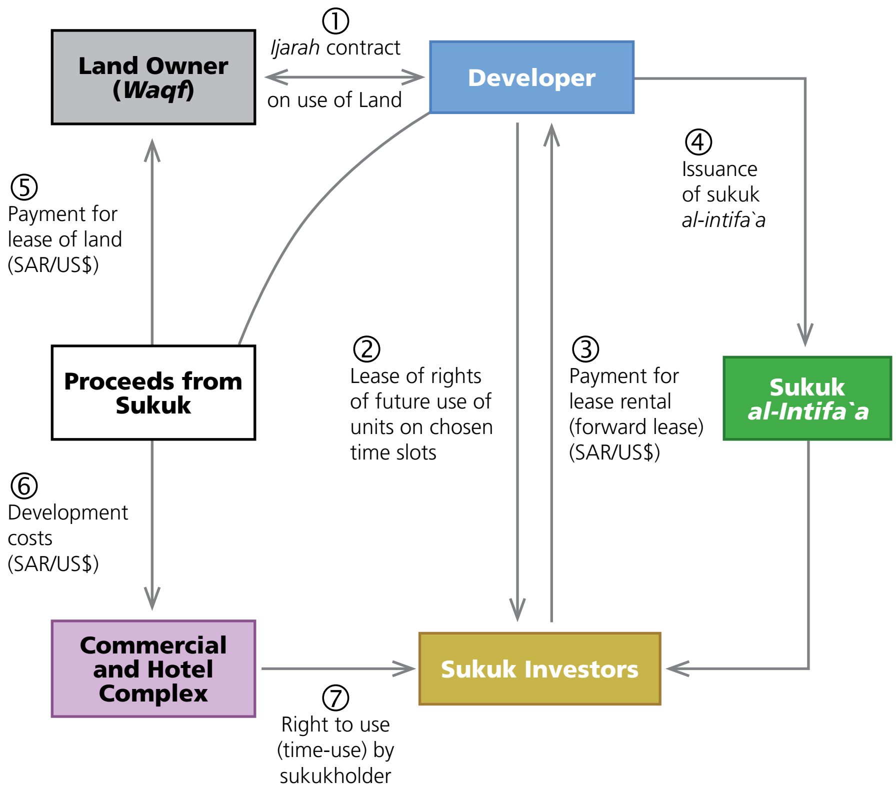
The interesting part of sukuk *al-intifa`a* is the recognition of a new asset class upon which the sukuk are based. This new asset class is in the category of usufruct *(manfa`ah)*. More specifically, it involves the right to benefit or enjoyment *(haq al-intifa`a)* in the form time-sharing in the use of a common property. These sukuk are fully negotiable. They can be sold, leased, lent, given, bequeathed, exchanged and delayed (subject to certain conditions). The investor participates by purchasing the sukuk and paying their value in advance, plus payment of annual charges for maintenance and managerial service.

3 Presentation on *Sokouk Al-Intifa`a* by Fuad Hamed Al-Homoud, Munshaat Real Estate Projects Company at the International Islamic Financial Markets Conference, Bahrain, May 2005 and *The Islamic Securities (Sukuk) Market* (p. 106), Securities Commission Malaysia, July 2009.

Zamzam Tower is part of Abraj Al-Bait Complex and is one of the seven towers at the complex.

Diagram 9

Issuance of sukuk al-intifa`a for the development of Zamzam Tower on waqf land in Makkah, Saudi Arabia



Source: SC

Note:

1. Developer (i.e. Munshaat) was granted with a 24-year lease over the *waqf* land.
2. Developer leased asset under construction to sukuk investors.
3. The sukuk investors made lump sum payment of lease rental to the developer (proceeds for the sukuk).
4. This forward lease was evidenced by the issuance of sukuk *al-intifa`a*.
5. Proceeds from sukuk issue were used to pay for the said lease.
6. Proceeds were also used to pay the development cost of commercial and hotel complex of Zamzam Tower.
7. After the construction, the sukuk investors enjoyed the usufruct of the asset based on time sharing slots.

2.2 INVESTING IN ISLAMIC CAPITAL MARKET PRODUCTS AND LEVERAGING ON INTERMEDIARY INSTITUTIONS

The Islamic capital market is not only capable of offering potential solutions in the context of capital raising and investments for the development of *waqf* assets, it also offers a regime of well-regulated intermediary institutions capable of managing various asset classes in the marketplace, including *waqf* assets.

2.2.1 Investments in Islamic Capital Market Products

The Islamic capital market further offers the availability of Shariah-compliant financial products that have the potential as underlying investments for maximising returns as well as generating a consistent and sustainable flow of income stream to *waqf* institutions.

Corporate *waqf* and cash *waqf* are among the contemporary form of *waqf* and have recently gained more traction as being the more effective mode of developing *waqf*. These *waqf* modeled themselves against more professionally-managed funds where *waqf* donors would contribute cash or financial assets which are then managed professionally by asset or fund managers on behalf of the *waqf* institutions. The assets will then be invested in Shariah-compliant financial assets with the intention of generating sustainable returns to the *waqf* funds.

These Islamic capital market financial instruments include:

Sukuk

Over the years, sukuk have progressively become the preferred choice for fundraising by public entities and private companies in many jurisdictions seeking a wider market for their funding needs. Due to the additional value-add of social benefits and Islamic principles incorporated into its structure as opposed to the typical conventional bond offering, sukuk would naturally appeal to a broader investor base.

The demand for sukuk comes from investors who seek Shariah-compliant investments such as takaful operators, Shariah-based unit trust funds, Islamic fund managers as well as non-Islamic institutions. The non-Islamic institutions view sukuk as a new asset class that fits their investment strategies and/or to diversify their portfolios, as the yields are competitive against similar conventional instruments.

Since most sukuk are assessed and rated by rating agencies, investors could refer to the sukuk rating as a guideline to assess risk or return parameters of the sukuk issue. Sukuk offer regular periodic income stream and a possibility of capital appreciation. They are also tradable and allow for easy liquidation, should there be a need for immediate cash.

Shariah-compliant shares

Shariah-compliant shares are another permissible Islamic capital market product for investment, based on the company's compliance with Shariah requirements such as its primary business, investment activities and financial ratios. Shareholders will receive their returns in the form of dividends or capital gains by selling the shares when the price of the shares has appreciated.

To classify a share of a company as Shariah-compliant, the business activities of the company and its financial ratios will be screened first and this is termed as the Shariah screening process. The concept of screening companies before making any investments is to comply with the Shariah principles that Muslims should not participate in non-permissible activities which are contrary to the teachings of Islam.

Islamic unit trust funds

Islamic unit trust funds (also known as Islamic mutual funds) is a type of collective investment scheme that offers investors the opportunity to invest in a diversified portfolio of Shariah-compliant securities, sukuk and money market instruments. It is available in many forms such as Islamic equity funds, sukuk funds and others. The investment objectives of Islamic unit trust funds vary according to the type of fund. It determines the risk of a fund and the kind of investor the fund is targeting.

Islamic unit trust fund provides investors with the opportunity to diversify their investments into various financial assets. It is professionally managed by fund managers who invest the money collected in a diversified portfolio of Shariah-compliant financial instruments depending upon the objective of the fund.

Investors can earn income from investment in Islamic unit trust fund through capital gains and/or distribution of income.

Islamic real estate investment trusts

Real estate investment trusts (REITs) are collective investment schemes (typically in the form of trust funds) which pool money from investors to buy, manage and sell real estate. The type of real estates that REIT invests in includes residential or commercial buildings, retail or industrial lots, or other real estate-related assets, such as shares in listed or unlisted securities of property companies. The objective is to obtain returns on investment generated from rental income plus any capital appreciation that comes from holding the real estate assets over an investment period. Unit holders receive their returns in the form of dividends or distributions and capital gains during the holding period.

REITs, in general, combine the best features of real estates and trust funds, and sit between bonds and equities. There are listed and non-listed REITs. While the former may be bought and sold through a stockbroker, like listed stocks, non-listed REITs may be bought from and sold to the management company or through other authorised agents. REITs, particularly the listed ones, are liquid assets and can be sold fairly quickly to raise cash and take advantage of other investment opportunities.

The Islamic REITs provide an investment opportunity for those who wish to invest in real estate through Shariah-compliant capital market instruments. By investing in Islamic REITs, the holder actually owns a fraction of a pool of real estate that generates income via renting, leasing and selling the said property. As an added bonus, Islamic REITs provide a platform for investors to invest in a particular country's real property without the hassle and responsibilities associated with direct ownership of such assets.

Islamic exchange-traded funds

An exchange-traded fund (ETF) is a unit trust fund that is listed and traded on the stock exchange. ETFs are open ended, with a unique in-kind creation and redemption mechanism supported by a system of participating dealers and liquidity providers. The difference between ETFs and mutual funds is in the manner in which their units are bought and sold. Since an ETF is listed, its unit can be sold anytime during the stock exchange trading hours.

The ETFs are generally passively managed index funds although there is ongoing work to create enhanced and actively managed ETFs. In managing index funds passively, managers do not pick stock based on fundamental analysis. Instead, managers track the performance of a benchmark index.

An Islamic ETF and a conventional ETF share common characteristics. The main difference between the conventional and Islamic ETF is the benchmark index that the Islamic ETF tracks. An Islamic ETF only tracks an Islamic benchmark index where the index constituents comprise companies which are Shariah-compliant.

Islamic ETFs are suitable for investors who search for a low-cost passive approach to investment in an equity portfolio which comprises Shariah-compliant securities. They can either be used for long-term investments, as asset-allocation, or as a flexible intra-day trading instrument. Islamic ETFs provide an easy way for investors to gain diversified exposure to a portfolio of Islamic stocks through one instrument.

2.2.2 Shariah-related Considerations for Investments in Shariah-compliant Products

For investments in the Shariah-compliant financial products, there are few Shariah-related considerations (Table 3) that ought to be considered. These Shariah-related considerations may be subjected to *fatwa* issued by the relevant religious authorities.

Table 3
Salient Shariah-related considerations for investment in Shariah-compliant products

- **Investments in capital protected financial products**
  Would investment in capital protected financial products meet the requirement of capital preservation under *waqf*?

- **Investments into tradable securities**
  Tradable securities is a category of securities that includes both debt and equity securities, and where an entity intends to sell in the short term for a profit that it expects to generate from increases in the price of the securities. Would investment of *waqf* funds in tradable securities (which may suffer losses) be permissible?

- **Guarantee of the investment capital**
  In the context of pursuing the interest of *waqf* beneficiaries, questions arise as to whether the provision of guarantee of the investment capital (principal capital) by the professional fund/asset managers in the management of the *waqf* funds is permissible?

- **Payment of professional fees for services rendered**
  Whether *waqf* funds can be used to pay the professional fees for services rendered and other related expenses/payments?

2.2.3 Leveraging on Islamic Capital Market Intermediary Institutions

While *waqf* had been an integral part of an Islamic economic system in the past, there has been renewed interest and it is only now that a more formal structure is evolving with emphasis on the need for professional management. Efficient and professional management in the undertaking of *waqf* assets and fund has become an increasingly important component to value creation and ensure the sustainability of the philanthropic activities.

Islamic fund and asset managers are some of the more common intermediaries in the Islamic capital market that provide the business of management of funds and other types of asset classes. These institutions are usually regulated and duly supervised by the relevant capital market authorities under a licensing or registration regime within a particular jurisdiction. They are required to adhere to stringent requirements in terms of their operations, skill sets and governance. More often, the assets invested are protected through custodianship and trustee arrangements. These fund and asset managers have the required capability to manage investments on behalf of their investors and ensure that the monies received are managed professionally.

A cash *waqf* or *waqf* fund can, therefore, leverage on the capability of these Islamic fund or asset managers for the professional management of the *waqf* funds and generate returns commensurate with the risks involved.

Similarly, the manager of a real estate investments trust (REIT) is duly regulated and supervised by the relevant capital market supervisory authority. Mature and income generating *waqf* assets can potentially be the investment asset of a REIT portfolio and this monetization process subject to Shariah permissibility can be a platform for *waqf* institutions to manage their *waqf* assets efficiently. In some jurisdictions, REIT managers are even permitted to undertake the development stage of a real estate project subject to certain limitations which add on to its capability of being not only a manager but also developer. Such capability where it exists can also be leveraged upon by *waqf* institutions as a means to unlocking the potential value of their strategically-located *waqf* lands especially those in commercially-developed areas.

The private and public sectors relationship could very well be an effective model to ensuring a successful development of *waqf* assets globally. The Singapore Bencoolen real estate and mosque development by MUIS is a classic example of a successful private-public sectors collaboration that meets both the social objective of the *waqf* institution and the commercial objective of the private sector i.e. the Ascott Group Singapore, for the professional management of the completed commercial real estate, in return for a fee.

Within the realms of fund and asset management, the role of supporting institutions such as trustee and custodian further strengthen the governance aspects of managing these fund and assets and act as an asset-protection mechanism for investors. Their role can to some extent be equated to the trusteeship role of waqf institutions in safeguarding the interest of the *waqf* assets for the benefit of the beneficiaries.

Therefore, the retention of a licensed or supervised intermediary to professionally manage the related waqf undertakings is premised on the following criteria:

- **Well-regulated and adopting of international best practices and standards**
  By virtue of being licensed and closely regulated, these licensed intermediaries could be entrusted with the management of *waqf* assets in a cost-efficient manners and create potentials for larger economic return to the community. Many jurisdictions further ensure that their supervised intermediaries meet international best practices and standards in order to promote cross border deals and mandates.

- **Technical knowledge and resources**
  It is well acknowledged that a licensed intermediary normally has a pool of capital market and financial experts that match the supply and demand in the marketplace. The expertise, skills and resources available within the licensed intermediaries could be leveraged out by *waqf* institutions to help manage and match the appropriate market risks and returns. The strategy and technical ability possessed by the licensed intermediaries could also create a large variety of financial assets.

- **Strong governance providing adequate level of investor protection**
  A licensed intermediary is subject to stringent regulation and supervision. Guidelines as well as the laws governing the capital market are meant to ensure an adequate level of investor protection whereby sufficient safeguards are in place to protect investors from default by market intermediaries or problems arising from the insolvency of such intermediaries.

- **Established technology infrastructure**
  Licensed intermediaries typically have an established technology infrastructure. The role that technology plays for financial intermediaries is undergoing a rapid change. Firms and institutions are investing in technology infrastructure for regulatory compliance and to gain a competitive edge. Rapid advances are being made in the relevant areas of the intermediaries such as boosting reporting capabilities, enhancing risk management, improving data management and establishing and maintaining market networks.

2.2.4 Demonstration Effect of Public-private Sector Relationship Involving Supervised Intermediaries in Waqf Development

There have been innovative developments in the marketplace where the public sector, normally represented by a government body is entrusted to act as trustee to manage the *waqf,* and the private sector has struck an effective collaborative relationship by leveraging on the latter's management and governance capability in the undertaking of identified *waqf* projects. This is for the benefit of targeted segments of the society, such as the provision of education and healthcare.

An example of such collaboration is Wakaf Selangor Muamalat, which is a collaboration between Perbadanan Wakaf Selangor Bhd (PWS), a subsidiary of the Selangor Islamic Religious Council, and Bank Muamalat Malaysia Bhd (BMMB). The collaboration is the closest example that demonstrates how a licensed intermediary has been leveraged to manage the *waqf* fund for investment.

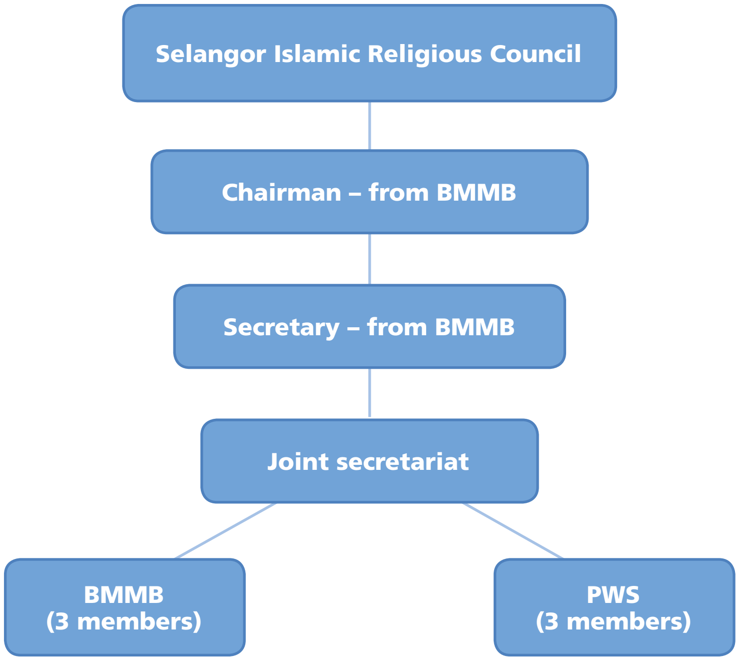
Wakaf Selangor Muamalat collects contributions from the public through BMMB banking services which function as a collecting agent. The minimum contribution is RM10 by individuals and RM100 by institutions and there is no maximum amount for contribution by both.

To ensure the smooth operation of Wakaf Selangor Muamalat, BMMB and PWS have established a Joint Management Committee (JMC) comprising a supervisory committee from Selangor Islamic Religious Council, a chairman, a secretary from BMMB and a joint secretariat consisting of six members i.e. three members each from BMMB and PWS. The JMC is mandated to channel the collected *waqf* funds into two areas which are investment and development (specifically for education and healthcare).

On the investment part, Muamalat Invest Sdn Bhd, a licensed Islamic fund management company, has been appointed to invest the allocated fund in Shariah-compliant instruments to generate returns. The PWS receives 25% of the returns, and the balance of 75% is returned to JMC for reinvestment in the areas determined by JMC. Diagram 10 and 11 illustrates the management structure of JMC and the financial and operational frameworks of Wakaf Selangor Muamalat respectively.

Diagram 10

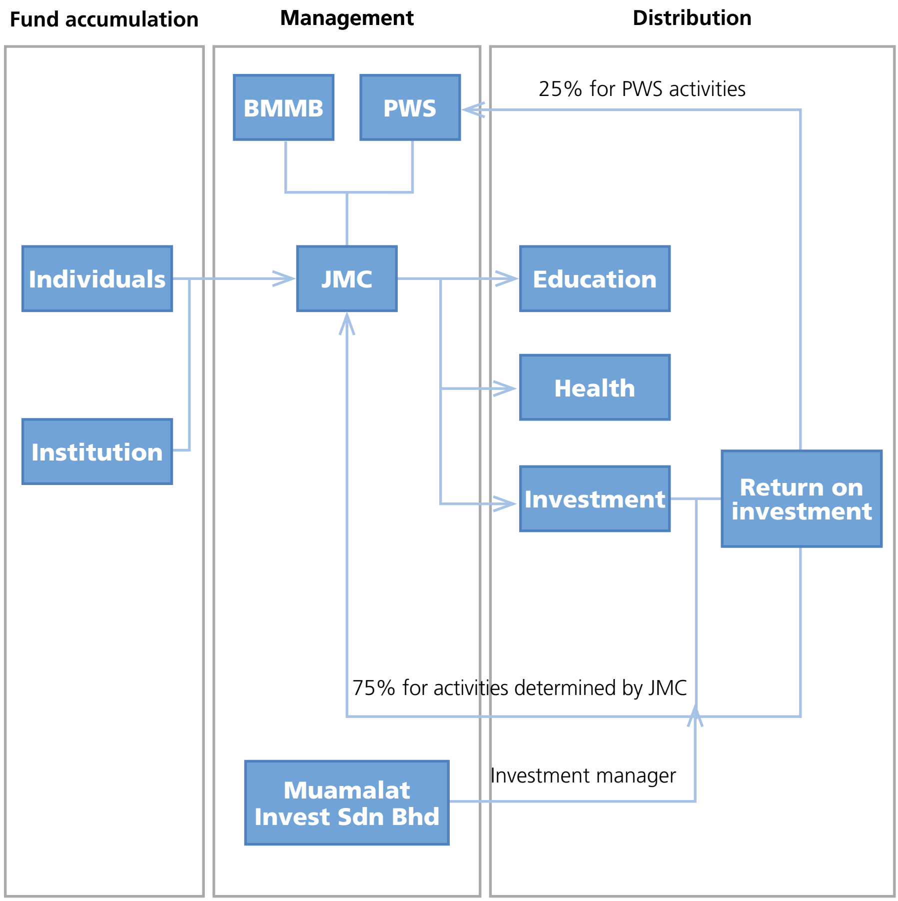
Management structure of Joint Management Committee



Source: Asharaf Mohd Ramli and Abdullaah Jalil, "Banking Model of Corporate Waqf: An Analysis of Wakaf Selangor Muamalat", January 2013.

Diagram 11

Financial and operational frameworks of Wakaf Selangor Muamalat



Source: Asharaf Mohd Ramli and Abdullaah Jalil, "Banking Model of Corporate Waqf: An Analysis of Wakaf Selangor Muamalat", January 2013.

CHAPTER 3

PROMOTING GOVERNANCE BEST PRACTICES IN WAQF

Ibn Umar RA reported that Rasulullah SAW said: Each of you is a guardian and each of you is questioned over his subjects.

~ (Narrated by al-Bukhari and Muslim)

Chapter 3

PROMOTING GOVERNANCE BEST PRACTICES IN WAQF

"Corporate governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value, whilst taking into account the interest of other stakeholders."

The Malaysian High Level Finance Committee Report, February 1999

Strengthening corporate governance represents one of the key thrusts to reinforce investor trust and confidence in the *waqf* institutions and Islamic capital market. These best practices are essential to further strengthen the management and effectiveness of *waqf* institutions and protect the interest of beneficiaries, both of which are essential to instilling public confidence.

This chapter serves as guidance on corporate governance best practices which *waqf* institutions are encouraged to adopt. *Waqf* institutions are also encouraged to disclose their statement on governance in the annual report or activity report.

DEFINITION OF PARTIES

Waqf trustee is the entity who receives the *waqf* assets from donors and is responsible for the administration of assets, including the appointment of *waqf* institutions to manage them. *Waqf* trustee may vary in form according to jurisdictions and may include Islamic religious authority, supervisory council, or any other bodies or institutions.

Waqf institution (who may include an individual) is a party appointed to manage the *waqf* assets and may be responsible on the distribution of the profits or gain from the utilisation of the assets to the beneficiaries.

Donor is the person who donates his or her assets for charitable purposes.

The following section is arranged as follows:

PRINCIPLES

The principles encapsulate broad concepts underpinning good corporate governance that *waqf* institutions should apply when implementing the recommendations.

RECOMMENDATIONS

The recommendations are a standard of best practices that *waqf* institutions are encouraged to adopt as part of their governance structure and processes. The institutions may determine the best approach to adopting the principles.

ANNOTATIONS

Each recommendation is followed by annotations which seek to assist *waqf* institutions in understanding the recommendation. It also provides some guidance to the institutions in implementing the recommendation. Although some of the commentaries provide examples and suggestions, these should not be taken to be exhaustive.

3.1 PRINCIPLE 1: STRENGTHENING THE OVERSIGHT OF WAQF INSTITUTIONS

RECOMMENDATION 1.1

The *waqf* trustee should establish clear roles and responsibilities reserved for them and those delegated to the *waqf* institutions

ANNOTATION

- The *waqf* trustee should exercise supervisory role and provide oversight to the *waqf* institutions on the management of the *waqf* assets.
- The *waqf* institutions should be responsible for the management of the *waqf* assets in accordance with the objectives and directions of the donors.
- The respective roles and responsibilities of the *waqf* trustee and the *waqf* institutions should be clearly defined and understood to ensure accountability of both parties, avoid overlaps and ensure efficiency.

Quick Fact

In India, the State Waqf Board (SWB) exercises supervisory role over the manager of waqf institutions and its subordinates. SWB is required to maintain a register of waqf, copies of waqf deeds, types of waqf, annual budget and audited accounts, name and succession procedure of the waqf institutions.

Source: Prof Dr Mohd Hashim Kamali, 'Shariah Regulations and Contemporary Reform of Waqf', March 2014

RECOMMENDATION 1.2

The *waqf* trustee should ensure that the *waqf* institutions are governed by a satisfactory code of conduct

ANNOTATION

- The *waqf* trustee is encouraged to foster good culture which engenders ethical conduct that is adhered to by all *waqf* institutions. The *waqf* trustee should ensure that the *waqf* institutions formalise a code of conduct which is satisfactory to the trustee. The code of conduct should reflect these ethical values and the *waqf* trustee needs to ensure the availability of appropriate internal systems to support, promote and ensure compliance by the *waqf* institutions.

- The code of conduct should address the need for the *waqf* institutions to act in good faith, with prudence and reasonable care and in the best interest of the donors and the beneficiaries, maintain independence and objectivity and avoid conflict of interests, maintain confidentiality of donor's information, adhere to all applicable laws, have in place appropriate communication and feedback channels.

- The code of conduct should be reviewed periodically and a summary of the code of conduct should be made available on the corporate website.

RECOMMENDATION 1.3

The *waqf* trustee should oversee and monitor the business operations and conduct of the *waqf* institutions

ANNOTATION

- The *waqf* trustee together with its *waqf* institutions should clearly establish and agree on the objectives in managing the *waqf* assets, including performance targets to be met by the *waqf* institutions. Regular review of the *waqf* institutions' performance should be conducted to ensure that the interest of stakeholders are protected and met.

- The *waqf* trustee should oversee and monitor the performance of its *waqf* institutions and ensure that the *waqf* assets are being properly managed. It should have in place appropriate measures to assess the *waqf* institutions' performance and effectiveness. The obligation to oversee the performance of the *waqf* institutions reflects a collegial relationship that is supportive yet vigilant.

- In the event a decision is made to distribute the profit, this should be fairly undertaken to preserve the altruistic purpose of *waqf* institutions. The *waqf* trustee and *waqf* institutions are encouraged to agree on a profit sharing arrangement, which should be formalised and made transparent.

- The profit sharing arrangement should outline the proportions of the returns on investments that will be utilised as-

    - trustee fee for the *waqf* trustee;
    - management fee for the *waqf* institutions, where the amount should reflect the extent of responsibilities and expertise of the *waqf* institutions as well as complexity of the activities undertaken by them in managing the *waqf* assets;
    - re-investment; and
    - distribution to beneficiaries, including charitable organisations.

Quick Fact

In Malaysia, the Johor Islamic Religious Council receives five per cent of the distribution from Waqaf An-Nur Corporation Bhd's investment. Another 25 per cent of the distribution is distributed to the selected charities and the remaining dividend is re-invested.

Source: www.wancorp.com.my

- The *waqf* trustee should implement and review the *waqf* institutions' internal controls and risk management systems. Periodic testing of the effectiveness and efficiency of the internal controls procedures and processes should be conducted to ensure that the system is viable and robust. The *waqf* trustee is encouraged to ensure that there is regular and timely reporting on internal controls and regulatory compliance on the management of the *waqf* assets.

RECOMMENDATION 1.4

The *waqf* trustee should be given access to information and advice

ANNOTATION

- The *waqf* trustee should have access to all information pertaining to the *waqf* institutions and be kept updated on the operations and decisions made by the *waqf* institutions in managing the *waqf* assets.

- The *waqf* institutions should provide accurate and complete information to the *waqf* trustee in a timely manner to enable the *waqf* trustee to effectively discharge its duties in assessing the performance of the *waqf* institutions and in safeguarding the interests of the stakeholders and the well-being of *waqf* institutions as a whole.

- The *waqf* trustee should be given access to independent expert advice, where necessary, to be able to make informed decisions with regard to activities undertaken by the *waqf* institutions in managing *waqf* assets.

- Access to independent expert advice refers to the right for the *waqf* trustee to have an expert, such as lawyers or independent advisers, to advise them on a particular investment proposal or activity in relation to the *waqf* asset, at the expense of the *waqf* institutions.

3.2 PRINCIPLE 2: STRENGTHENING THE EFFECTIVENESS OF WAQF INSTITUTIONS

RECOMMENDATION 2.1

The *waqf* institutions should have the necessary expertise to manage *waqf* assets

ANNOTATION

- The *waqf* institutions should satisfy the fit and proper test by relevant supervisory authority to ensure that they possess the skills and expertise required to manage the *waqf* assets.

- The *waqf* institutions should be experienced and knowledgeable in Islamic principles and laws governing *waqf* as well as the Islamic capital market.

- Officers of the *waqf* institutions should undergo regular training to ensure that they are kept abreast with the latest developments of the Islamic capital market to execute their responsibilities in managing the *waqf* assets efficiently. Training programmes will equip the officers of the *waqf* institutions with better understanding of the various methods to utilise their *waqf* assets, thus enabling them to make informed decisions in the management of the assets.

RECOMMENDATION 2.2

The *waqf* institutions should have a clear strategy in managing *waqf* assets

ANNOTATION

- The *waqf* institutions are encouraged to formulate strategies to maximise the returns from the utilisation of *waqf* assets and be closely involved in the day-to-day management and operations of such assets. They should take into account all appropriate risks and returns as well as other relevant considerations in establishing these plans to manage the *waqf* assets.

- The strategy should be specific, measurable, attainable, realistic and timely (SMART) within the scope of business in which the *waqf* institutions operates. The *waqf* institutions should also leverage on their competitive edge, which refers to their capabilities and strengths in order to achieve the objectives.

- Strategies may be formulated in collaboration with the appointed intermediaries, licensed by supervisory authorities who possess the necessary skills and capabilities in dealing with the complexity of the Islamic capital market, taking into account the potential risks of these activities.

RECOMMENDATION 2.3

The *waqf* institutions should have in place adequate internal controls including risk management and internal audit

ANNOTATION

- The *waqf* institutions should identify principal risks and ensure the implementation of appropriate internal controls and mitigation measures. The institutions should fully comprehend the principal risks of all aspects on the Islamic capital market activities and recognise that these activities are not risk-free. Therefore, the *waqf* institutions should ensure that there are systems in place to effectively manage these risks.

- The *waqf* institutions should establish a sound framework to manage risks. The institutions should determine its level of risk tolerance and actively identify, assess and monitor the risks to safeguard stakeholders' interest and preserve the *waqf* assets.

- The *waqf* institutions are encouraged to ensure that they have a comprehensive repository of information on all their *waqf* assets. The information database should contain details pertaining to the type, location and value of assets and the database should also be updated periodically.

Quick Fact

In Singapore, information on waqf properties, revenues and expenditure, and disbursement are collated. The information facilitates better supervision of the awqaf to generate revenues, which generally finance the mosques and other religious activities.

Source: Prof Dr Mohd Hashim Kamali, 'Shariah Regulations and Contemporary Reform of Waqf', March 2014

- The financial affairs of *waqf* institutions should be audited annually to ensure that financial statements are reliable sources of financial information. They are encouraged to engage independent auditors to avoid conflicts of interest and to ensure the integrity of the auditing process. Audited accounts should comply with applicable financial reporting standards.

RECOMMENDATION 2.4

The *waqf* institutions should produce an annual report which is made public

ANNOTATION

- The *waqf* institutions should produce an annual report to provide an overview of their operations in the respective year. The key to quality and meaningful reporting is presenting a balanced and understandable assessment of their financial position and prospects. The report should be made available on their corporate website.

3.3 PRINCIPLE 3: STRENGTHENING THE ENGAGEMENT WITH STAKEHOLDERS

RECOMMENDATION 3.1

The *waqf* institutions should continuously engage its stakeholders

ANNOTATION

- The *waqf* institutions are encouraged to have regular engagements with the *waqf* trustee and public on their performance, corporate governance, and other matters affecting their interest.

- Direct engagements with the waqf trustee and public provide *waqf* institutions with a better appreciation of stakeholder expectations and concerns, quality of their management and challenges. Such engagements allow the public to evaluate the performance of these *waqf* institutions and instill public confidence.

RECOMMENDATION 3.2

The *waqf* institutions should establish a clear and effective communication policy to manage relationships with its stakeholders

ANNOTATION

- The *waqf* institutions should establish a policy to enable effective communication with the *waqf* trustee and public. This policy should include the frequency of reporting and how feedback received from the *waqf* trustee and public will be considered when making decisions. Such reporting can be provided via periodic mails, corporate website or any other method that is convenient for both parties. A designated officer should be appointed to attend to queries from the public.

- The *waqf* institutions should leverage on information technology in communicating with stakeholders to ensure efficient and timely dissemination of information. The institutions are encouraged to create their own corporate website where information such as the annual report, activities, assets management strategies, the identities of beneficiaries and the net value of *waqf* assets administered by them are made available for the stakeholders. All information published on the website should be accurate and regularly updated.

CHAPTER 4

OPPORTUNITIES TO DEVELOP WAQF ASSETS THROUGH THE ISLAMIC CAPITAL MARKET IN MALAYSIA

Abu Hurairah RA reported that Rasulullah SAW said: “When a person dies, all his/ her acts come to an end, but three: recurring (ongoing) charity, or knowledge from which people benefit, or a pious offspring, who prays for him/her”.

~ (Narrated by Muslim)

Chapter 4

OPPORTUNITIES TO DEVELOP WAQF ASSETS THROUGH THE ISLAMIC CAPITAL MARKET IN MALAYSIA

Malaysia has a long history and track record in contemporary Islamic finance. The industry has developed exponentially in the last three decades and transformed into an important component of the Malaysian economy. A well-entrenched foundation, strong domestic capacity equipped with global capability helps drive the Malaysian Islamic finance industry internationally and is today branded as the world's marketplace for Islamic finance business and transactions. Indeed, Malaysia has a comprehensive Islamic finance ecosystem complete with the legal framework, market players, human capital development and the diversity of Shariah-compliant instruments which are continuously enhanced through innovation. Such innovations so far are carried out by institutions that are accustomed with corporate finance.

The robust development of Islamic finance especially the Islamic capital market in Malaysia should benefit the *waqf* institutions by adding value to its incomes and investments. However, the majority of these institutions are not accustomed to the financial tools available that can be used for *waqf* development. There is an imperative need for a paradigm shift to exploring the Islamic capital market to meet the needs of *waqf* and this can be complemented through good corporate governance practices and legal facilitation.

4.1 THE DEVELOPMENT AND MANAGEMENT OF WAQF ASSETS IN MALAYSIA

There have been several financing modes applied in the development and management of *waqf* assets in Malaysia but using the Islamic capital market products has yet to be realised. Nevertheless, there are existing models in developing *waqf* and these include government assistance through federal funding, collaborative initiatives between *waqf* institutions and Islamic financial institutions and unilateral initiatives from the private sector.

4.1.1 Allocation from Federal Government

Understanding that there were vast areas of idle *waqf* properties in Malaysia and due to financial constraints on the part of *waqf* institutions at the state level, the Federal Government through the Department of Awqaf, Zakat and Hajj (JAWHAR) allocated RM250 million for the development of *waqf* lands nationwide in its Ninth Malaysia Plan (2006–2010). This allocation was used by JAWHAR to finance various *waqf* development initiatives that have been categorised into field building, capacity building and institution building.

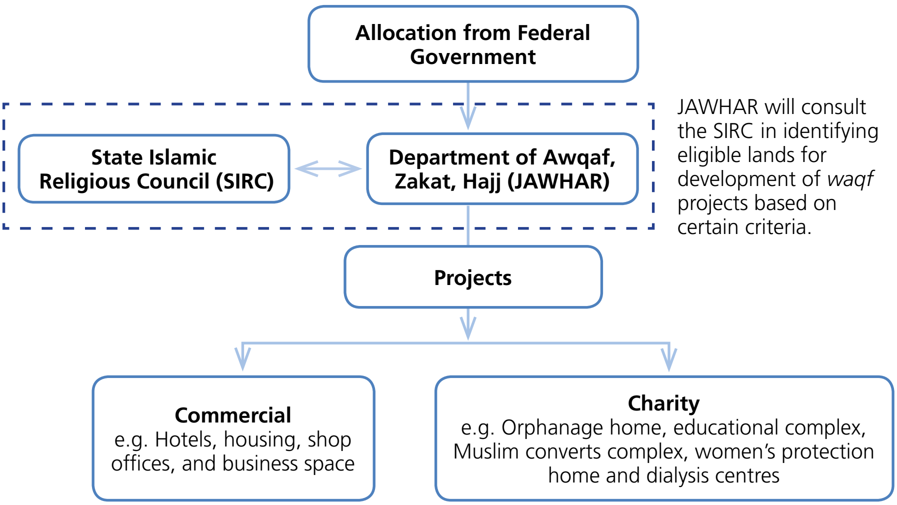
The field building initiative focuses on the development of *waqf* lands while the capacity building allocates funds for the establishment of Malaysian Waqaf Foundation and National Baitulmal as well as funding *waqf* research and the setting up an electronic *waqf* system. Under the institution building initiative, JAWHAR utilises the fund for conducting research and development of the institution of *waqf* in Malaysia.[1]

Diagram 12 describes how a Federal Government allocation is channelled for the development of *waqf* projects at the state level.

[1] Tunku Alina Raja Muhd Alias, *Unleashing the Potential of the Waqf as an Economic Institution in Malaysia: Policy, Legal and Economic Reforms*, (Doctoral Dissertation) INCEIF (p.294), September 2011

Diagram 12

Federal Government allocation for the development of waqf projects at a state level in Malaysia



Source: JAWHAR

Hotel Wakaf Melaka

Courtesy of JAWHAR

Hotel Wakaf Port Dickson, Negeri Sembilan

Courtesy of JAWHAR

Dialysis Centre, Batu Pahat, Johor

Courtesy of JAWHAR

4.1.2 Collaboration Between Waqf Institutions and Islamic Financial Institutions[2]

One of the most prominent contemporary *waqf* developments is the development of Menara Bank Islam (previously known as Menara Wakaf) via the concept of build, operate and transfer (BOT). It involved the construction of a high-rise commercial building on a *waqf* land, within the Golden Triangle of Kuala Lumpur. The construction project commenced in July 2007 and was completed in October 2010. The Malaysian Pilgrims Fund Board or Lembaga Tabung Haji (LTH) was the main contractor and financier of this project amounting to RM151 million (US$49 million).

This RM151 million project is considered as the first large-scale commercial development on a *waqf* land in Malaysia. Under this model, the Islamic Religious Council of the Federal Territory (IRCFT) entered into an agreement with LTH, under which the IRCFT offered its land for lease to LTH which in turn funded the development project. Construction was completed within 48 months based on the principles of *istisna*` and *wakalah*.

As a consideration for the said arrangement, LTH enjoys the right to utilise the land and building for a period of 25 years. At the same time, IRCFT receives RM56.6 million from the LTH as a one-off rental payment for the lease of the land based on the principle of *ijarah*. At the end of the 25-year lease period, LTH will hand over the building and land to IRCFT.

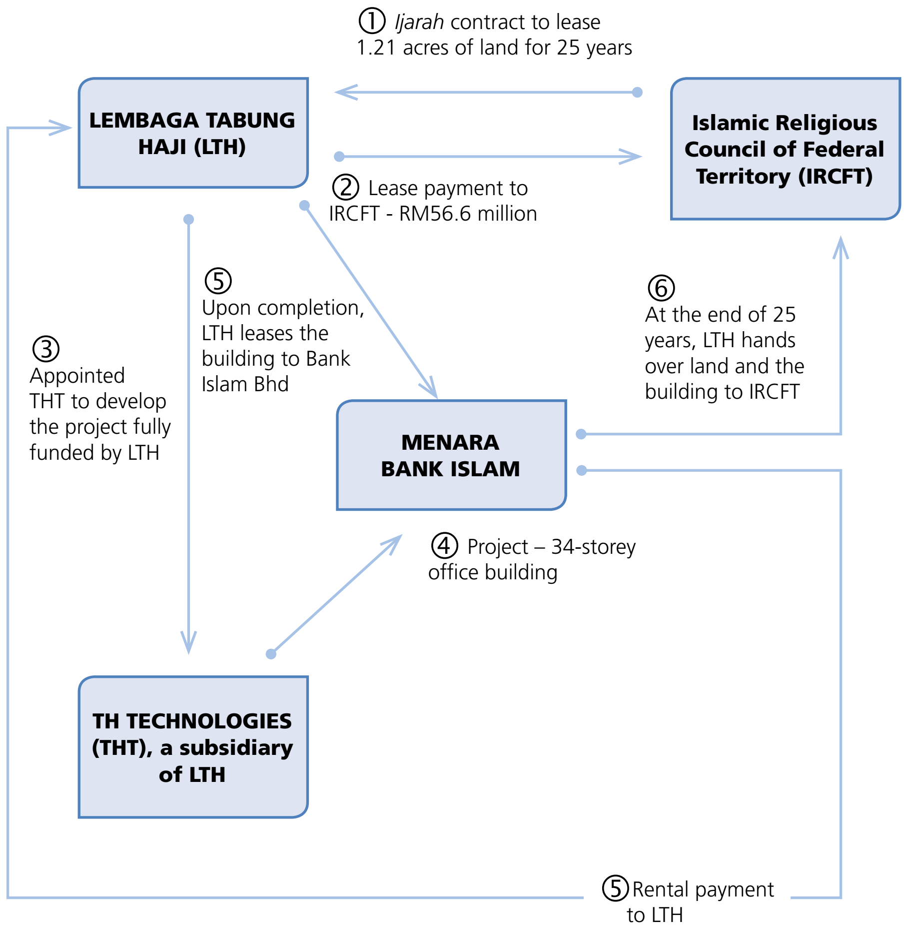
2 Refer to http://www.bankislam.com.my/en/Documents/cinfo/GivingBacktoSocietyWaqfDevelopment.pdf

Menara Bank Islam, Kuala Lumpur

Courtesy of Bank Islam Malaysia

Diagram 13

Development of Menara Bank Islam



Source: Bank Islam Malaysia

4.1.3 Private Sector Initiative

Johor Corporation (JCorp)[3] became the first corporate entity that introduced the concept of corporate *waqf* by donating 12.35 million shares of its public-listed subsidiaries valued at RM200 million on net asset value basis.[4]

The shares were donated to a corporate entity known as Waqaf An-Nur Corporation Bhd (WANCorp), a JCorp subsidiary. WANCorp was appointed as the *mutawalli* for those 12.35 million *waqf* shares. This arrangement was made possible through an agreement between the Johor Islamic Religious Council (JIRC) and JCorp.

Under the agreement, the JIRC will, among others, receive 5% of total dividend income arising from the *waqf* shares while 25% will be channeled for purposes of *fisabilillah* (in the way of Allah) activities comprising healthcare programme, orphanage, education assistance, financial assistance to the needy and socially responsible programmes. The balance 70% of dividend will be reinvested and used for human capital development. JCorp's corporate *waqf* structure has given a new perspective on how business organisations can effectively perform and undertake their corporate social responsibility by way of giving back to society and reaching out to the community via *waqf*. The following diagram, simplifies the distribution of dividend in this corporate *waqf* structure.[5]

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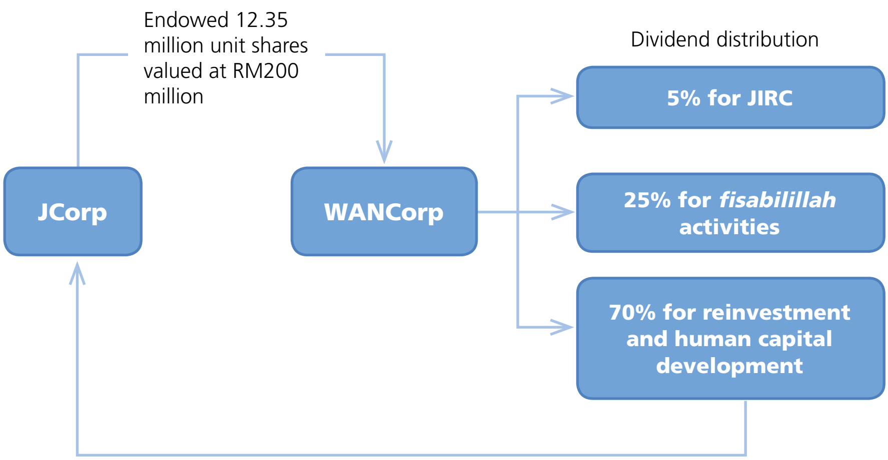
3 One of the nation's largest conglomerates, with core business sectors encompassing palm oils, foods and quick service restaurants, specialist healthcare services, hospitality, property and logistic / services as well as entrepreneur business.

4 Johor Corporation, Annual Report 2006.

5 Waqaf An-Nur Corporation Bhd, Annual Report 2010

Diagram 14
WANCorp structure



Source: Waqaf An-Nur Corporation Bhd

4.2 ISLAMIC CAPITAL MARKET IN MALAYSIA

Malaysia's Islamic capital market being a major component of the Islamic finance industry continues to gain global recognition. Malaysia today is a sustained global sukuk hub commanding a global market share of about 60%, attracting diversity both in terms of international issuers and issuances as well as currency denomination. The sustained sukuk supply with diverse varieties offers global Islamic intermediaries Shariah-compliant investment products that meet their commercial needs.

The Islamic equity market has demonstrated strong growth and resilience and is today a vibrant marketplace. It offers attractive value propositions of Shariah-compliant companies in diverse economic segments of the global economy. By the end of 2013, there were 650 companies designated as Shariah compliant on Bursa Malaysia with a market capitalisation of about RM1 trillion or 60.5% of the total market capitalisation.

At the same time, the Malaysian Islamic funds industry continues to attract global brands offering capability in managing and offering Shariah-compliant products with assets under management of RM97.5 billion as at end of 2013, the second largest globally.

The strong Islamic capital market is premised on its regulatory strength and capability, equipped with frameworks for investors' protection and efficient market infrastructure. With these building blocks in place, there is a significant scope for Malaysia to continue innovating and expanding the Islamic capital marketplace to support the development of *waqf* in Malaysia. In this regard, *waqf* institutions being the core entity entrusted to develop *waqf* assets may consider leveraging on the Islamic capital market for capital raising and professional management of its *waqf* assets.

4.2.1 Importance of Effective Regulation for Islamic Capital Market

Malaysia's capital market regulatory framework is largely administered by the SC, a statutory regulatory body with licensing, approval, investigative, supervisory and enforcement powers. The stock exchange, Bursa Malaysia, acts as the front-line regulator regulating the affairs of listed companies especially in the area of continuous disclosure obligation. The Shariah Advisory Council (SAC) of the SC, the apex body for Shariah governance, serves as a single point of reference in providing guidance to all participants in the Islamic capital market on matters pertaining to Shariah compliance.

The SC is also a member of the International Organization of Securities Commissions (IOSCO) and a signatory to the IOSCO Multilateral Memorandum of Understanding, a global information-sharing arrangement among the world's securities regulators. Malaysia's regulatory framework is globally recognised as of international standards.

In a voluntary independent assessment to benchmark its compliance with the IOSCO's *Objectives and Principles of Securities Regulation* in 2008, the SC was rated highly compliant with the IOSCO regulatory framework by external assessors. In addition, the independent assessment in 2012 by the Financial Sector Assessment Program (FSAP), covering all aspects of a country's financial system by the International Monetary Fund and the World Bank, acknowledged the strong regulatory regime in Malaysia validated by its approach to regulation that was appropriately benchmarked to global standards.

The comprehensive and internationally-benchmarked regulatory framework provides excellent investor protection and has enabled the country to remain largely resilient against contagion effects during the recent global financial crisis. Investors in Malaysia's Islamic capital market products are accorded similar legal and regulatory protection and recourse available to those of conventional products as the requirements for disclosure, transparency and governance apply equally to both markets. The core securities law – the *Capital Markets and Services Act 2007* (CMSA) – supports the regulation and development of both the Islamic capital market and the Malaysian capital market in general. Adherence to Shariah principles is enforced through the establishment of a Shariah governance framework and disclosure requirements. These are put in place to ensure that the products and services offered in the Islamic capital market are true to label, and that investor interests and rights with respect to these products and services are safeguarded.

Product Regulation

Product regulation is an important tool to ensure investor protection. In Malaysia, the offering or issuance of the various capital market products, including Islamic capital market products requires the approval of the SC and is governed by specific legal provisions and guidelines. A critical aspect of Islamic capital market product regulation is compliance with specific Shariah requirements and the associated additional disclosures. These include disclosures on the appointed Shariah adviser, Shariah principles or contracts applied in structuring the product as well as specific risks associated with the product. Breaches of these guidelines are enforceable under the securities law, i.e. the CMSA, administered by the SC and carry civil and criminal liabilities for non-compliance.

The guidelines, best practices and Shariah methodology applicable for Islamic capital market are listed in Table 3. They address issues relating to the various Shariah disclosures, Shariah due diligence and Shariah internal compliance aspects. These are important elements of investor protection and serve to provide reliable information for informed decision making.

Table 3

List of Guidelines, Best Practices and Shariah Methodology Related to the Islamic Capital Market

Framework and Methodology	Description
Guidelines on Unit Trust Funds	The guidelines are aimed at providing a regulatory environment that would protect the interests of the investing public and facilitate the orderly development of the unit trust industry in Malaysia. The guidelines are also drawn up to govern the operation of unit trust funds established in Malaysia.
Guidelines for Islamic Real Estate Investments Trusts	The guidelines facilitate the establishment of an Islamic REIT and must be read together with the *Guidelines on Real Estate Investment Trusts.* The guidelines stipulate among others the Shariah-compliant assessment by the Shariah adviser to assess the property to be acquired by Islamic REITs.
Guidelines on Exchange-Traded Funds	The guidelines provide a regulatory framework for exchange-traded funds in Malaysia that would protect the interest of investors and facilitate the orderly development of the funds.
Guidelines on Sukuk	The guidelines provide the requirements for authorisation or approval for an issuance, offering or invitation to subscribe or purchase sukuk. It also provides the relevant Shariah rulings, principles and concepts that have been endorsed by the SAC.
Guidelines on the Offering of Structured Products	The guidelines stipulate the criteria which must be met when issuing, offering, making an invitation for, or making available unlisted structured products to investors. The guidelines also set out the requirements of a Shariah adviser for Islamic structured products and the principles and concepts for Islamic structured products.
Guidelines on Islamic Fund Management	The guidelines set out requirements for a fund management company that carries on Islamic fund management business under an Islamic window or via a normal set up. The guidelines also set out the requirements for the appointment of Shariah advisers and Shariah principles applicable for an Islamic fund management business.
Guidelines on Registration of Venture Capital and Private Equity Corporations and Management Corporations	The guidelines set out the requirements for the registration and ongoing requirements for corporations undertaking a venture capital or private equity activity.
Registration of Shariah Advisers Guidelines	The guidelines set out the criteria for the registration and renewal of a Shariah adviser and the circumstances under which the SC can deregister a registered Shariah adviser. The registration process was streamlined to allow Shariah advisers to provide advice on a broad range of Shariah-based products and services regulated by the SC.
Best Practices in Islamic Stockbroking Services Undertaken by Participation Organisation	The best practices provide guidance to the Islamic Participating Organisations for practices recommended to be observed in the carrying out of Shariah-compliant stockbroking services undertaken by the Islamic Participating Organisations whether on a full fledge basis or 'window' basis.
Shariah Screening Methodology	The methodology is established to facilitate screening process to determine Shariah status of listed securities.

Source: SC

Shariah governance framework

In developing the Malaysian Islamic capital market, a robust Shariah governance framework was adopted as an effective mechanism to ensure adherence to Shariah principles. This governance framework ensures greater certainty and consistency on Shariah-related matters for industry participants to operate on a common Shariah platform. The SC has implemented a two-tier Shariah governance framework namely, the establishment of a national-level SAC, and the appointment of Shariah advisers at the industry level. The SC also closely pays attention to the risk management of non-compliance to Shariah principles.

a. <u>Establishment of a National Shariah Advisory Council</u>

The SAC is a central body that scrutinises, deliberates, and thereafter issues Shariah rulings pertaining to the Islamic capital market. It is empowered to advise or rule on any Shariah matter relating to Islamic capital market products and services, promote the standardisation of market practices, and provide consistency and clarity to the marketplace. The SAC ensures that matters pertaining to the validity of investment structures and the subsequent documentation involved are properly enforced. The CMSA has enhanced the SAC's role in providing greater consistency, clarity and certainty to investors in Malaysia's Islamic capital market.

The SAC is also the point of reference on matters relating to dispute resolutions, including rulings referred by the courts or arbitrators. The binding effect of the SAC's rulings on the court, arbitrators and any person who refers Shariah matters to the SAC, addresses the issue of uncertainty in contracts and transactions based on Shariah.

The members of the SAC comprise highly-qualified individuals with relevant experience and expertise in Islamic jurisprudence and finance. The SAC's members are appointed by DYMM Seri Paduka Baginda Yang di-Pertuan Agong (the King of Malaysia) under the CMSA, further legitimising the SAC's institutional role as the authority on Shariah matters.

Since its establishment in 1996, the SAC has also facilitated the development of the Islamic capital market through its resolutions on Shariah concepts and structures. These resolutions constitute a body of reference on Shariah-related issues concerning the

Islamic capital market. Key resolutions of the SAC were compiled and published as the *Resolutions of the Securities Commission Shariah Advisory Council* in 2002. The second edition of the book which incorporated additional resolutions was launched in 2006. The SAC periodically reviews its past resolutions, taking into consideration the dynamic nature of the Islamic capital market, and new developments that emerge from time to time.

b. Registration of Shariah advisers

For Islamic capital market products, investors place reliance on rulings, opinions and assurances provided by the Shariah advisers in respect of the products' compliance with Shariah. They are the backbone of the Islamic financial services industry, without whom, the integrity of the industry is at stake. Shariah advisers must carry out their duties professionally and diligently by ensuring that they fully understand the intricacies of the products and provide proper Shariah advice.

The SC requires companies that issue or offer Islamic capital market products, such as Islamic funds and sukuk, to appoint Shariah committees or Shariah advisers to advise on, review and endorse the compliance of these products with Shariah principles. Similarly, companies licensed by the SC to offer solely Islamic capital market services such as Islamic fund management companies are required to appoint Shariah committees or advisers to provide advice and ultimately certification that the companies are operating and being managed in accordance with Shariah principles.

To ensure proper and timely advice to the industry and to facilitate regulatory reach, it is a requirement for licensed intermediaries and issuers in Malaysia to appoint Shariah advisers to advise on all aspects of Islamic capital market products and services offered by the licensed intermediaries and issuers. They must be registered with the SC under the *Registration of Shariah Advisers Guidelines*, which include stipulations on general roles and responsibilities, fit and proper criteria, academic qualification and experience, and requirements for continuous professional development.

c. Risk management of non-compliance to Shariah principles

In managing the risk of Shariah non-compliance, the SC has put in place a two-stage procedure for the review, assessment and issuance of Islamic capital market products and services: the pre-issuance and post-issuance stages.

At the pre-issuance stage, Shariah advisers are appointed to render Shariah advice on Islamic capital market products and services. Subsequently, the Shariah advisers and other intermediaries are required to carry out post-issuance obligations that ensure compliance with Shariah principles. These obligations are primarily embedded in various product and services guidelines issued by the SC.

Additionally, intermediaries that are providing advice on industry proposals may engage with the SC through the Islamic Capital Market Business Group (ICMBG) at the pre-submission stage of the regulatory approval. The ICMBG which acts as a dedicated Secretariat to the SAC is primarily responsible for its management and administration, and ensures full compliance with its processes and procedures.

The ICMBG also supports the SAC in their decision-making by undertaking Shariah-related research, and bridges the industry with the SAC to ensure efficient resolution of all Shariah matters.

LICENSED CAPITAL MARKET INTERMEDIARIES

Under the *Capital Markets and Services Act 2007* (CMSA), anyone who wishes to carry out capital market activities (unless he/she is a registered person) is required to be duly licensed. The SC is the sole licensing authority which approves licences for capital market intermediaries to be engaged in the regulated activities. The SC is also entrusted with the responsibility of ensuring an efficient and transparent licensing process and that the licensed intermediaries and its representatives are competent and professional in providing their services to the investors. To ensure that the licensed intermediaries comply with the licensing requirement, they are required to submit an Annual Reporting for Authorisation of Activity (ARAA) form to the SC every year.

Those who wish to be licensed by the SC must fulfill the requirements as set out in the *Licensing Handbook* which include:

i. the criteria to be met for applying for and varying the conditions of a licence;
ii. the application procedures; and
iii. ongoing obligations imposed on licensed persons, including conditions and restrictions attached to a licence

There are two types of licences issued by the SC, which are:

i. New Capital Markets Services Licence (CMSL) - granted to a principal; and
ii. New Capital Markets Services Representative's Licence (CMSRL) - granted to a representative to enable him/her to carry on any one or more regulated activities on behalf of his/her principal

The licences issued to the licensing intermediaries are for the following regulated activities:

i. Assets management
ii. Investment portfolio management

To enable members of the public to ascertain whether they are dealing with a licensed person to carry out the regulated activity, the lists of licensed intermediaries are made available on the SC's website, www.sc.com.my.

4.2.2 Islamic Capital Market Products and Its Regulation

Malaysia has a variety of Islamic capital market instruments that has the potential to be used for the development and management of *waqf* assets. These instruments comprise sukuk, Shariah-compliant securities, Islamic unit trust funds, Islamic real estate trusts and Islamic exchange-traded funds. Sukuk has the potential to be used both for raising of capital in sizeable amounts and as underlying investments with the aim of maximising returns and liquidity management purposes. Similarly, other Islamic capital market instruments have the potential to be used as investment underlying assets. The following write-up provides some description on each of the said instruments.

Sukuk

The Malaysian sukuk market has been the driver of growth for the Malaysian Islamic capital market and has accounted for the majority of the world's issuance of sukuk over the last 10 years. The world's first ringgit Malaysia corporate sukuk was issued in 1990 by a Malaysian subsidiary of the Shell Group.

The SC guidelines and framework for the issuance of sukuk serve to expedite facilitative and transparent approval scheme for corporate issuances. This results in greater disclosure requirements and enhances legal protection for investors. The *Guidelines on Sukuk* outlines the requirements for the issuance of sukuk which provide greater clarity on the application of Shariah rulings and principles endorsed by the SAC in relation to sukuk transactions.

The main regulatory requirements for the issuance of sukuk are stated in the *Guidelines on Sukuk*. These requirements can be categorised into two groups, namely, specific requirements and common requirements. Table 4 lists down the examples of these requirements.

Table 4

Relevant Requirements for Sukuk Issuance

Specific requirements	Common requirements
• Naming of ringgit-denominated sukuk i.e. for sukuk structured using a single Shariah principle and the sukuk structured using multiple Shariah principles • Appointment of Shariah adviser, registered with the SC • Compliance with Shariah rulings, principles and concepts for ringgit-denominated sukuk • Proceeds from the approved sukuk are utilised for Shariah-compliant purposes only	• Appointment of principal adviser and sukuk trustee • Compliance with trust deed requirements • Rating requirements for certain type of issuance • Requirement to obtain other regulatory approvals • Disclosure of material information • Submission of certain documents for the purpose of obtaining the SC's authorisation/ approval/ lodgement

Source: SC

There are also other parties that play an important role in the sukuk issuance process. These parties are responsible for ensuring that the sukuk issuance is properly structured and sukukholders' interests are duly safeguarded. A brief description on the function of each party is set out in the Table 5, whereas the basic process for the issuance of sukuk in Malaysia is illustrated in Diagram 15.

Table 5

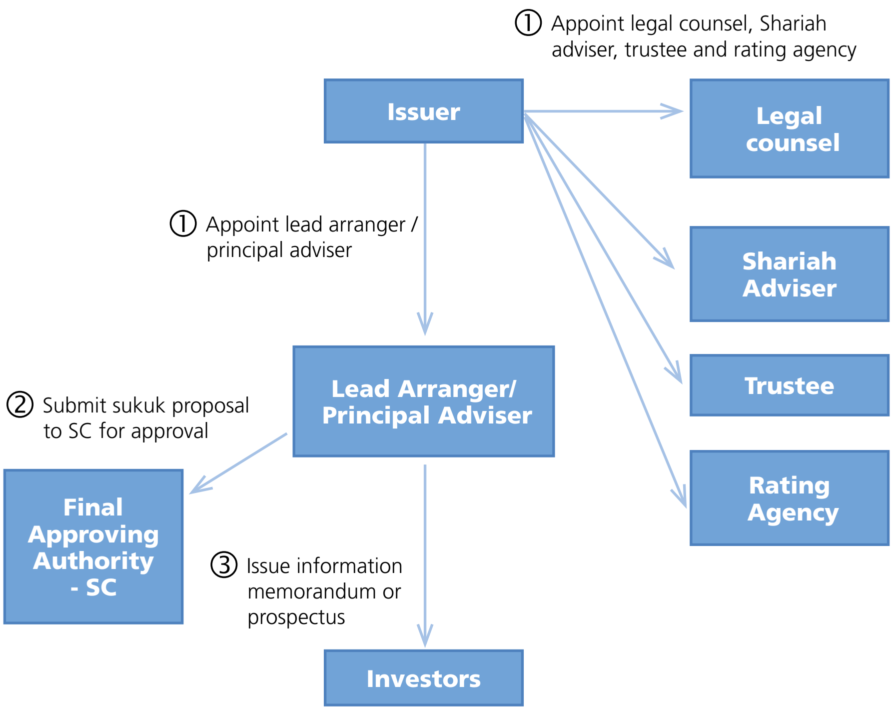
Function of the main parties involved in the sukuk issue

Parties	Function
Lead arranger/principal adviser	Structure the sukuk proposal together with any other arrangers, and submit the application to the approving authority.
Legal counsel	Conduct a legal due diligence exercise on the issuer, related projects and project information pertaining to sukuk issue.
Shariah adviser	Advise the issuer on the appropriate and acceptable Shariah concepts and principles to be used in the issuance. These Shariah concepts and principles must be approved by the SC's SAC.
Trustee	Safeguard the interest of sukukholders. Trustee administers a sukuk issue for investors and ensures that the issuer meets all the requirements set by SC.
Credit rating agency	Conduct credit assessments on sukuk issuers at the initial stage and provide continuous monitoring of the sukuk issue after its initial rating to ensure that investors are provided with the relevant information on the issue in a timely and efficient manner to hold, buy or sell a particular sukuk issue.

Source: SC

Diagram 15

Basic process for primary issuance of sukuk



Source: SC

Shariah-compliant securities

Shariah-compliant securities are securities[6] of a Bursa Malaysia-listed company which have been classified as Shariah permissible for investment, based on the company's compliance with Shariah principles in terms of its primary business and investment activities as well as financial position.

The list of Shariah-compliant securities, first introduced in 1997, is available in a booklet entitled the *List of Shariah-compliant Securities by the Shariah Advisory Council of the Securities Commission Malaysia*.

[6] Include ordinary shares and warrants (issued by the companies themselves)

In classifying these securities, the SAC receives input and support from the SC. In turn, the SC obtains the relevant information on the companies through, among others, their annual reports and enquiries made to the companies. The SAC, through the SC, will continue to review the Shariah compliant status of securities listed on Bursa Malaysia, on an annual basis, based on the latest available annual audited financial statements of the companies.

The SAC adopts a two-tier quantitative approach which applies the business activity benchmarks and financial ratio benchmarks, in determining the Shariah status of the securities.

In addition to the two-tier quantitative approach, the SAC also takes into account the qualitative aspect which involves public perception or image of the company's activities from the perspective of Islamic teaching. The SAC will classify these securities as Shariah compliant if they pass both the quantitative and qualitative tests. Table 6 summarises the two-tier quantitative approach and qualitative aspects applied by the SAC.

SC's publication on the 'List of Shariah-compliant Securities'

The list gives investors the necessary guidance, opportunities and confidence to choose and invest in listed securities that comply with Shariah principles. The list is updated twice a year, i.e. in May and November, and is available on the SC's website, www.sc.com.my.

Table 6

Two-tier quantitative and qualitative approach adopting by the SAC

1. QUANTITATIVE		
First tier: Business Activity Benchmark		
Activity	**Computation**	**Benchmark**
5% benchmark To assess the level of mixed contributions from the activities that are clearly prohibited according to Shariah law. The activities fall under this category including conventional banking, conventional insurance, gambling, liquor and liquor-related activities, pork and pork-related activities, non-halal food and beverages, Shariah non-compliant entertainment, interest income from conventional accounts and instruments, tobacco and tobacco-related activities, and other activities deemed non-compliant according to Shariah.	$\frac{\text{Revenue of activity}}{\text{Group revenue}}$ or $\frac{\text{Profit before tax of activity}}{\text{Group profit before tax}}$ (whichever is higher)	Must be less than 5%
20% benchmark To assess the level of mixed contributions from the activities that are generally permissible according to Shariah law and have an element of *maslahah* to the public, but there are other elements that may affect the Shariah status of these activities. The activities fall under this category including hotel and resort operations, share trading, stockbroking business, rental received from Shariah non-compliant activities and other activities deemed non-compliant according to Shariah.	$\frac{\text{Revenue of activity}}{\text{Group revenue}}$ or $\frac{\text{Profit before tax of activity}}{\text{Group profit before tax}}$ (whichever is higher)	Must be less than 20%
Second tier: Financial Ratio Benchmark		
Cash and cash equivalent placed in conventional accounts and instruments	$\frac{\text{Cash and cash equivalent}}{\text{Total assets}}$	Must be less than 33%
Interest bearing debt	$\frac{\text{Debt}}{\text{Total assets}}$	Must be less than 33%
2. QUALITATIVE		
The SAC takes into account the qualitative aspect which involves public perception, *maslahah* or image of the company's activities in relation to Islamic teachings. This qualitative method does not refer to any of the above benchmarks for activities which do not comply with the Shariah in deciding the status of the listed company.		

Source: SC

To invest in Shariah-compliant securities, one is required to open a Central Depository System (CDS) account. In general, anyone (including an individual and company) can open a CDS account and be an investor provided that the person opening it, is either an Authorised Nominee or a Beneficial Owner.

Islamic unit trust funds

Islamic unit trust funds provide retail investors with an opportunity to channel their savings into Shariah-compliant investments that are designed to match their risk-return profiles. These professionally-managed funds with diversified portfolios would, in theory, have relatively lower risk profiles compared to direct investments in individual securities.

The first Islamic unit fund in Malaysia was launched in 1993. The Shariah-compliant products, particularly the Shariah-compliant securities (shares) are the main source of investment for the Islamic unit trust funds.

The main element that differentiates Islamic unit trust funds from other conventional funds is the appointment of a Shariah committee or Shariah adviser to determine the compliance of the fund against existing Shariah guidelines.

The Shariah committee assesses a fund's overall activities to ensure that they are managed and administered in accordance with Shariah principles. Islamic unit trust funds are managed by unit trust fund managers licensed by the SC.

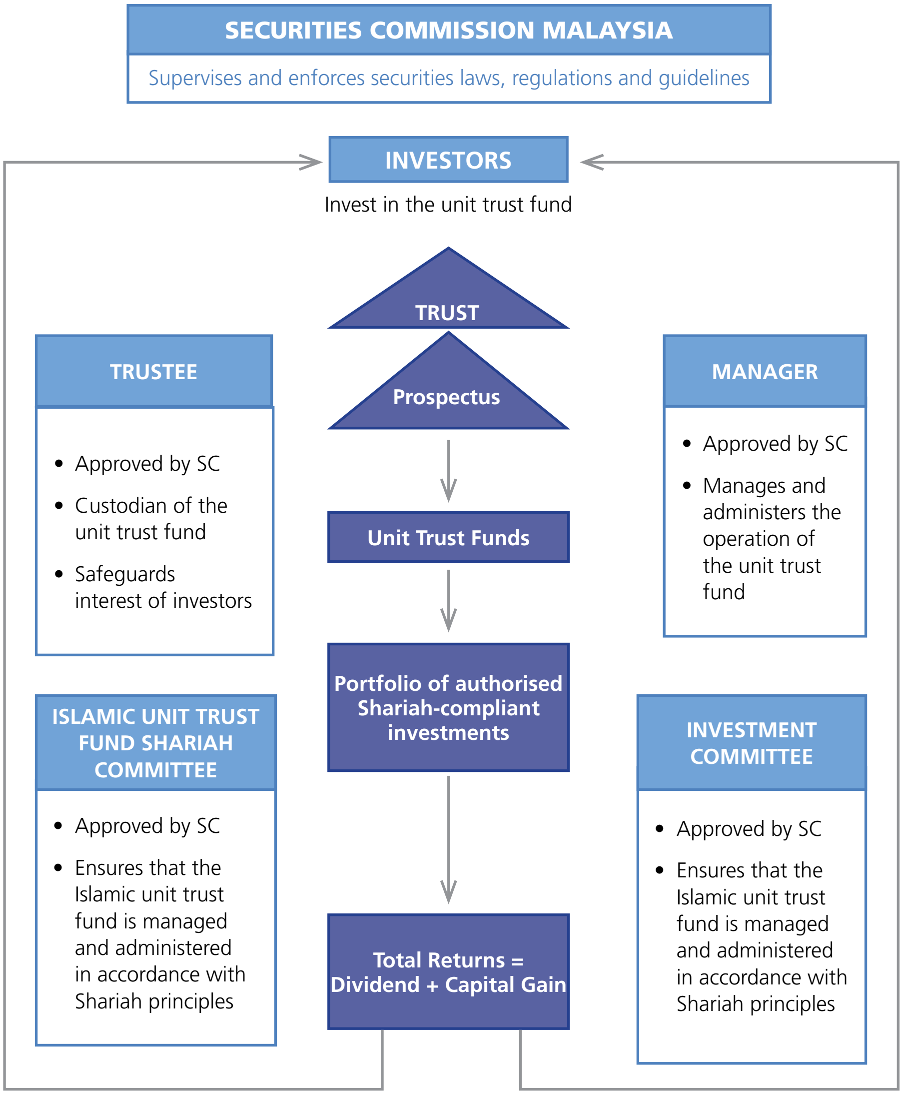
Typical structures of an Islamic unit trust fund consists of:

- A manager – who handles the investment and operations of the fund;
- A trustee – to protect the rights and interest of the unit holders;
- Shariah adviser – to ensure the Islamic unit trust fund is managed and administered in accordance with Shariah principles; and
- Unit holders – investors who are entitled to a proportionate interest of the assets of the fund.

Diagram 16 illustrates the concept of investment in Islamic unit trust funds in Malaysia.

Diagram 16

Concept and Regulation of Islamic Unit Trust Funds in Malaysia



Source: SC

Islamic Real Estate Investment Trusts (i-REITs)

Islamic REITs, which are traded on the exchange, allow investors to gain exposure to real estate assets with a smaller capital outlay. The *Guidelines for Islamic Real Estate Investment Trusts* (Islamic REITs Guidelines) was issued in 2005 to assist market players in developing and managing an Islamic REIT.

The Islamic REITs Guidelines comprises Shariah parameters relating to investment properties requiring less than 20% benchmark on rental received from Shariah non-compliant activities (e.g. sale of liquor and tobacco, conventional banking and insurance and non-permissible entertainment activities), the requirements for using the *takaful* scheme to insure the properties, and Shariah-compliant financing. The thrust of the guideline is to offer an Islamic investment product based on real estate assets that allows individual investors and fund managers to diversify their investment sources and portfolios. Diagram 17 shows the structure of i-REITs whereas Diagram 18 illustrates type of Shariah permissible investment for i-REITs.

To ensure that investments by i-REITs are Shariah-compliant, they are reviewed, monitored and approved by an appointed Shariah committee or Shariah adviser, who observes the following criteria as outlined in the Islamic REITs Guidelines:

- Rental of real estate by i-REITs for business purposes;
- Investment, deposit and financing for i-REITs;
- Takaful schemes to insure real estate. Conventional insurance is only allowed if takaful schemes are unable to provide insurance coverage; and
- Forward sales or purchases of currency for risk management with Islamic financial institutions under the concept of *wa`d* (promise)[7]. Participation in conventional forward sales or purchases of currency is permitted if the i-REITs deal with conventional financial institutions.

Rental from real estate is permissible, except when the property is used for non-permissible activities such as:

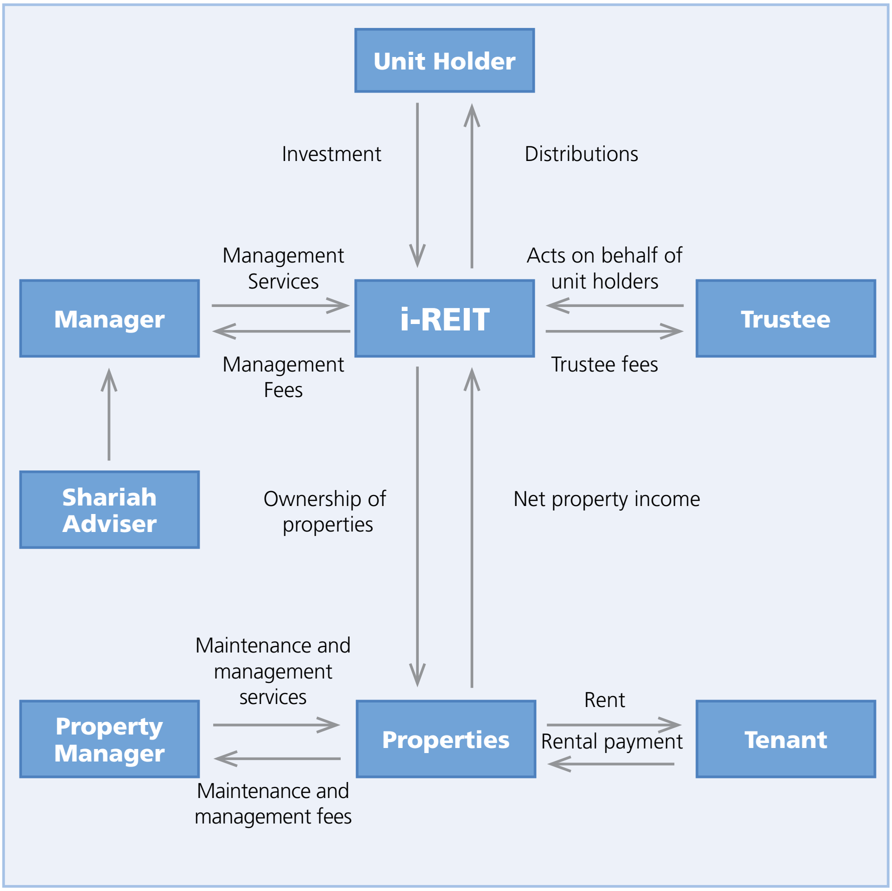
o Financial services based on *riba* (interest/usury);
o Gambling/gaming;
o Conventional insurance;

[7] Only one party is obligated to fulfill his promise/responsibility.

- o Entertainment activities that are not permissible according to Shariah laws;
- o Manufacturing or sale of tobacco-based products or related products;
- o Stockbroking or share trading in Shariah non-compliant securities; and
- o Hotels and resorts.

Diagram 17

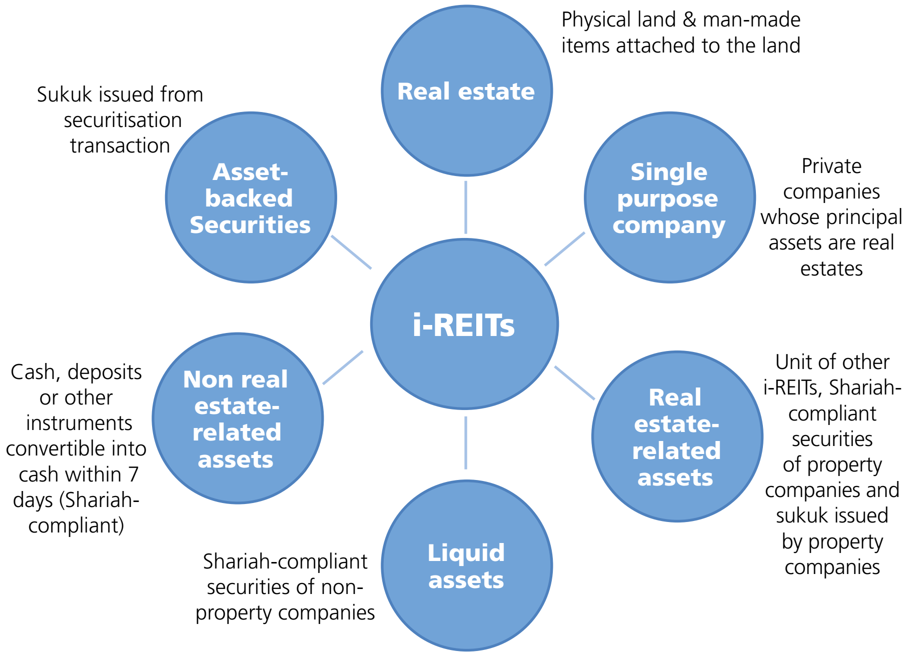
How i-REITs work



Source: SC

Diagram 18

Shariah Permissible Investment for i-REITs



Source: SC

Apart from the activities listed above, the Shariah committee or Shariah adviser can apply *ijtihad* (intellectual reasoning) for other non-permissible activities to be included as a criterion in assessing the rental income for the i-REITs.

There are listed and non-listed i-REITs. For listed i-REITs, investors can buy and sell them like listed stocks. For i-REITs listed on Bursa Malaysia, investors need to go through a stockbroker to invest in them. Like any product listed on the exchange, investors should be aware that i-REITs may trade at a premium or discount to their respective net asset values. Investors can buy unlisted i-REITs, from or sell them to the management company or through other authorised agents like any other unit trust products.

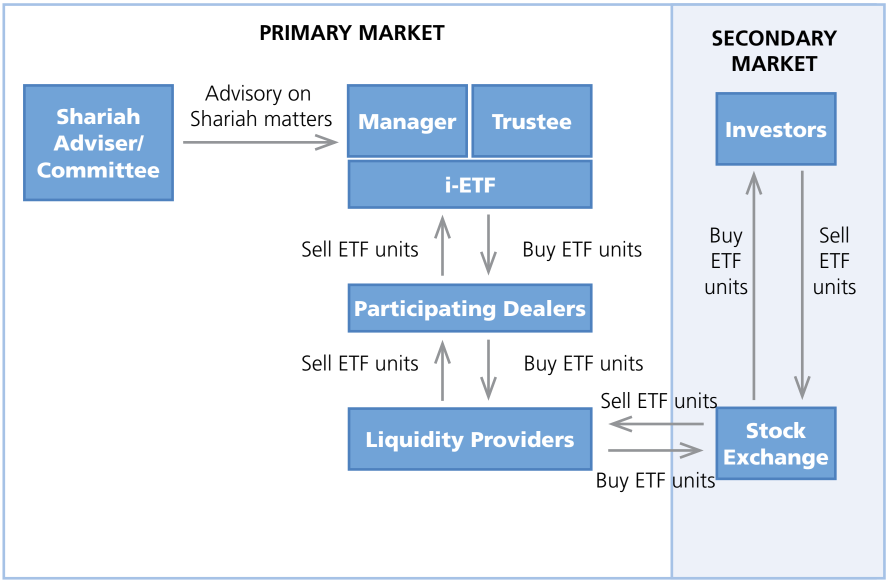
Islamic Exchange-traded Fund (i-ETF)

The Malaysia' first Shariah-compliant exchange-traded fund (i-ETF), known as the MyETF Dow Jones Islamic Market Malaysia Titans 25, was launched in 2008, being the first of its kind in Asia. To ensure i-ETF's structure, investments and all matters related to the fund's activities comply with the Shariah, it is a requirement in Malaysia to appoint the Shariah adviser/committee to provide expertise and guidance.

Diagram 19 shows the basic structure of an i-ETF whereas Diagram 20 shows concept and regulation of i-ETF in Malaysia.

Diagram 19

Basic Structure of an i-ETF

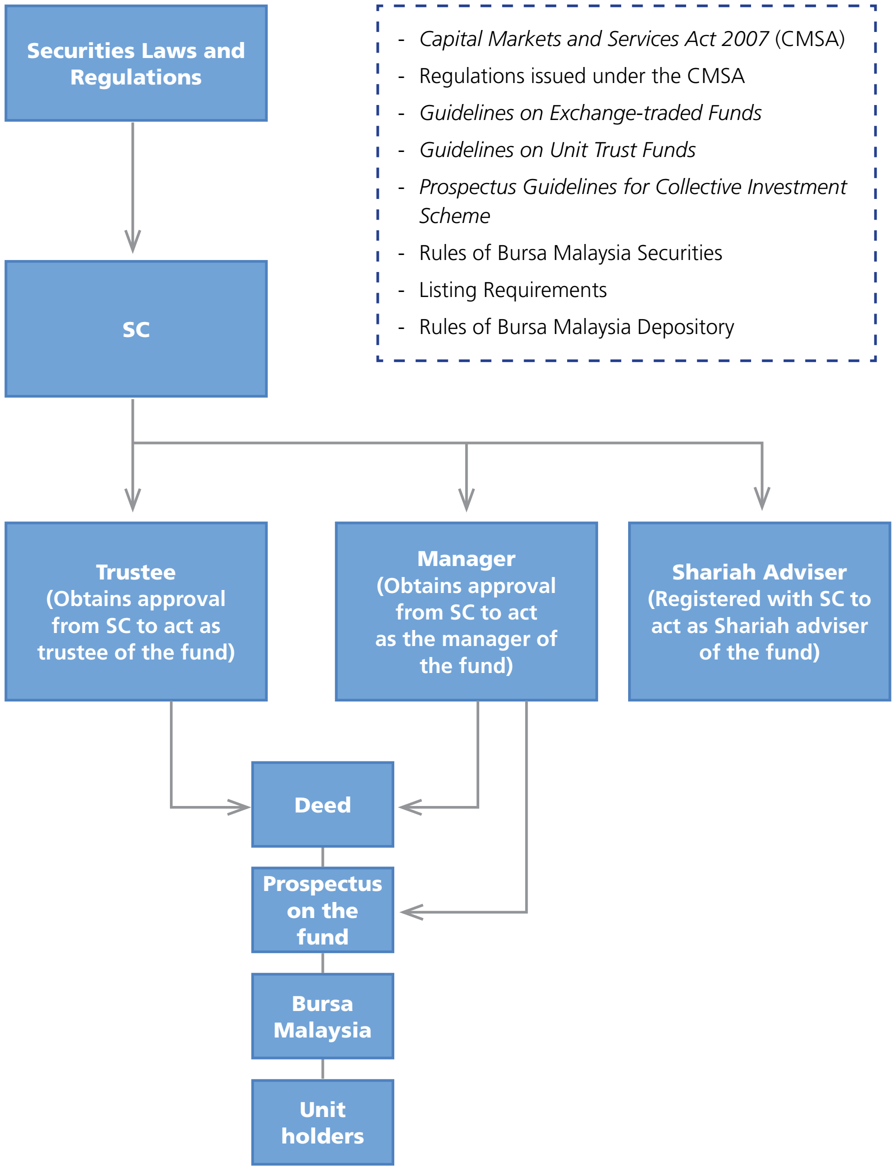


Source: SC

Note: In ETF, a basket of securities (index's constituent) can be converted into an ETF unit via "in-kind" creation process while "in-kind" redemption converts the ETF unit back to securities.

Diagram 20

Regulation Framework and Parties Involved in Malaysia's i-ETFs



Source: SC

Benefits of investing in ETFs are as follows:

- ***Diversification***

  Similar to index funds, ETFs provide investors with similar diversification benefits derived from holding the benchmark's index constituent stocks without having to invest in each of the stocks directly.

- ***Lower expense ratio***

  As a passively managed fund, ETF incurs lower management fee and lower transaction costs as compared to an actively managed fund.

- ***Lower transaction cost***

  ETF units are bought and sold at the same transaction cost as those charged for trading in shares on the stock exchange. Buying and selling of normal unit trusts are subjected to transaction costs which are generally higher.

- ***Tradability***

  ETF units can be bought and sold at anytime during trading hours of the stock exchange.

- ***Transparency***

  ETF prices are disseminated throughout trading hours on the stock exchange. The constituent stocks of the index which the ETF tracks are normally published on the fund or index provider's website.

- ***Shariah-compliant investment***

  As for i-ETFs, an additional benefit is its conformity to the Shariah principles and practices, which is important to Muslims. Non-Muslims may also wish to invest in such funds based on Shariah principles.

THE WAY FORWARD

Never will you attain the good [reward] until you spend [in the way of Allah] from that which you love. And whatever you spend - indeed, Allah is Knowing of it.

~ Quran 3:92

THE WAY FORWARD

The success of contemporary management and finance demonstrate that the revival of *waqf* should be underpinned by capital, capacity and confidence as its foundation. With the infrastructure that is conducive within the domain of the Islamic capital market, stakeholders of the industry would have ample opportunities to create better value out of the *waqf* assets thereby creating sustainable and positive social impact for all.

The development of *waqf* assets is essentially a collective responsibility of the various stakeholders including the public, government, religious bodies, private sector and financial institutions. Strong support by the government and relevant authorities is essentially the push factor in providing an enabling environment for *waqf* development. This may include legal and regulatory facilitations, the need for transparency, disclosures through appropriate governance standards and relevant incentives for *waqf*-related parties. *Waqf* stakeholders should also leverage on the digital era by embracing information technology. All relevant information relating to *waqf* should be recorded and made available for strategic planning and development purposes.

There are abundant opportunities for economic and commercial benefits to be derived from undertaking concerted and co-ordinated efforts, which would create sustainable and positive social impact for the community. Joint venture and partnership arrangements between *waqf* institutions and the private sector may prove to be an effective way to develop *waqf* properties. Furthermore, a certain degree of international co-operation and co-ordinated planning among countries may perhaps be necessary for better exploitation of *waqf* resources within and beyond their particular countries for the benefit of the wider *ummah*.

Developing *waqf* assets would require innovation in the form of new ways of financing and investment. Among such innovations are the corporate *waqf* and cash *waqf*, managed by professional asset or fund managers on behalf of the *waqf* institutions. These are currently among the effective models of developing *waqf* through collaboration between *waqf* institutions and the private sector.

There is also an imperative need to raise the level of awareness and appreciation of the benefits of effective *waqf* development. Due to the perception that *waqf* is only for religious purposes such as mosques and cemeteries and exclusive for Muslims, potential donors have looked to other avenues of charity. It is therefore equally important to correct such misperception or misplaced reservations of *waqf*.

While the notion and principle of collective responsibility have been numerously articulated, the effectiveness of developing *waqf* assets is premised on having a well-designed strategy complemented with relevant blueprints and initiatives that can accelerate the development of *waqf*. It requires the development of a complete ecosystem that would contribute not only towards the welfare of the individual and society as a whole but also effectively integrate with the Islamic financial system notably the Islamic capital market.

The Islamic capital market is therefore capable of offering innovative solutions to the development of *waqf* assets as evidenced over the years by the numerous marketplace innovations in both products and services. *Waqf* should seize opportunities available in the Islamic capital market that would effectively fast-track and spur its development.

ACRONYMS AND ABBREVIATIONS

GLOSSARY OF ARABIC TERMS

ACRONYMS AND ABBREVIATIONS

BOT	Build, operate and transfer
CMSA	*Capital Markets and Services Act 2007*
CTP	Commodity Trading Participant
ETF	Exchange-traded fund
i-ETF	Islamic Exchange-traded fund
i-REIT	Islamic real estate investment trust
ICM	Islamic capital market
IOSCO	International Organization of Securities Commissions
IRCFT	Islamic Religious Council of the Federal Territory
JAWHAR	Department of Awqaf, Zakat and Haji
JCORP	Johor Corporation
JIRC	Johor Islamic Religious Council
LTH	Lembaga Tabung Haji
MUIS	Majlis Ugama Islam Singapura (Islamic Religious Council of Singapore)
OCIS	Oxford Centre for Islamic Studies
REIT	Real estate investment trust
SAC	Shariah Advisory Council
SC	Securities Commission Malaysia
SIRC	State Islamic Religious Council
WANCorp	Waqaf An-Nur Corporation Bhd

GLOSSARY OF ARABIC TERMS

Awqaf	Plural of *waqf.*
Baitulmal	An Islamic treasury institution intended for community development and provides for disadvantaged Muslims.
Fatwa	Decree or Shariah ruling issued by qualified Shariah scholars.
Ijarah	A contract whereby a lessor (owner) leases out an asset to a lessee at an agreed lease rental for a predetermined lease period. The ownership of the leased asset shall always remain with the lessor.
Istibdal	Substitution of *waqf* asset.
Istisna`	A purchase order contract where a buyer requires a seller or a contractor to deliver or construct the asset to be completed in the future according to the specifications given in the sale and purchase contract. The payment term can be as agreed by both parties in the contract.
Maslahah	Consideration of public interest.
Murabahah	A contract that refers to the sale and purchase of an asset whereby the cost and profit margin (mark-up) are made known.
Mudharabah	A contract made between two parties to enter into a business venture. The parties consist of the *rabb al-mal* (capital provider) who shall contribute capital to finance the venture, and the *mudharib* (entrepreneur) who will manage the venture. If the venture is profitable, the profit will be distributed based on a pre-agreed ratio. In the event of a business loss, the loss shall be borne solely by the *rabb al-mal*, unless the loss is due to the negligence or mismanagement of the *mudharib* in managing the venture.
Musharakah	A partnership arrangement between two or more parties to finance a business venture whereby all parties contribute capital either in the form of cash or in kind for the purpose of financing the said venture. Any profit derived from the venture will be distributed based on a pre-agreed profit-sharing ratio, but a loss will be shared on the basis of capital contribution.
Mutawalli	*Waqf* administrator.
Muwakkil	Principal or party who appoints the agent.
Riba	Interest/usury.

Salam	A sale and purchase contract whereby the payment is made in cash at the point of contract but the delivery of the asset purchased will be deferred to a pre-determined date.
Sakk	Certificate.
Sukuk	This is the plural of *sakk*. Certificates of equal value which evidence undivided ownership or investment in the assets in accordance with Shariah principles and concepts.
Tawarruq	Tripartite sale involving the purchasing of a commodity on a deferred price and then selling it to a third party for cash.
Ummah	Nation or community.
Wa`d	Promise.
Wakalah bi al-Istithmar	Agency contract for investment.
Wakalah	A contract where a party authorises another party to act on behalf of the former based on the agreed terms and conditions as long as he/she is alive.
Wakeel	Agent.
Waqf	Islamic endowment – a voluntary and irrevocable endowment of Shariah-compliant assets for Shariah-compliant purposes.
Waqif	Donor.