

AN EXPLORATORY STUDY ON THE ISSUANCE OF

SUKUK WAQF

IN MALAYSIA

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IIUM INSTITUTE OF ISLAMIC
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An Exploratory Study on the Issuance of Sukuk *Waqf* in Malaysia

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ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
B	Banker
CMP3	Capital Market Masterplan 3
FGD	Focus group discussion
GG	Government guarantee
IB	Investment banker
IC	Investment company
ICM	Islamic capital market
ICMA	International Capital Market Association
IRB	Inland Revenue Board
IsDB	Islamic Development Bank
KWSP	Kumpulan Wang Simpanan Pekerja
LE	Legal expert
LHDN	Lembaga Hasil Dalam Negeri
MAIN	State Islamic Religious Council
MAIPP	Majlis Agama Islam Pulau Pinang
MAIWP	Majlis Agama Islam Wilayah Persekutuan
MOF	Ministry of Finance
MR	Market regulator
MUIS	Islamic Religious Council of Singapore
OECD	Organisation for Economic Co-operation and Development
P	Policymaker
PBUH	Peace Be Upon Him
PHB	Pelaburan Hartanah Berhad
PPP	Public-Private- Partnership
PR	Principal Researcher
PRI	Principles for Responsible Investment
R	Researcher
RA	Rating agency
REIT	Real estate investment trust
SC	Securities Commission Malaysia
SDG	Sustainable Development Goal
SME	Small and medium-sized enterprise
SPV	Special Purpose Vehicle
SRI	Sustainable and Responsible Investment
YAPEIM	Malaysian Islamic Economic Development Foundation
YTM	Yield to maturity
YWM	Yayasan Waqaf Malaysia

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EXECUTIVE SUMMARY

Over recent years, Malaysia's socio-economic landscape is marked by pressing challenges, including poverty, inequality, and the growing impacts of climate change, necessitating adequate funding to address these critical issues effectively. With government resources increasingly stretched thin, the adoption of alternative financial instruments that foster public-private-philanthropic partnerships has become imperative for bridging funding gaps to advance social and economic development.

Waqf, a traditional Islamic philanthropic arm, holds immense potential in this regard, but is often constrained by its reliance on immovable assets, such as land and buildings, which limit its scalability and adaptability. Unlocking the full potential of *waqf* calls for integrating it with modern Islamic capital market instruments, particularly sukuk. Such innovative synergy can pave the way for effective and sustainable funding mechanisms, enabling Malaysia to increase its economic resilience.

This report presents an exploratory study of sukuk *waqf* issuance in Malaysia, examining its conceptual foundations and proposing terms and structure tailored to align with Shariah principles while meeting the practical needs of both issuers and investors. The study also identifies key compliance and market challenges that could hinder the issuance and subscription of sukuk *waqf*, and offers policy recommendations to tackle these challenges, ensuring operational efficiency and market acceptance.

The report is structured as follows: Chapter 1 outlines the research objectives and the methods used to address them, including literature reviews, policy analysis, and focus group discussions with market experts and other stakeholders.

Chapter 2 discusses the revitalization of *waqf* through innovation in sukuk issuance, exploring how these financial instruments can reform *waqf* practices and scale up their impact. It begins with a review of the evolution of *waqf* practices, transitioning from traditional asset-based endowments to cash *waqf*, which offers greater flexibility in making contributions in the pursuit of societal well-being. While cash *waqf* holds significant potential for amplifying charitable giving, challenges such as poor governance and low public awareness hinder its full utilization. The chapter then shifts focus to sukuk as a key fundraising instrument in the Islamic capital market, highlighting its nature and alignment with Shariah principles. It emphasizes the integration of *waqf* into sukuk structures, leveraging Malaysia's robust Islamic finance ecosystem. The incorporation of *waqf* into sukuk not only aligns with the *maqasid* or

objectives of Shariah but also caters to the rising demand for socially responsible investments. Case studies, including the development of Zamzam Tower in Saudi Arabia and Indonesia's cash *waqf*-linked sukuk program, illustrate the successful application of such integrations in mobilizing funds for high-impact projects.

Chapter 3 provides a comprehensive exploration of the concept and definition of sukuk *waqf*. Sukuk *waqf* is defined as certificates representing undivided shares in Shariah-compliant assets or investments, with an option given to investors to convert their principal, returns, or both into *waqf* during the sukuk's tenure or upon maturity. Unlike traditional approaches that focus exclusively on developing physical *waqf* properties, the proposed concept allows the proceeds to be invested in broader Shariah-compliant assets. This flexibility enhances its appeal to a diverse investor base, ranging from profit-driven entities to philanthropists. Additionally, the chapter highlights the economic significance of sukuk *waqf*, including reducing fiscal reliance on government resources for public infrastructure, fostering financial inclusion by empowering small and medium-sized enterprises (SMEs), and meeting the needs of Malaysia's ageing population.

Chapter 4 outlines a framework for the proposed sukuk *waqf* programme. It begins with an overview of the programme's terms and conditions, emphasizing the key operational elements critical for its successful issuance. It then presents the proposed sukuk *waqf* structure, including its design and transaction flows, ensuring adherence to Shariah principles while meeting market expectations. Additionally, the chapter delineates the roles and responsibilities of key stakeholders, specifying their contributions to the programme's implementation. The chapter concludes by identifying the primary documents and deliverables required to ensure legal and regulatory compliance, streamline operations, and build investor confidence.

Chapter 5 delves into the operational, market-related, legal, and Shariah challenges associated with issuing sukuk *waqf*. It explores critical concerns such as the necessity of using a SPV as the issuer, the obligor's ability to generate sufficient revenue, and the rating mechanisms for sukuk *waqf*. The chapter also discusses operational complexities associated with converting sukuk holdings into *waqf*. Market issues such as distribution methods, pricing structures, sukuk tenure, market liquidity and tradability, and investors' appetite for social impact are evaluated, with tax incentives also addressed as a way to attract subscriptions. Legal concerns include whether sukuk *waqf* qualifies under existing laws, the ownership of *waqf* assets by private companies, as well as jurisdictional issues in determining trusteeship. Lastly, the chapter discusses Shariah compliance issues revolving around sukuk *waqf* issuance. These

issues, among others, include, reconciling sukuk's fixed tenure with *waqf*'s perpetual nature, the permissibility of temporary *waqf*, and the commingling of *waqf* and non-*waqf* investments.

Finally, Chapter 6 suggests key policy recommendations to support the effective issuance and implementation of sukuk *waqf* in Malaysia. It emphasizes the need for market guidelines tailored to sukuk *waqf*, standardized definitions, and amendments to *waqf* enactments to incorporate financial assets. Clear criteria for issuers, tax incentives, and streamlined mechanisms for converting sukuk into *waqf* are proposed to enhance clarity and attract investors. Governance measures include defining stakeholder roles, establishing oversight committees, and requiring periodic impact reporting, supported by independent validations to ensure accountability and transparency. Capacity building is highlighted through training programs for Majlis-Majlis Agama Islam Negeri (MAINs), collaborative research to innovate sukuk *waqf* models, and public awareness campaigns to showcase its social and financial benefits. Lastly, fostering partnerships between public and private entities is crucial, with recommendations to involve professional fund managers and enhance collaboration between MAINs and regulators, ensuring compliance, efficiency, and scalability of sukuk *waqf* initiatives.

CHAPTER

01

Introduction



CHAPTER 1 INTRODUCTION

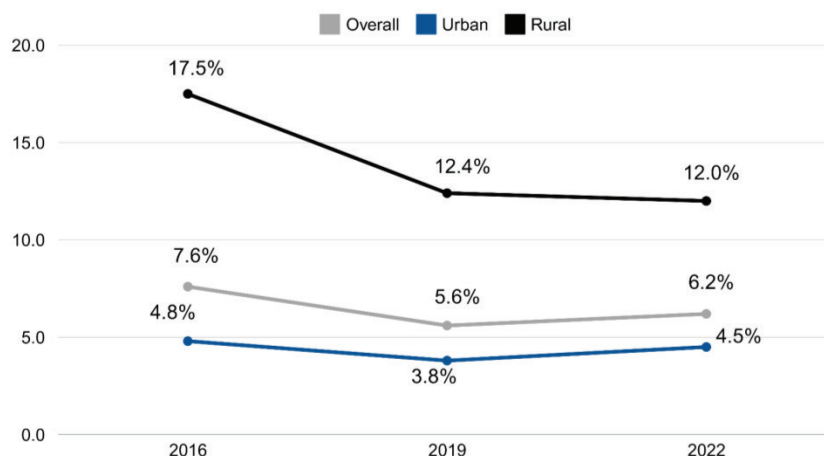
1.1. Background of the Study

1.1.1. Socio-Economic Landscape in Malaysia

Malaysia faces existential challenges that pose substantial threats to its long-term economic and social stability. These risks are multifaceted, encompassing persistent issues such as inequality and poverty, demographic shifts, and climate-related risks. Addressing these challenges requires coordinated efforts and innovative financing solutions to ensure resilience and inclusive growth for the nation.

Poverty and inequality remain critical challenges in Malaysia as the nation aspires to achieve high-income status. Despite the government's ambitious goal of eradicating hardcore poverty by 2025, efforts to realize this target have been hindered by the lingering economic impacts of the COVID-19 pandemic. Between 2019 and 2022, the country witnessed an increase in absolute poverty, with the rate rising from 5.6% to 6.2%, while the incidence of hardcore poverty doubled from 0.2% to 0.4%.¹ Meanwhile, income inequality, as measured by the Gini coefficient, widened from 0.416 to 0.417 during the same period. These disparities are particularly pronounced in the rural-urban divide, with less developed states such as Kelantan, Sabah, and Sarawak recording significantly higher poverty rates than the national average.

Figure 1.1: Percentage of households living absolute poverty (2016-2022)



Source: Khazanah Research Institute's report titled "Households and the Pandemic 2019-2022: The State of Households 2024".

¹ Khazanah Research Institute (2024)

Apart from that, Malaysia’s demographic structure is undergoing a significant transition, marked by a rapidly ageing population. According to estimates from the Department of Statistics Malaysia, the proportion of individuals aged 60 and above is expected to rise from 11.6% in 2024 to 17.3% by 2040.² This demographic shift carries profound implications for the nation’s healthcare. An ageing society is expected to drive a surge in non-communicable diseases, driving an increased demand for geriatric care and specialized medical services. Simultaneously, the country’s pension system is confronting critical vulnerabilities, with many retirees lacking sufficient savings to support their financial needs throughout retirement.

Additionally, Malaysia is increasingly exposed to the adverse effects of climate change, with floods being among the most frequent and destructive calamities. Floods have accounted for 85 percent of all natural disasters in the country since 2000. Malaysia ranks 12th globally in terms of the frequency of flood events and 78th in terms of average annual damages. It is estimated that the damages caused by the flood events in December 2021 and January 2022 alone amounted to RM6.1 billion, equivalent to 0.4 percent of the country’s nominal GDP.³



Photos: Flood events in Malaysia

² Department of Statistics Malaysia (2024)

³ World Bank & Bank Negara Malaysia (2024)

1.1.2. Funding Gap in Addressing the Social and Environmental Challenges

Addressing these pressing social and environmental challenges requires consistent and substantial financial commitments each year. For instance, in the 2025 budget, the government allocates RM52.6 billion, equivalent to 12.5% of total budget expenditures, toward initiatives aimed at combating poverty and inequality. These measures include social assistance programs and subsidies for essential goods, designed to provide relief to low-income households and narrow the income and wealth gap. In addition, RM150 million has been allocated for flash flood mitigation, falling significantly short of the estimated annual required cost of approximately RM1 billion.

Unfortunately, the government's ability to invest in such initiatives is often constrained by competing fiscal priorities, including development projects, public services, and debt servicing. Moreover, Malaysia remains reliant on cyclical sources of income, such as oil and gas revenues, which are subject to volatility in global markets. This dependency limits the government's capacity to consistently channel resources toward addressing long-term social and environmental challenges.

Furthermore, the reluctance of private investors to participate in funding these initiatives poses an additional challenge. Private sector involvement in social and environmental projects is often deterred by perceptions of low financial returns and high associated risks. For instance, projects focusing on poverty alleviation or flood adaptation often do not generate immediate or tangible profits, making them less attractive to private investors, who typically favour quicker and more predictable returns. Additionally, uncertainties surrounding regulatory frameworks and bureaucratic inefficiencies further dissuade private sector participation.

In light of these funding hurdles, it is imperative to explore alternative sources and mechanisms of financing. Options such as philanthropy, public-private partnerships, and blended financing can play a pivotal role in supporting these crucial initiatives.

1.1.3. *Waqf* as a Sustainable and Inclusive Financing Mechanism

***Waqf*, a philanthropic arm rooted in Islamic tradition, holds significant potential to bridge funding gaps and drive impactful change for the benefit of the community at large.** By engaging and mobilizing resources from diverse stakeholders, *waqf* serves as a sustainable financing model that effectively complements government efforts in tackling socio-economic and environmental challenges. Its capacity to deliver long-term,

equitable solutions underscores its strategic importance as a tool for fostering societal resilience and development in today's modern society.

Despite its significant potential, *waqf* institutions in Malaysia face considerable constraints in expanding their outreach and maximizing their impact within broader socio-economic frameworks. A primary limitation arises from the nature of *waqf* assets, which predominantly consist of immovable properties such as land and buildings. These assets often lack liquidity, restricting the ability of *waqf* institutions to respond promptly to societal needs. Furthermore, the maintenance and management of such immovable assets can impose substantial financial and operational burdens. Reports indicate that approximately 87% of *waqf* land in Malaysia, covering an estimated 26,000 hectares with a valuation of RM1.3 trillion, remains either unused or underutilized. This highlights a significant untapped potential that could be harnessed to strengthen the role of *waqf* in advancing equitable and inclusive development.

Looking ahead, it is essential for policymakers to explore innovative financial mechanisms that can further unlock the potential of *waqf* assets. The tradition of reliance on immovable *waqf* properties, such as land and buildings, often results in liquidity constraints and underutilization, thereby limiting their effectiveness in improving people's welfare.

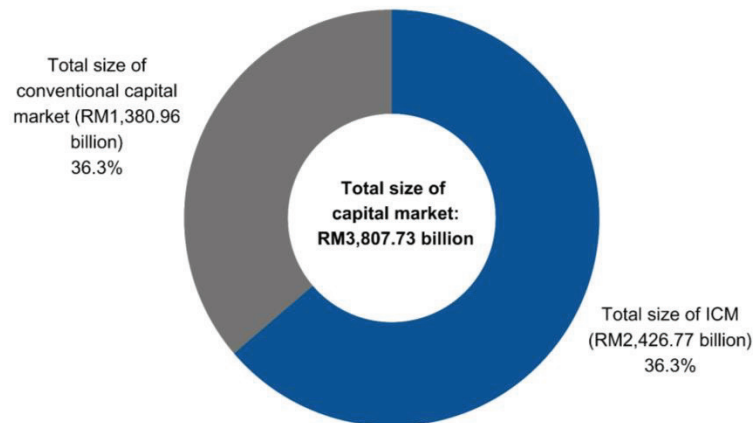
1.1.4. Driving Innovation in the Islamic Capital Market

One promising strategy to be considered is to mainstream *waqf* by integrating it with contemporary Shariah-compliant capital market instruments. The Islamic capital market (ICM) in Malaysia continues to demonstrate robust growth, solidifying its position as a key pillar of the country's financial system. As of December 2023, the ICM accounted for 63.73% of the overall capital market, expanding by 4.5% year-on-year to reach RM2.43 trillion, up from RM2.32 trillion in 2022. This growth is underpinned by the performance of Shariah-compliant securities and sukuk issuances. The market capitalization of Shariah-compliant securities increased by 3.25% in 2023, reaching RM1.16 trillion, and accounted for 64.32% of total market capitalization. Concurrently, sukuk outstanding stood at RM1.27 trillion, representing 52.38% of the total bonds and sukuk market.

Recognising the catalytic potential of Islamic social finance and impact investing, the Securities Commission Malaysia (SC), through its Capital Market Masterplan 3 (CMP3), envisions the utilisation of *waqf* alongside modern financial instruments. This effort aligns with the SC's broader goal of creating a more diversified

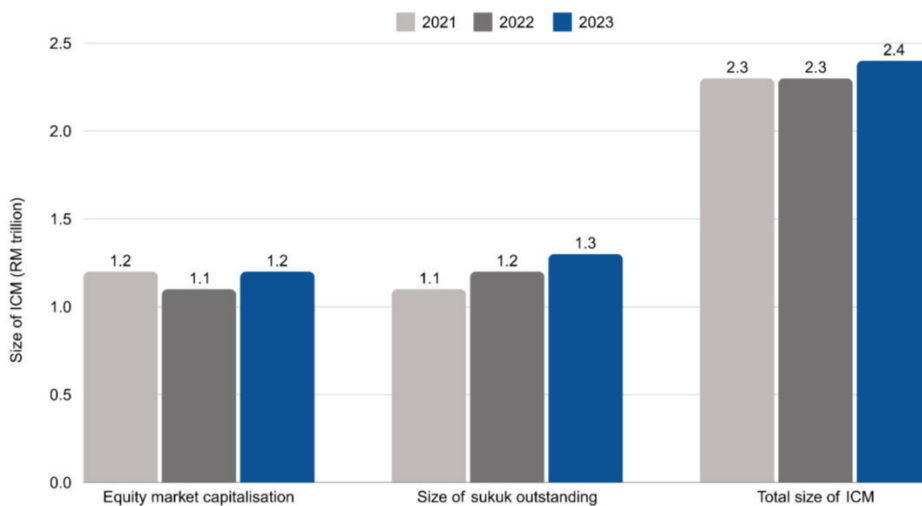
capital market landscape that supports Malaysia's inclusive and sustainable development objectives. Complementing this initiative is the Waq-Featured Fund Framework, launched in 2020, which facilitates the issuance of innovative ICM products that provide the public with access to Islamic funds that allocate all or part of their returns to high-impact projects benefiting *waqf* beneficiaries.

Figure 1.2: Size of the Malaysian capital market as of 2024



Source: Securities Commission Malaysia's Annual Report 2023

Figure 1.3: Size of Malaysia's Islamic capital market (2021-2023)



Source: Securities Commission Malaysia's Annual Report 2023

1.2. Research Objectives

Aligned with this vision, this study explores the feasibility of issuing sukuk *waqf*, an innovative approach to incorporating *waqf* principles into the traditional sukuk structure. This integration seeks to ensure greater efficiency and transparency in the management of *waqf* funds while broadening its appeal to a wider spectrum of investors. Leveraging such a model can reposition *waqf* as a pivotal component of Malaysia’s financial development ecosystem, creating sustainable funding streams to support national missions, such as poverty alleviation and climate resilience. The following objectives outline the key areas of focus of this study:

Table 1.1: Description of the research objectives

Objective	Description
<i>Research Objective 1:</i> To construct the practical definition and concept of sukuk <i>waqf</i>	This objective aims to delve into the theoretical and operational aspects of sukuk <i>waqf</i> to establish a clear and universally applicable definition. In doing so, it examines how sukuk <i>waqf</i> is positioned within the broader framework of Islamic finance, with a focus on its underlying principles, key features, and distinct characteristics. It also considers the integration of traditional <i>waqf</i> concepts with contemporary financial instruments, ensuring the practical relevance of the definition to stakeholders, including regulators, issuers, and investors.
<i>Research Objective 2:</i> To propose terms and structures of sukuk <i>waqf</i>	This objective seeks to develop innovative terms and structures for sukuk <i>waqf</i> that align with Shariah principles while addressing the needs and preferences of issuers and investors. This is done by analyzing existing sukuk models and their adaptability to <i>waqf</i> arrangements, proposing structures that optimize financial efficiency and social impact. Key considerations include identifying suitable underlying assets, mechanisms for distributing and endowing returns, and governance frameworks to ensure transparency and accountability in managing and investing <i>waqf</i> proceeds.

<p><i>Research Objective 3:</i></p> <p>To identify the potential Shariah, legal, and operational issues and challenges related to the issuance of sukuk <i>waqf</i> in Malaysia</p>	<p>This objective focuses on examining the challenges that may arise during the structuring, issuance, and implementation of sukuk <i>waqf</i> in Malaysia. The study assesses potential Shariah non-compliance risks, legal ambiguities, and operational complexities that could hinder successful issuance. It also evaluates market readiness and stakeholder acceptance, providing insights into barriers that need to be addressed to ensure the seamless issuance and management of sukuk <i>waqf</i>.</p>
<p><i>Research Objective 4:</i></p> <p>To map out strategies to facilitate the issuance of sukuk <i>waqf</i> in Malaysia</p>	<p>This objective suggests actionable plans to promote the widespread adoption and scaling up of sukuk <i>waqf</i> in Malaysia. The research proposes policy measures and market incentives to attract issuers, investors, and other relevant stakeholders. It also identifies collaborative opportunities between government agencies, financial institutions, and <i>waqf</i> trustees to create an enabling ecosystem. The strategies focus on fostering innovation, enhancing governance, and ensuring the long-term sustainability of sukuk <i>waqf</i> initiatives, positioning Malaysia as a global leader in this field.</p>

1.3. Methodology

To address the above objectives, this study adopts a multi-method approach that combines academic literature review, an extensive analysis of relevant regulatory frameworks and policy documents, and a focus group discussion (FGD) with key stakeholders. Each method is systematically applied to address the four research objectives, ensuring both theoretical rigor and practical relevance. This combined approach allows for a comprehensive understanding of sukuk *waqf*, bridging conceptual insights with real-world applicability. Below is a detailed explanation of each method and its application to the respective research objectives:

Table 1.2: Description of the research methods

Method	Description
Literature review	This method involves systematic searches of academic publication databases (e.g., Google Scholar, Scopus) using targeted keywords such as “sukuk,” “ <i>waqf</i> ,” “Islamic capital market,” and other related terms to establish a theoretical and conceptual basis for understanding sukuk <i>waqf</i> .
Legal and policy document review	<p>This method entails a comprehensive review of Malaysia’s regulatory frameworks, policy documents, and guidelines related to Islamic finance, capital markets, and <i>waqf</i>. Additionally, international regulations and best practices are examined for benchmarking purposes. The documents reviewed include, but are not limited to:</p> <ul style="list-style-type: none">• SC’s Guidelines on Issuance of Corporate Bonds and sukuk to Retail Investors• SC’s Guidelines on Unlisted Capital Market Products Under the Lodge and Launch Framework• SC’s <i>Waqf</i>-Featured Fund Framework• SC’s Sustainable and Responsible Investment (SRI) sukuk Framework• State Enactments Related to the Administration and Management of <i>Waqf</i>• Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) Shariah Standards• International Capital Market Association’s (ICMA) Sustainability Bond Guidelines• ICMA’s Sustainability-Linked Bond Principles• Organisation for Economic Co-operation and Development’s (OECD) Development Assistance Committee Blended Finance Guidance
Focus group discussion	<p>This method involves structured discussions with key stakeholders, including market regulators, policymakers, State Islamic Religious Councils (MAIN), government-linked investment companies, investment bankers, Shariah scholars, legal experts, and academics. The FGD allows the study to capture practical perspectives, validate theoretical findings from the literature review and document analysis, and identify strategies and recommendations related to the issuance and management of sukuk <i>waqf</i>. The procedure for conducting the FGD is provided in Figure 1.4. Meanwhile, Table 1.4 explains each section of the FGD. Below are the details of the FGD session conducted by the research team:</p> <ul style="list-style-type: none">• Date: 15 October 2024• Time: 8.30 a.m. - 5.00 p.m.• Venue: Dewan Tun Abdul Razak, Menara Kembar Bank Rakyat, Kuala Lumpur• Attendees: 6 research team members, 34 FGD participants, and 3 enumerators. The list of the FGD participants is provided in Appendix 2.

Table 1.3: Application of methods to research objectives

Method	Objective 1	Objective 2	Objective 3	Objective 4
Literature Review	✓ <p>This method identifies key principles, features, and historical context of <i>waqf</i>, along with contemporary applications of sukuk. By synthesizing theoretical insights from Islamic finance literature, it aims to establish a robust foundation for defining sukuk <i>waqf</i> in a manner that integrates classical <i>waqf</i> concepts with modern financial instruments.</p>	✓ <p>This method gathers and examines existing sukuk structures documented in the literature. These structures serve as a foundational reference, offering insights for formulating the terms and structures of innovative sukuk <i>waqf</i> proposed in the study.</p>	✓ <p>This method identifies the circumstances that give rise to common risks such as Shariah non-compliance, exposure to fluctuations in market conditions, and tax treatment, as well as barriers hindering sukuk issuance as highlighted in previous studies.</p>	
Legal and policy document review	✓ <p>This method provides the necessary regulatory context for understanding how sukuk <i>waqf</i> can be effectively issued within the Malaysian financial ecosystem, ensuring conceptual and operational relevance.</p>	✓ <p>This method identifies compliance requirements necessary to ensure the permissibility and feasibility of sukuk <i>waqf</i> in accordance with Shariah principles and regulatory expectations. It then informs and guides the drafting of sukuk <i>waqf</i> terms and structures.</p>	✓ <p>By scrutinizing existing regulations and guidelines, this method identifies potential gaps, ambiguities, and conflicts that could pose challenges to the issuance and management of sukuk <i>waqf</i>.</p>	
Focus group discussion	✓ <p>This method provides a platform for participants to discuss and refine the proposed concept and definition of sukuk <i>waqf</i>, ensuring alignment with practical considerations.</p>	✓ <p>Through this method, participants evaluate the proposed terms and structures for sukuk <i>waqf</i>, providing feedback on Shariah and regulatory compliance, investor preferences, risk factors, and potential social impact, while also suggesting improvements.</p>	✓ <p>This method provides participants with an opportunity to share insights on the practical challenges that may emerge during the issuance and operational phases of sukuk <i>waqf</i>. Participants can highlight real-world issues such as compliance with Shariah principles, navigating regulatory complexities, managing operational inefficiencies, asset management hurdles, and investor hesitations.</p>	✓ <p>This method allows participants to contribute ideas and strategic recommendations aimed at facilitating and scaling up sukuk <i>waqf</i> issuance.</p>

Figure 1.4: Step-by-step procedure for conducting the focus group discussion

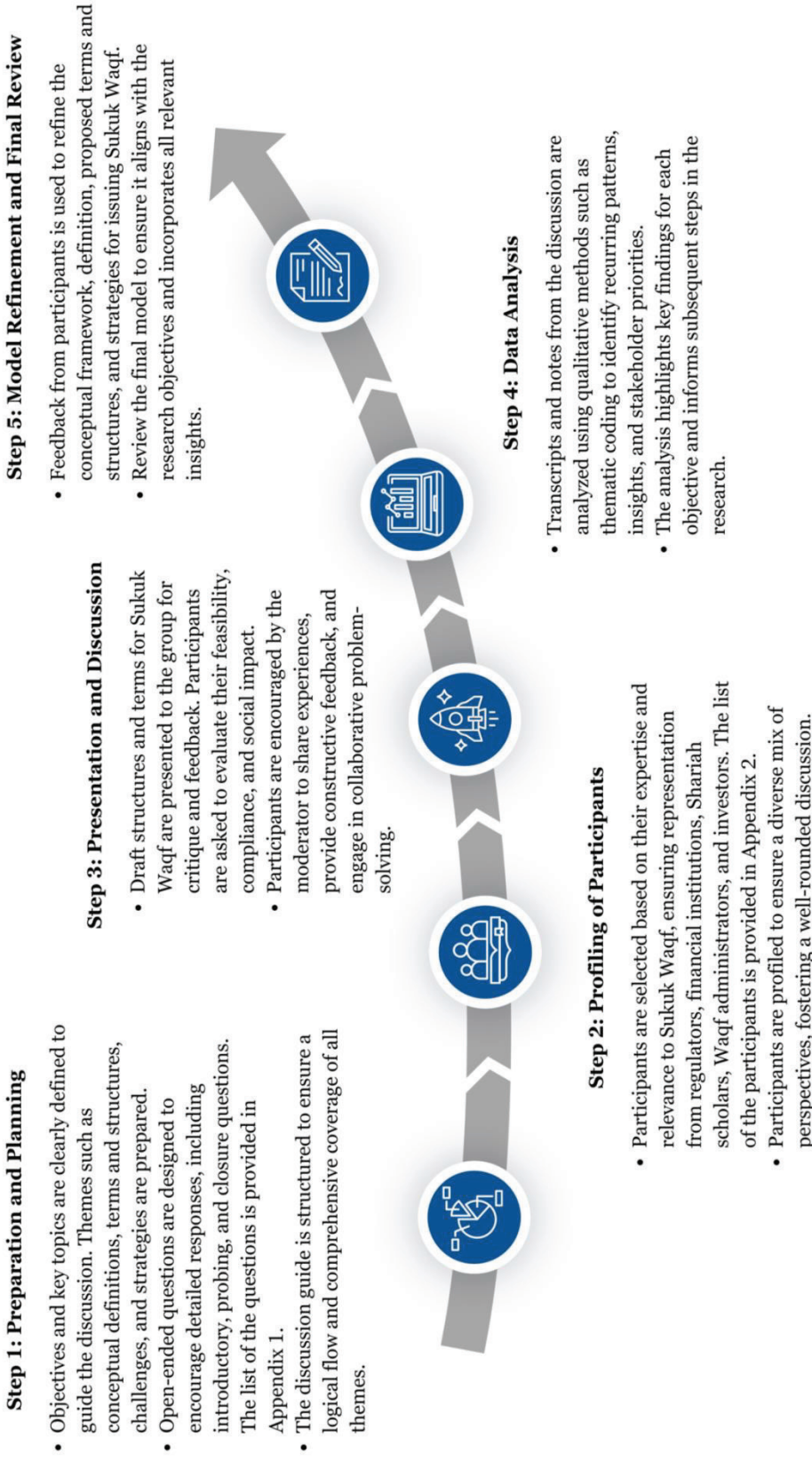


Table 1.4: Sections of the focus group discussion

FGD Section	Description	Output
<i>Section 1:</i> Understanding the Concept of Sukuk Waqf	<p>This section of the focus group aims to explore participants' understanding of the practical meaning and concept of sukuk <i>waqf</i>. It will also address how participants perceive the distinctive characteristics and features that set sukuk <i>waqf</i> apart from other Islamic financial instruments. Additionally, participants will share their perspectives on why sukuk <i>waqf</i> is important for social and economic development, and discuss possible motivations for issuers and other stakeholders to engage in sukuk <i>waqf</i> issuance, such as fulfilling corporate social responsibility, enhancing reputation, or aligning with ethical investment principles. The insights gathered will inform strategies for promoting and deepening understanding of sukuk <i>waqf</i>.</p>	<ol style="list-style-type: none">1. A practical definition of sukuk <i>waqf</i>2. The potential motivations and factor influencing the decisions for issuing and subscribing sukuk <i>waqf</i>
<i>Section 2:</i> Understanding the Concept of Sukuk Waqf	<p>This section of the focus group is dedicated to evaluating the proposed sukuk <i>waqf</i> structure. Participants will be asked to review and provide feedback on the salient terms and conditions of the proposed sukuk <i>waqf</i> program, assessing whether they are appropriate and aligned with the objectives of the issuance. The discussion will also cover the transaction flows, examining the processes involved in the issuance, management, and utilization of funds, as well as how the specific <i>waqf</i> features are embedded in the structure. Next, the roles and responsibilities of the key parties involved, such as the issuer, trustee, lead arranger, and Shariah advisor, will be discussed to determine whether the allocation of duties is clear and practical. Additionally, the session will address the main documents required for the sukuk <i>waqf</i> issuance, along with the deliverables, to ensure that the legal, operational, and compliance requirements are adequately covered. By examining these elements, the session aims to identify potential improvements, address any concerns, and ensure that the proposed sukuk <i>waqf</i> structure is robust, feasible, and aligned with stakeholders' needs.</p>	<ol style="list-style-type: none">1. Enhanced sukuk <i>waqf</i> Structure2. Relevant revision to the terms and conditions of the proposed sukuk <i>waqf</i> issuance

<p><i>Section 3:</i> Identifying the Challenges in Issuing Sukuk <i>Waqf</i></p>	<p>This section of the focus group aims to identify the key challenges associated with issuing sukuk <i>waqf</i>. Participants will discuss various obstacles that may arise throughout the issuance process, including legal, regulatory, and Shariah compliance issues, as well as operational difficulties related to asset management, liquidity, and market acceptance. The discussion will also explore challenges in structuring the sukuk <i>waqf</i> to ensure it meets both financial and social objectives, such as mobilizing funds for development while preserving the principles of <i>waqf</i>. Additionally, participants will be asked to share insights on the gaps in knowledge or expertise, limitations in the existing regulatory framework, and any perceived risks or barriers that could hinder the widespread adoption of sukuk <i>waqf</i>. The insights gained will inform strategies for overcoming these challenges and facilitating a more streamlined and effective issuance process.</p>	<p>1. A list of potential challenges and barriers to the issuance of sukuk <i>waqf</i> in Malaysia</p>
<p><i>Section 4:</i> Developing Action Plans to Facilitate Sukuk <i>Waqf</i> Issuance</p>	<p>This final section of the focus group focuses on developing strategies to facilitate and scale up the issuance of sukuk <i>waqf</i>. Participants will suggest practical steps that can be taken to overcome the challenges and barriers previously discussed, aiming to create a more conducive environment for sukuk <i>waqf</i> issuance in Malaysia. The discussion will cover key areas such as policy recommendations, regulatory improvements, capacity-building initiatives, and strategies to enhance market acceptance. Participants will also explore ways to streamline the issuance process, improve the management and investment of <i>waqf</i> assets, and address any legal, Shariah, or operational constraints. The insights gathered will be used to formulate concrete action plans that can support the widespread adoption of sukuk <i>waqf</i> in Malaysia.</p>	<p>1. A list of action plans and policy recommendations to overcome the challenges associated with sukuk <i>waqf</i> issuance in Malaysia</p>



Photos: The FGD session conducted by the research team at Menara Kembar Bank Rakyat on 15 October 2024



Photos: The FGD session conducted by the research team at Menara Kembar Bank Rakyat on 15 October 2024

CHAPTER

02

Revitalizing *Waqf* Through Sukuk



CHAPTER 2

REVITALISING WAQF THROUGH SUKUK INNOVATION

2.1. Evolution of *Waqf* Practices

2.1.1. Traditional Concept of *Waqf*

The term *waqf* originates from the Arabic root word “*waqafa*,” meaning to halt, pause, or hold. In Islamic jurisprudence, it refers to the dedication of a specific asset for the sake of Allah the Almighty for a righteous and perpetual purpose. A *waqf* is established by making an asset inalienable, where its corpus is preserved, and its benefits or usufruct are used to support causes aligned with Islamic principles. The primary aim of doing so is to eradicate poverty and promote societal well-being through investing in healthcare, education, public infrastructure, and the creation of economic opportunities.

Although the Holy Quran does not explicitly mention the term *waqf*, its spirit aligns with the broader Islamic ethos of charity and societal upliftment. Allah says in the Quran:

“...Rather, the righteous are those who believe in Allah, the Last Day, the angels, the Books, and the prophets; who give charity out of their cherished wealth to relatives, orphans, the poor, [needy] travellers, beggars, and for freeing captives; who establish prayer, pay alms-tax, and keep the pledges they make; and who are patient in times of suffering, adversity, and in [the heat of] battle. It is they who are true [in faith], and it is they who are mindful [of Allah].” (Al-Baqarah, verse 177).

Furthermore, the institution of *waqf* is grounded in the teachings of the Prophet Muhammad, Peace Be Upon Him (PBUH), who stated that:

“When the son of Adam dies, his deeds come to an end except for three things: ongoing charity (*Ṣadaqah Jāriyyah*), beneficial knowledge, or a righteous child who prays for him.” (Al-Tirmidhi, 1975).

Through these divine virtues, Islamic scholars, such as Khaṭīb al-Shurbūnī, have identified *waqf* as a form of a perpetual charity whose benefits extend beyond the donor’s lifetime, securing both worldly and spiritual rewards.

This concept is further illustrated in the case of Umar Ibn al-Khattab, may Allah be pleased with him, who consulted the Prophet (PBUH) regarding a piece of fertile land he had acquired. The Prophet advised him:

“Tie up the property (Aşl, or corpus) and devote the usufruct (Manfa‘ah) to human beings. It cannot be sold, given as a gift, or inherited; dedicate its produce to your children, kindred, and the poor for the sake of Allah.” (Al-Tirmidhi, 1975).

Following such advice, Umar established the land as *waqf*, inspiring a perpetual funding model for the prosperity of generations to come.

Over centuries following the Prophetic era, Muslims have endowed their assets and properties to serve communal needs, such as the construction of mosques, schools, hospitals, and infrastructure. This institution has remained a hallmark of Islamic civilization, fostering public welfare and reflecting the enduring notion of collective responsibility in Islam.⁴

2.1.2. Leveraging Cash *Waqf* for Promoting Social Well-Being

While traditional *waqf* predominantly involved immovable assets like land and buildings, the concept has evolved to include cash *waqf*, a more flexible and scalable form of endowment. Cash *waqf* entails the allocation of monetary contributions into a *waqf* fund, which can then be strategically invested in Shariah-compliant financial instruments or businesses, and the returns are used to finance various social and developmental projects.⁵ This approach makes cash *waqf* highly adaptable to today’s economic systems while preserving its Islamic principles of charity and perpetuity.

These advantages of cash *waqf* make it a powerful tool for amplifying the impact of charitable giving in modern contexts to promote socio-economic development. Its flexibility allows for diversification across multiple projects and sectors, ensuring income generated from those investments can address a variety of societal needs. Furthermore, its scalability allows individuals of varying financial capacities to pool resources, contributing to large-scale initiatives with significant social impact.

⁴ Çizakça (2017)

⁵ Mohsin (2013)

Despite its potentials, cash *waqf* faces several challenges that hinder its potential as an effective tool for advancing social welfare. A major issue is the lack of awareness and understanding among the public and institutions, limiting participation and contributions. Governance and transparency deficits, such as insufficient reporting, accountability gaps, and inefficiencies in fund management, erode trust in *waqf* institutions. Additionally, archaic legal and regulatory frameworks create bureaucratic hurdles and ambiguities in establishing cash *waqf*. Limited integration with formal financial systems and insufficient human capital in investment management further constrain its scalability and effectiveness, while public resistance to viewing cash *waqf* as an alternative to traditional asset-based *waqf* slows its adoption.

Addressing these challenges requires a fresh perspective and an evolution in the approach to cash *waqf* by integrating it with modern financial market instruments, such as sukuk, which is the focal point of this study. This integration not only modernizes *waqf* but also attracts broader participation, enabling it to meet the evolving needs of our society.

2.2. Innovation in Sukuk Issuance

2.2.1. Sukuk Definitions

Sukuk, derived from the Arabic word “*sakk*,” refers to certification or pay-out order. The term has its roots in the early Islamic caliphates, where it was used to facilitate trade and commerce within Muslim communities. These instruments served as written records of financial commitments and obligations, aligning with the following Quranic directive about the importance of ensuring transparency and fairness:

“...You must not be against writing [contracts] for a fixed period—whether the sum is small or great. This is more just [for you] in the sight of Allah, and more convenient to establish evidence and remove doubts...” (Al-Baqarah, verse 282).

In the context of modern Islamic finance, sukuk has evolved into a crucial instrument in the Islamic capital markets. One of the earliest formal definitions of sukuk was articulated during the fourth session of the International Islamic Fiqh Academy in 1988.⁶ The Council defined sukuk as:

⁶ Islamic Fiqh Academy (1988)

“Any combination of assets (or usufruct) that can be represented by written financial instruments that can be sold at a market price, provided that the majority of the tangible assets make up the composition of the asset groups represented by sukuk.”

This definition emphasizes the requirement of asset in the issuance of sukuk, distinguishing them from debt-based financial instruments. Unlike conventional bonds, which represent debt obligations, sukuk represent an ownership stake in underlying tangible assets, usufruct, services, or investment activities.

As the sukuk market expanded and became more complex, the need for standardized definitions and regulatory guidelines became apparent. In response, the AAOIFI introduced its Shariah Standard on Investment Sukuk in 2003.⁷ According to AAOIFI, sukuk are defined as:

“Certificates of equal value, representing undivided shares in the ownership of tangible assets, usufruct, and services, or in the ownership of the assets of particular projects or special investment activity. This applies once the value of the sukuk has been received, the subscription has closed, and the funds received have been put to use for which the sukuk has been issued.”

This standard highlights the importance of ensuring that the proceeds from sukuk issuance are invested in permissible activities.

Later in 2015, the SC, in its Guidelines on Issuance of Corporate Bonds and Sukuk to Retail Investors, defined sukuk as:⁸

“Certificates of equal value which evidence undivided ownership or investment in the assets using Shariah principles and concepts endorsed by the Shariah Advisory Council.”

⁷ AAOIFI (2003)

⁸ Securities Commission Malaysia (2015)

This definition underscores the ownership representation of sukuk and the adherence to Shariah, which prohibit interest and speculative transactions, and reflects Malaysia's strong emphasis on governance.

2.2.2. Integrating Philanthropy into Sukuk

Malaysia has established itself as a global leader in the sukuk market, with a robust legal framework, strong institutional support, and a well-developed ecosystem for Islamic finance. However, as the financial landscape continues to evolve, the future growth and sustainability of sukuk issuance will require Malaysia to embrace innovation in product structuring and market practices. Moving forward, innovation will be essential to address emerging challenges and maintain Malaysia's competitive edge in the global sukuk market.

One significant challenge is the saturation of traditional markets. Malaysia's sukuk market has become highly established, characterized by high issuance volumes and deep market penetration. To sustain growth, it is imperative to explore untapped sectors and broaden the investor base. Furthermore, the global competition is intensifying, with other regions such as the Middle East and North Africa (MENA) and Europe aggressively expanding their sukuk markets.

Another increasingly significant factor shaping the future of sukuk issuance is the heightened global focus on sustainability in finance. The growing demand for sukuk that align with environmental and social objectives underscores the evolving preferences of investors toward responsible and impact-driven financial instruments. While Malaysia has made notable progress in advancing green sukuk, incorporating philanthropic elements such as *waqf* into sukuk structures represents a new transformative opportunity. This integration would further align sukuk with the overarching objectives of Shariah (Maqasid al-Shariah) for promoting social justice and community well-being, enhancing their appeal to a broader spectrum of ethical investors seeking both financial and social returns.

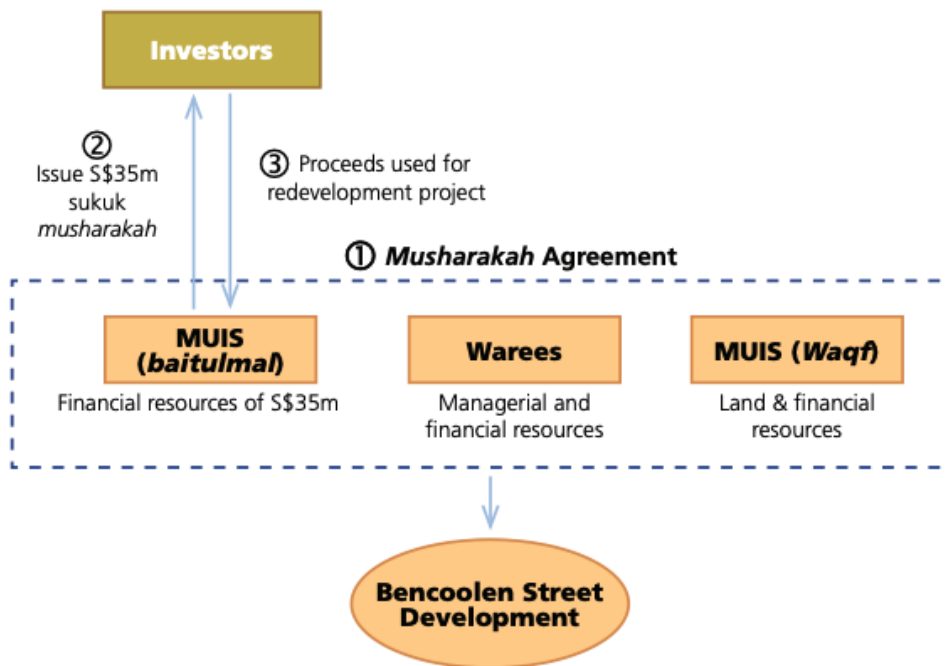
Previous initiatives to harmonise *waqf* with sukuk have predominantly centered on leveraging sukuk issuances as a mechanism to unlock the economic potential of *waqf*, particularly through the development of *waqf* lands and buildings. These efforts have aimed to mobilize capital for projects that enhance the utility and productivity of *waqf* properties while preserving their Shariah-compliant nature.

One notable example is the sukuk *musharakah* issuance for the redevelopment of an old mosque on Bencoolen Street, Singapore. This project was spearheaded by Warees Pte Ltd, a

subsidiary of the Islamic Religious Council of Singapore (MUIS). The project involved transforming the mosque into a multi-purpose complex that included a modern mosque, a three-story commercial building, and a 12-story apartment block with 84 units in 2002.

The financing mechanism utilized was a sukuk *musharakah* structure (see Figure 2.1), raising S\$35 million. This was a joint venture between three parties: MUIS (as Baitulmal), MUIS (as *waqf* Trustee), and Warees, with institutional investors fully subscribing to the sukuk issuance. The proceeds from the sukuk were allocated for the redevelopment of the Bencoolen Street site. The structure allowed for effective resource utilization, combining financial contributions from investors and managerial expertise from Warees.

Figure 2.1: The structure of sukuk *musharakah* issued by MUIS (partnership arrangement)

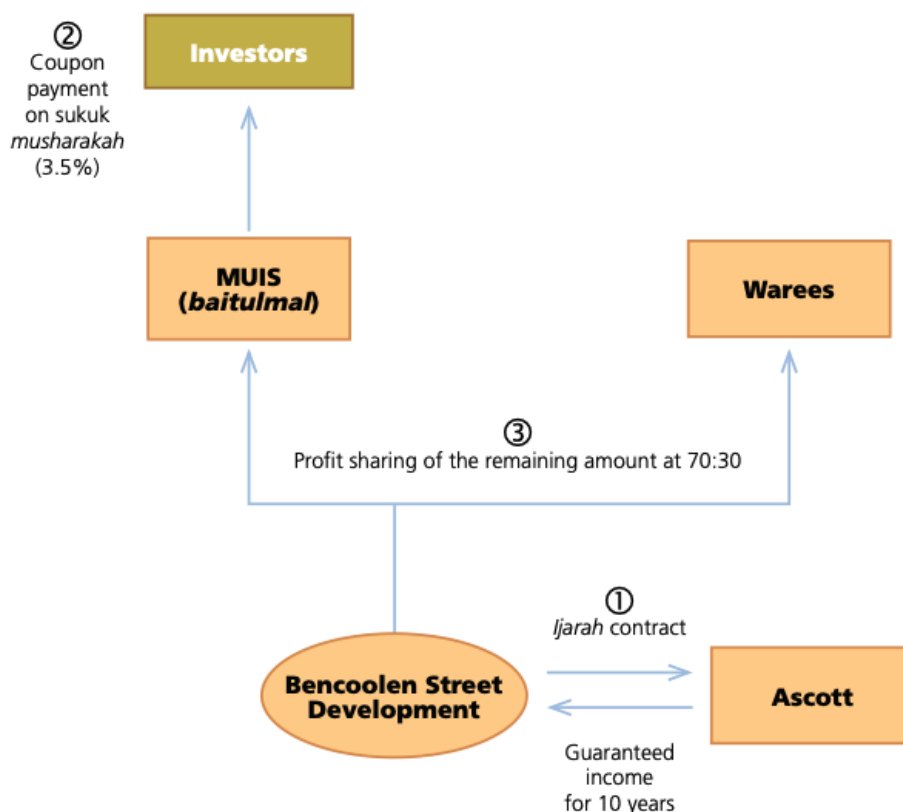


Source: Securities Commission Malaysia's report titled "*Waqf Assets: Development, Governance and the Role of Islamic Capital Market*".

As illustrated in Figure 2.2, the project ensured financial sustainability through profit-sharing mechanisms together with a 10-year *ijarah* agreement with Ascott Investments Pte Ltd for leasing apartments. This arrangement guaranteed a 3.5% annual return to investors from rental income, while remaining profits were distributed between MUIS and Warees at a 70:30 ratio.

Another example is the issuance of sukuk *al-intifa'a* for the development of Zamzam Tower in Makkah, Saudi Arabia. The project was initiated by Munshaat Real Estate Projects Co., which was granted a 24-year lease to construct one of the seven towers on the land adjacent to the Grand Mosque, which is owned by the King Abdul Aziz Waqf for the Two Holy Mosques.

Figure 2.2: The structure of sukuk *musharakah* issued by MUIS (distribution of returns)

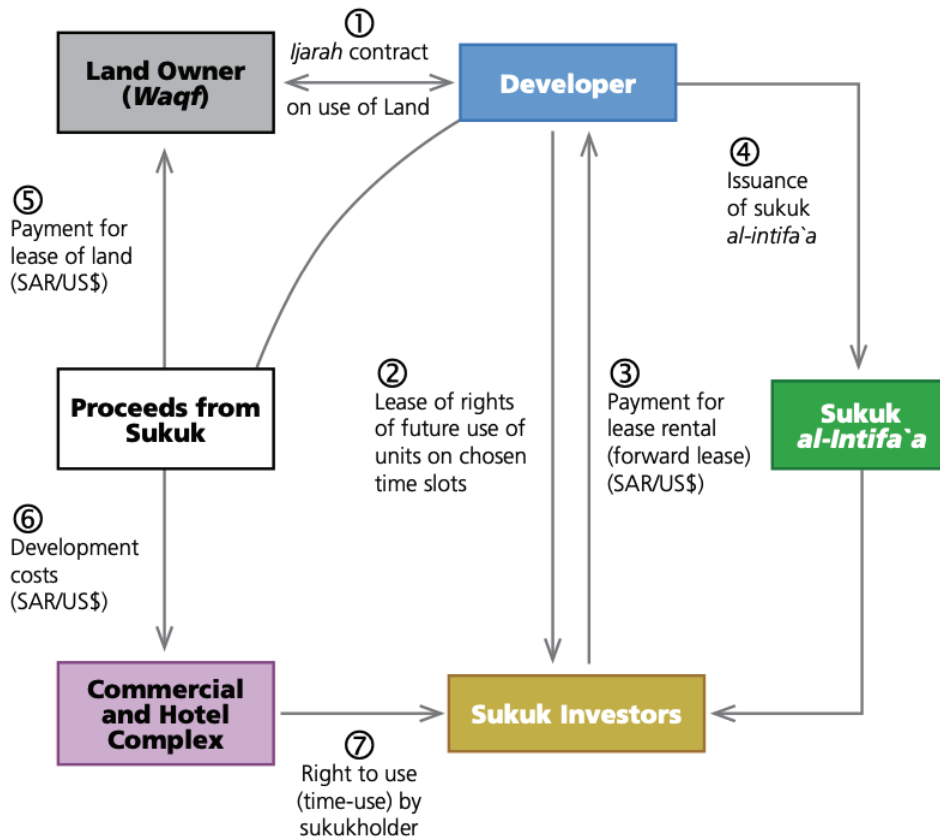


Source: Securities Commission Malaysia's report titled "*Waqf Assets: Development, Governance and the Role of Islamic Capital Market*".

The financing structure, as shown in Figure 2.3 below, involved a forward lease (*ijarah mawsufah fi dhimmah*), allowing the developer to lease the asset under construction to sukuk investors for 22 years. The sukukholders paid their lease rental upfront in a lump sum, evidenced through the issuance of sukuk *al-intifa'a*. The proceeds from the sukuk were allocated to pay for the lease of the *waqf* land and cover the construction costs of Zamzam Tower. Upon completion, the sukukholders were entitled to usufruct rights to the property based on a time-sharing arrangement, allowing them to use the property during allocated time slots. These rights could also be traded, leased, or bequeathed, subject to certain conditions.

More recently, in Indonesia, there was an initiative to mobilize cash *waqf* contributions from individuals and corporations. The funds collected are used to purchase Shariah-compliant sukuk issued by the Indonesian Ministry of Finance, known as Surat Berharga Syariah Negara. The returns from these investments are directed toward financing various social programs, while the principal amount is either preserved or returned, depending on the nature of the *waqf*—whether it is endowed as a temporary or permanent *waqf*.

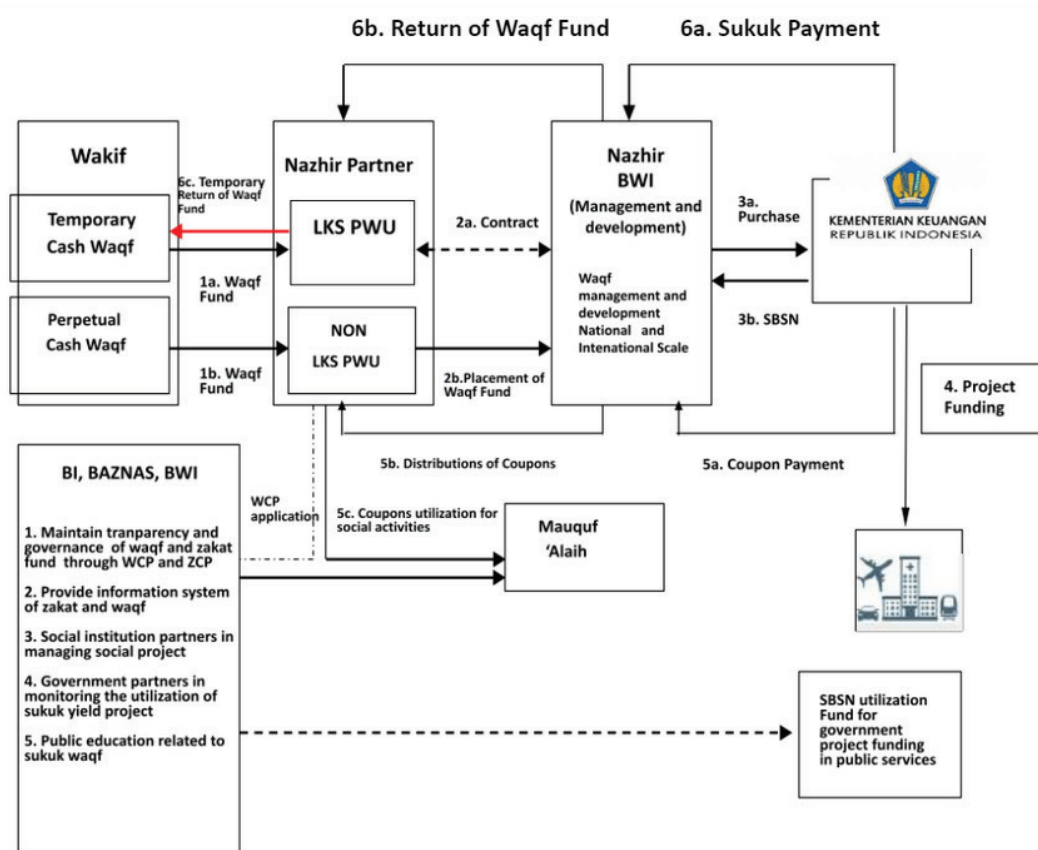
Figure 2.3: The structure of sukuk *al-intifa'a* for the development of Zamzam Tower



Source: Securities Commission Malaysia's report titled "*Waqf Assets: Development, Governance and the Role of Islamic Capital Market*".

Several key stakeholders are involved in the financing arrangement, as depicted in Figure 2.4 below. The Indonesian Ministry of Finance issues the sukuk and utilizes the funds for public projects. Badan Wakaf Indonesia (BWI), the Indonesian *Waqf* Board, acts as the regulator and supervisor, managing the *waqf* funds to ensure their proper utilization. Bank Indonesia facilitates the implementation of the cash *waqf* programme, aligning it with national financial policies, while Islamic financial institutions, such as Bank Muamalat Indonesia and BNI Syariah, serve as an agent for collecting and distributing cash *waqf* contributions.

Figure 2.4: The structure of Indonesia's cash waqf-Linked sukuk programme



Source: Wulandari et al. (2022). *Public Intention in Buying Cash Waqf-Linked Sukuk: Modification of Theory of Reasoned Action*.

CHAPTER

03

The Concept and Definition of Sukuk *Waqf*



CHAPTER 3: THE CONCEPT AND DEFINITION OF SUKUK WAQF

3.1. What is Sukuk Waqf?

The present study seeks to transcend the traditional emphasis on the utilisation of sukuk for developing *waqf* immovable properties like in the cases of MUIS's sukuk *musharakah* and Zamzam Tower's *sukuk al-Intifa'a* by introducing a more comprehensive and innovative approach to integrating *waqf* within sukuk structures. This approach culminates in the birth of a new sukuk variant, namely, sukuk *waqf*.

Sukuk *waqf* is defined by the research team as:

“Certificates of equal value representing undivided shares in the ownership of assets or investments that are compliant with Shariah principles, where sukukholders are given with the option to convert the principal they own, the income distribution received, or both, in whole or in part, into waqf throughout the tenure of the sukuk or upon maturity.”

This definition was thoroughly deliberated during the FGD. The feedback received from the participants was carefully documented and synthesized for the purpose of enhancing and refining the proposed concept and definition of sukuk *waqf*.

3.2. The Value Propositions of Sukuk Waqf

The new dimensions outlined in the definition have expanded the scope and applications of *waqf* through sukuk issuance in multiple ways, as elaborated in the following subsections.

3.2.1. Diversified Use of Proceeds

Firstly, the definition of sukuk *waqf* does not restrict the proceeds raised from the sukuk issuance to be only allocated for the development of existing *waqf* assets, such as lands and buildings. Instead, the proceeds can be invested in traditional Shariah-compliant investment or financial assets, with the option to subsequently convert the principal, the returns, or both into *waqf* at a later stage. This broader perspective was emphasized by the Principal Researcher at the outset of the moderation session, highlighting the wider applicability of the sukuk *waqf* framework:

*“The intention here is to make it broader and more flexible, meaning **it can accommodate various needs and situations**...For example, if a Majlis Agama (MAIN) owns land and wants to develop it, or if it starts as a regular investment instrument, such as a fixed-income product, they can convert it into waqf at a later stage. That is the flexibility that we want to have here.”*
(PR)

This remark was made in response to an observation raised by a banker, who noted that the requirement with regard to the use of proceeds is missing from the definition:

*“To clarify, what makes Green sukuk green is the use of proceeds being directed toward environmentally friendly projects, and what makes a Sustainability sukuk sustainable is the allocation of proceeds to initiatives that meet sustainability objectives. I initially understood that **the defining characteristic of sukuk waqf is also tied to the use of proceeds for waqf purposes**. Are we now moving away from this fundamental premise?”* (B)

Technically, the present definition of sukuk *waqf* extends beyond the scope of the Sustainable and Responsible Investment (SRI) Sukuk Framework⁹ developed by the Securities Commission Malaysia (SC), which focuses solely on the use of proceeds. The SRI Sukuk Framework defines such sukuk as those whose proceeds are applied exclusively for funding activities or transactions related to eligible SRI projects, which include the development of *waqf* properties and assets. This provision was highlighted by a market regulator, who mentioned that:

*“...under our SRI sukuk Framework, we already have eligible projects which are to develop the waqf project...In this session, we have to be clear about what we want out of this sukuk waqf. Are we seeking to convert the instrument into something else, or do we want the proceeds to be used for waqf purposes. If it is the latter, we already have that under our SRI sukuk Framework, which specifically **facilitates the development of waqf land**.”*
(MR)

⁹ Securities Commission Malaysia (2019)

In contrast, the sukuk *waqf* definition provided in this study offers a more holistic and versatile approach, extending its scope beyond the specific use of proceeds. The intention behind keeping the definition silent on the use of proceeds is to provide greater room for allocating the funds raised, enabling investments in a broader range of financial and non-financial assets rather than limiting their application only to the development of existing *waqf* assets. This diversification is expected to enlarge the investor base, appealing to a wider audience, including traditional investors.

However, this raises an important question: how can the instrument still be classified as sukuk *waqf* if the proceeds are not directed toward the development of *waqf* assets?

3.2.2. Greater Flexibility in *Waqf* Contributions

To address the above question, the definition identifies a sukuk as sukuk *waqf* if it satisfies at least one of the following two conditions: First, if the proceeds are allocated to the development of *waqf* assets; or second, if the sukukholders opt to convert their principal, income distributions, or both, either partially or fully, into *waqf*. This conversion can occur during the sukuk's tenure or upon maturity. These conditions were clearly understood by a market regulator, who emphasized that:

*“So, from my perspective, I need to look into this concept of sukuk waqf in two ways: Either we want to structure the instrument itself so that it can eventually be converted into waqf, or we want to use the proceeds generated by the instrument for waqf purposes, while **allowing the instrument itself to remain as a fixed-income instrument**” (MR)*

The second condition regarding *waqf* contributions aligns in spirit with the SC's *waqf*-Featured Fund Framework¹⁰, introduced in November 2020. This Framework facilitates the offering of Islamic unit trusts and Islamic wholesale funds specifically designed to channel all or a portion of the income generated toward *waqf* purposes, as highlighted by the market regulator:

“Just to draw another comparison, we also introduced our waqf-Featured Fund Framework. It operates under a unit trust fund structure, where the investment portfolio consists of typical Shariah-compliant securities, such

¹⁰ Securities Commission Malaysia (2020)

as equities. **The dividends are, however, channelled toward waqf initiatives.**"

(MR)

Nevertheless, the current definition of sukuk *waqf* offers an additional layer of flexibility not provided by both SC's Frameworks. Specifically, it allows the sukukholders to endow not only the income generated from the investments but also their principal amount, representing the face value of the sukuk. This innovative aspect was recognised by the market regulator, responding to the following question by the Principal Researcher:

"In the current scenario, what is covered under the SRI Framework is when we issue sukuk and the proceeds are used to develop waqf assets. That is straightforward and aligns with the Framework. However, it does not address situations where, for example, the proceeds are invested into a non-waqf underlying project, but the returns are allocated to waqf purposes. Additionally, it does not cover cases where investors have the option to later convert their sukuk, which is initially not endowed, into waqf. That flexibility is not included in the current framework. Am I correct?" (PR)

"Yes, up to the point of the dividend allocation, it does not fall under the SRI framework—that aligns more closely with the model of our waqf-Featured Fund Framework. However, the idea of including waqf contributions from the principal amount is something entirely new." (MR)

3.2.3. Broadened Investor Base

Incorporating flexibility in the use of proceeds and approaches to *waqf* contributions is expected to significantly enhance the commercial viability of sukuk *waqf*. These features increase the sukuk's appeal to a diverse range of investors, including both profit-oriented individuals and institutions as well as those driven by philanthropic objectives.

This perspective was emphasized by the Principal Researcher in response to a question posed by an investment banker:

"The definition here is quite straightforward that at maturity or during payments, you can let go [into waqf] or take back the principal or profit

portion. But the other thing is by you issuing this sukuk waqf, what kind of investors are you attracting? Maybe you need to clearly identify the group of investors you are targeting.” (IB)

“Our intention is to target a **very wide range of potential investors**. As I mentioned just now, some investors may take this purely for profit. To them, they treat this sukuk as a normal sukuk. They are not interested in doing waqf or charity. For example, if I am a corporate entity and I have a surplus, when I see the return is good, the sukuk is good, and everything fits within my investment criteria, I will come and buy. So, we want to be flexible in that sense.” (PR)

Simultaneously, the definition of sukuk *waqf* also accommodates investors who intend to make charitable contributions in the form of *waqf* from the inception of their investment, as suggested by a legal expert:

“I think, yes, legally, it is workable, but I think we should be a little bit more adventurous and expand the concept further. Can we design a sukuk waqf where from the start, there are no options [for conversion] at all? In other words, **the instrument is already a waqf from the beginning**...Where I am getting at is a model, which would not only enhance marketability but also make structuring these instruments much easier. Yes, of course, from the capitalist’s point of view, there may be an argument saying that who would want to give away profits by investing in this charitable type of sukuk. But, I think that is just a presumption, and there is indeed a market for such instruments. We have so many trusts and endowments, which want to do that and, of course, investing in this particular type of sukuk gives them not only a formalised presence but also added value in terms of amplifying their message and enhancing their overall impact, not just returns per se.” (LE)

However, this view was contested by another market regulator, who stated that:

“But *why are we providing the options then? If we know from day one that they want to do waqf.*” (MR)

The concept of sukuk *waqf* was later affirmed by the Principal Researcher, who stressed that:

“My suggestion is for us to have a sukuk structure we name it as sukuk *waqf*, where **those who come to [subscribe to] this sukuk can have many intentions.** An individual can come in from day one with the intention of doing *waqf*, meaning his principal investment is immediately designated as *waqf*, or he might choose not to *waqf* the principal but only the returns from the investment. Then there is another category of investor who might decide to *waqf* only a portion of the returns, for example, only 20%, while retaining the remaining 80% for himself. Yet another group might decide to allocate the returns only to *waqf* for the first three years but later opt to convert the principal into *waqf* from year four onward. The idea is to create a sukuk structure that offers maximum flexibility, allowing investors to tailor their contributions to *waqf* based on their individual circumstances and preferences. The sukuk, by its very nature, should be able to accommodate this level of adaptability, which is the primary intention behind this proposal.” (PR)

In summary, a single sukuk *waqf* issuance can potentially be subscribed by various categories of investors, each with distinct investment objectives and motivations. These categories of investors and their corresponding decisions can be illustrated through a hypothetical sukuk *waqf* issuance priced at par, with a 5-year maturity, a coupon rate of 5%, and a face value of RM1,000, as detailed (but not limited to) below:

Table 3.1: Examples of investors subscribing to sukuk *waqf*

Investor category	Motivation	Example of decision
Pure philanthropists	Solely focused on contributing to social causes.	He will allocate the entire principal amount of RM1,000, along with all periodic coupon payments of 5%, to <i>waqf</i> .

Impact-first investors	Primarily driven by charitable goals but may retain partial returns for personal or institutional use.	He will contribute the entire or a significant portion of the principal amount of RM1,000 to <i>waqf</i> , along with 3% of the periodic coupon payments, while keeping the remaining 2% for personal use.
Socially responsible investors	Primarily profit-driven but supportive of socially impactful initiatives.	<ol style="list-style-type: none"> 1. He will allocate only 50% of the periodic coupon payments to <i>waqf</i>, while retaining the remaining 50% and redeeming the full face value of RM1,000 at maturity for personal use. 2. He will allocate the entire periodic coupon payments of 5% to <i>waqf</i> only during the first three years, enjoy the coupon payments for the remaining two years prior to maturity, and redeem the full face value of RM1,000 at maturity.
Pure profit-driven investors	Exclusively focused on financial returns with no intention to contribute to <i>waqf</i> .	He will retain the entire periodic coupon payments of 5% and redeem the face value of RM1,000 at maturity.

3.3. The Economic Importance of Sukuk *Waqf* Issuance

Next, the FGD delves into exploring the potential economic as well as social benefits associated with sukuk *waqf* issuance, uncovering the underlying motivations driving institutions' interest in utilising this innovative funding mechanism. The key insights from this discussion are presented in the following subsections.

3.3.1. Funding the Development of *Waqf* Assets

One of the primary challenges in developing existing *waqf* assets is the persistent lack of funding. Despite their immense potential to generate social and economic benefits, many of

these assets remain underutilised or in disrepair due to inadequate financial resources for maintenance, renovation, or modernisation. This issue was pointed out by a representative of a State Islamic Religious Council (MAIN) in response to a question posed by the Principal Researcher regarding the availability of *waqf* lands to be developed in the state:

*“Yes, we have several lots, many of which are in very strategic locations. However, **our main problem is project funding**, we do not have much cash.”*
(MAIN)

He further highlighted that among the funding constraints faced by MAIN in developing *waqf* lands and buildings are the absence of collateral and limited interest from private investors, who often demand a form of financial guarantee before the fund can be disbursed:

*“When the Prime Minister announced the allocation of RM200 million to develop *waqf* land in Penang¹¹, we went to see the Ministry of Finance (MOF)”*
(MAIN)

“Did you get it?” (PR)

*“No, the MOF asked for collateral. **They requested collateral from *waqf* lands when they already know that *waqf* assets cannot be charged.** And then, we went to see a registered market operator, but they required a state guarantee, which is also not possible for us to obtain.”* (MAIN)

Alternatively, *sukuk waqf* presents a practical and innovative solution to overcome these funding challenges by fostering increased participation from private investors. In the *sukuk waqf* structure (please see Chapter 4 for more details), the underlying asset does not necessarily have to be a *waqf* asset; it can instead be a commercial, income-generating asset that provides secure and stable returns to *sukuk*holders. The proceeds successfully raised from the *sukuk* issuance can then be allocated for developing the *waqf* asset, maximising their socio-economic impacts. By adopting such an arrangement, *sukuk waqf* effectively aligns investor interests with the development needs of *waqf* properties, creating a sustainable financing mechanism that benefits both investors and *waqf* beneficiaries.

¹¹ Dermawan (2023)

This approach mirrors the structure employed in the issuance of MUIS's sukuk *musharakah*, which was utilized to develop commercial properties on *waqf* land at Bencoolen Street, Singapore, as highlighted by the Principal Researcher:

*"Take, for example, the sukuk musharakah issued in Singapore by MUIS. In that case, the sukuk itself is not a waqf instrument. Those investors [who participated in the sukuk], they never did waqf. They put their capital, they got their dividends and they exited with their principal plus income. However, **what ties it to waqf is that the proceeds from the sukuk were used for developing the waqf property**. So, it is still deemed as a waqf instrument in that sense."* (PR)

This capacity of sukuk *waqf* was further emphasised by an investment banker, who mentioned that:

*"...I do believe that for waqf-linked sukuk, the use of proceeds must be directed toward waqf projects. However, **the underlying assets for the sukuk do not necessarily have to be waqf projects or waqf assets** because that (i.e., involving waqf assets as the underlying) could raise various problems, such as issues of ownership. Instead, the underlying asset for the sukuk—such as in the case of sukuk *ijarah*—could be a commercial building or a plant..."* (IB)

Furthermore, the proceeds from sukuk *waqf* can be strategically directed toward the development of commercial assets and projects that, although not initially designated as *waqf*, hold the potential to be transformed into *waqf* assets in the future. This approach was suggested by a policymaker who cited the example of Menara Bank Islam as a notable case study:

*"...It is not only on idle waqf lands, but we are also looking at future waqf assets. Over a span of 20 to 30 years, **those commercial assets developed today could eventually be designated as waqf**...We can take the model of Menara Wakaf, for instance. Such approach focuses on future waqf rather than current waqf, but it ensures that the underlying instrument is structured with waqf in mind."* (P)

3.3.2. Reducing Fiscal Dependency in Public Infrastructure Construction

Secondly, the sukuk *waqf* framework offers an effective mechanism for the government to work with private sectors and philanthropic organisations, enabling the development of infrastructure and the delivery of essential social programs. Private entities may provide funding for project development, such as constructing hospitals, schools, or commercial properties on *waqf* land, while the government ensures that these projects align with public welfare goals. Revenue generated from the underlying projects, such as rental income from commercial properties, can be used to repay sukukholders and reinvest in infrastructure development or other *waqf* initiatives. This ensures the sustainability of *waqf* development and reduces the fiscal strain on governments and allows them to focus on other critical areas, as highlighted by a policymaker:

*“I think another reason why this is very important, particularly in the context of sukuk in Malaysia, which is recognised as the most prolific sukuk market in the world, is **the opportunity to relieve the dependency on the federal government**. This is going back to what the federal government and the MOF have been trying to address...This framework could establish sukuk as a recurring funding option for MAIN and serve as a replicable model for other institutions involved in waqf development...By utilizing sukuk as a funding instrument, instead of relying on federal support, this approach provides a sustainable way to develop waqf assets for the benefit of the society as a whole.” (P)*

In addition, private sector participation brings valuable expertise in project management, construction, and operational efficiency. Unlike government-led initiatives, private entities operate under market-driven principles, ensuring timely delivery, cost-effectiveness, and high-quality outcomes. In the context of sukuk *waqf*, this expertise ensures that *waqf* assets are developed into income-generating projects that maximize both social and economic impact.

3.3.3. Empowering Small and Medium-Sized Enterprises

Small and medium-sized enterprises (SMEs) often face challenges in accessing affordable financing. These difficulties stem from a variety of factors, including stringent lending criteria imposed by banks, high interest rates, and the limited availability of collateral and credit history. Traditional financial institutions tend to perceive SMEs as higher-risk borrowers due

to their smaller scale and less diversified revenue streams. As a result, SMEs are frequently subjected to unfavourable borrowing terms or are entirely excluded from formal financial systems, as noted in a witty remark by the Principal Researcher:

*“Many of the SMEs, particularly among Bumiputera entrepreneurs, are considered unbankable. In fact, **they cannot even knock on the bank’s door, let alone access financing.**” (PR)*

Sukuk *waqf* can address these barriers by utilizing the proceeds from sukuk issuance to create dedicated financing programs or *waqf*-based funds for SMEs. These programs can provide SMEs with Shariah-compliant financing options, enabling them to invest in business growth, technology adoption, and human capital. With improved access to financing through sukuk *waqf*, SMEs can also invest in innovation, expand their product offerings, and explore new markets.

Moreover, the funds raised through sukuk *waqf* can be used to establish SME-focused incubators, training programs, or research initiatives. These programs can equip SMEs with the skills, knowledge, and resources needed to thrive in competitive markets. By strengthening the overall SME ecosystem, sukuk *waqf* contributes to job creation, economic diversification, and community development.

Lastly, it is also important to channel the sukuk *waqf* proceeds towards creating a supportive and conducive living environment for SMEs, predominantly comprising the B40 Bumiputera group, to enable them to succeed in their businesses, as pointed out by a policymaker:

*“If I may, before we talk about SMEs and businesses, let us take a step back and look at the Bumiputera as a whole, especially the B40 group. **When we develop waqf properties, such as student accommodations and hospitals, the primary beneficiaries will naturally be Bumiputeras.** Take university accommodations as an example. When Bumiputera students stay in these facilities, they should be offered subsidized rates, making it more affordable for B40 families to access quality housing for their children. This is a direct benefit to these students and their families. Similarly, in the case of hospitals, even if we establish private or semi-private hospitals on waqf land, Bumiputeras who seek treatment there should receive subsidies. This could*

provide a significant alternative to government hospitals, ensuring they receive affordable and quality healthcare. The question, of course, is: who will subsidize these services? That is where I believe the proceeds from the sukuk waqf, along with the income generated by these facilities could be used partially or entirely to subsidize those in need of treatment.” (P)

3.3.4. Meeting the Needs of an Ageing Population

The ageing population presents a complex socio-economic challenge, driven by increased life expectancy and declining birth rates. As the proportion of elderly individuals in society rises, there is growing pressure on healthcare systems, social services, and public finances. Ageing populations require specialised healthcare and social support facilities, which can further strain government budgets and pension systems, as mentioned by the Principal Researcher:

*“There is another issue people often overlook, we are an ageing nation, and aged care is becoming increasingly important. What we might call old folks’ home. Like in the UK, their equivalent of the Employees’ Provident Fund can no longer sustain the costs to fully support retirees. So, instead of providing direct payouts, they lease aged care centres where retirees can live comfortably. We are heading the same direction as an ageing nation, like it or not. Moving forward, the question is: **What safety nets are we going to provide to our people?** Particularly to the Malay community, where their average savings are often insufficient to support them for more than the years post-retirement.” (PR)*

Additionally, a shrinking workforce due to fewer younger individuals entering the labour market can hinder economic growth and reduce tax revenues, further exacerbating fiscal pressures.

These challenges highlight the urgent need for innovative policies and sustainable financing mechanisms to ensure the well-being of elderly individuals while balancing economic sustainability.

One of the primary ways sukuk *waqf* can make a meaningful impact is by financing the enhancement and expansion of healthcare facilities. The proceeds can be utilised to build

geriatric hospitals, clinics, and rehabilitation centres, particularly on *waqf* land, ensuring that affordable and inclusive healthcare services are accessible to beneficiaries. Such facilities can operate on a not-for-profit basis, with subsidies for low-income elderly individuals funded through the income generated by *waqf*-based projects.

Another critical area where sukuk *waqf* proceeds can contribute is in the development of elder-friendly housing communities. These projects can create safe, comfortable, and accessible living environments for older adults, equipped with essential amenities such as healthcare services, recreational facilities, and social engagement programs. By subsidizing housing costs for low-income seniors, sukuk *waqf*-funded projects can alleviate financial burdens on families and promote dignified living conditions for the elderly. Furthermore, the proceeds can be directed toward preventive healthcare initiatives, such as wellness campaigns, health screenings, and educational workshops aimed at promoting healthy aging. These programs can reduce the prevalence of chronic diseases and improve the overall quality of life for elderly individuals.

CHAPTER

04

The Proposed Sukuk *Waqf* Model



CHAPTER 4: THE PROPOSED SUKUK WAQF MODEL

4.1. Salient Terms and Conditions

This chapter outlines the salient terms and conditions of the prototype sukuk *waqf* programme, designed within the concept and framework established in the previous chapter. It provides a detailed overview of the operational elements and investment mechanisms that govern its implementation. These terms and conditions are summarised in Table 4.1 below.

Table 4.1: Suggested terms and conditions of the proposed sukuk *waqf* programme

Parameter	Key indicative term
Issuer	SPV to be wholly owned by Obligor
Obligor	MAIN / YWM / PHB etc.
Facility	SRI sukuk programme with <i>waqf</i> feature of up to RMXX million in nominal value
Programme Tenure	Up to XX years from the date of issuance of the proposed sukuk programme
Issue Tenure	From 1 year up to XX years prior to maturity of the proposed sukuk programme. The benchmark tenure is typically set at 3, 5, 7, or 10 years
Islamic structure	<i>wakalah bil istithmar</i> or other Islamic structures as advised by the Shariah Adviser
Utilisation of Proceeds	The proceeds may be utilised (but not limited to) to fund the development of <i>waqf</i> properties or assets and Shariah-compliant activities or transactions relating to the eligible green or social projects as stated under the SC's SRI Sukuk Framework
Rating	A stand-alone credit rating that reflects the financial profile of the Obligor. The rating shall be enhanced by the guarantee provided by the Government of Malaysia, or financial guarantor.
Mode of Issuance	Book building, bought deal, or private placement

Profit Rate	To be determined prior to the launch of the transaction based on the final rating of the sukuk
Profit Rate Frequency	Semi-annually or other periods to be agreed prior to each issuance
Security	<ul style="list-style-type: none"> • Assignment of Collection Account(s), including income derived from Shariah-compliant activities or transactions relating to green or social projects. • Assignment of Finance Service Reserve Account (FSRA), a fund set aside to ensure the timely payment of periodic distributions to the sukukholders. • Such other securities may be agreed between the Issuer and the Lead Arranger.
<i>Waqf</i> Feature	<ul style="list-style-type: none"> • The sukukholders may endow the principal or profit payments or both. • The sukukholders may endow the principal and profit payments in a full amount or a specified portion thereof. • The sukukholders may exercise the option to endow the principal and profit payments: <ol style="list-style-type: none"> 1. Throughout the tenure of the sukuk 2. At the time of exiting the sukuk (i.e., selling the sukuk on the secondary market) 3. Upon a dissolution event 4. At the maturity date
Financial covenant	<ul style="list-style-type: none"> • Finance Service Cover Ratio (i.e., the Issuer's operating income / its total debt servicing costs) • Other financial covenants imposed by the rating agency and financial guarantor

4.2. Proposed Sukuk *Waqf* Structure

Next, a proposed sukuk *waqf* structure, along with its corresponding transaction flows are illustrated in Figure 4.1 and Table 4.2, respectively. The diagram and table are designed to offer step-by-step guidance for understanding of the structural framework and operational mechanisms of the sukuk *waqf*, covering from issuance processes to fund allocation.

Figure 4.1: Proposed sukuk waqf structure using *wakalah bi al-istithmar* contract

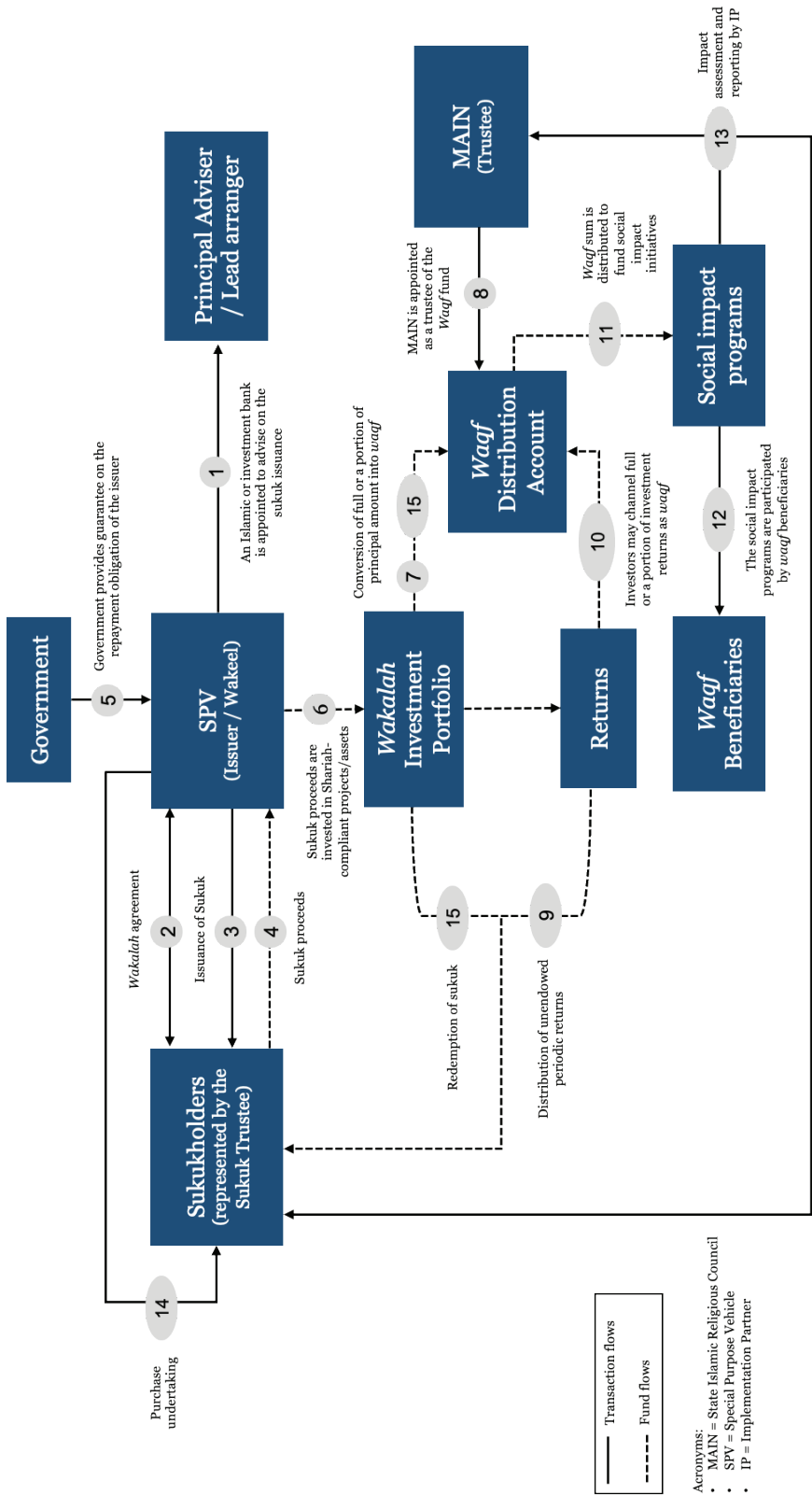


Table 4.2: Transaction flows of the proposed sukuk *waqf* structure

Step	Description
Step 1	The Originator shall appoint a Principal Adviser or Lead Arranger for the documentation, marketing, and distribution process of the sukuk issuance. See Table 2 for more details about the roles and responsibilities of the Principal Adviser/Lead Arranger.
Step 2	<p>Pursuant to a <i>wakalah</i> agreement entered into between the sukuk Trustee (acting on behalf of the sukukholders) and the SPV, the SPV shall be appointed as an agent of the sukukholders to perform duties on behalf of the sukukholders including investing the sukuk proceeds in the Shariah-compliant <i>wakalah</i> Investment Portfolio and management of the Portfolio, in accordance with the <i>wakalah</i> agreement. The <i>wakalah</i> Investment Portfolio shall comprise a collection of investment in the following:</p> <ol style="list-style-type: none">1. Development of <i>waqf</i> properties or assets; and2. Shariah-compliant activities or transactions relating to green or social projects
Step 3	The Issuer shall declare a trust on the trust assets for the benefit of the sukukholders. The Issuer shall issue sukuk <i>wakalah</i> to the sukukholders.
Step 4	The sukukholders shall subscribe to the sukuk <i>wakalah</i> by paying the sukuk proceeds. The sukuk <i>wakalah</i> shall represent the sukukholders' undivided proportionate interest in the trust assets.
Step 5	The Government of Malaysia shall provide a guarantee for the repayment obligations of the Issuer, thereby enhancing the creditworthiness and attractiveness of the sukuk issuance. A Financial Guarantor may also be considered.
Step 6	The proceeds of the sukuk <i>wakalah</i> shall be utilized by the Issuer for the investment in the <i>waqf</i> assets and Shariah-compliant green or social projects. The Issuer may appoint an Investment Manager, who will manage the investment in the <i>waqf</i> assets and Shariah-compliant green or social projects for the benefit of the sukukholders.
Step 7	The sukukholders will have the option to convert either the entire principal amount or a specified portion thereof into a <i>waqf</i> throughout the tenure of the sukuk <i>wakalah</i> . The endowed sum will be channelled to the <i>waqf</i> Distribution Account.

Step 8	Majlis Agama Islam Negeri (MAIN) shall be appointed as the trustee for the <i>Waqf</i> Distribution Account. MAIN may appoint an external party as an agent to manage the <i>Waqf</i> Distribution Account.
Step 9	<ul style="list-style-type: none"> The Issuer shall distribute returns generated from the <i>wakalah</i> Investment Portfolio (being income from <i>waqf</i> assets development and Shariah-compliant green and/or social investment) to the sukukholders, amounting to: <ol style="list-style-type: none"> In respect of sukuk <i>wakalah</i> with periodic distribution, the expected periodic distribution amount in the form of periodic distribution on each periodic distribution date; or In respect of sukuk <i>wakalah</i> without periodic distribution, the expected one-off distribution amount, which shall be equal to the difference between the nominal value and the sukuk Proceeds of the sukuk <i>wakalah</i> in the form of a one-off distribution upon the date of a declaration of a dissolution event or the maturity date of the sukuk <i>wakalah</i>, whichever is earlier. Any surplus exceeding the expected periodic or one-off distribution amount shall be waived by the sukukholders and retained by the Issuer as incentive fee.
Step 10	The sukukholders will have the option to convert either the entire returns amount or a specified portion thereof into a <i>waqf</i> throughout the tenure of the sukuk <i>wakalah</i> . The endowed sum will be channeled to the <i>Waqf</i> Distribution Account.
Step 11	The accumulated endowed sum (comprising both principal and returns) in the <i>Waqf</i> Distribution Account shall be distributed to finance social impact programs after deducting administrative fees and other related costs.
Step 12	<i>Waqf</i> beneficiaries identified by MAIN shall participate in the social impact programs conducted by the Implementation Partner (IP).
Step 13	<p>The IP shall undertake impact assessments to evaluate the effectiveness of the social impact programs on the well-being of the <i>waqf</i> beneficiaries.</p> <p>A periodic social impact report shall be submitted to the SIRC. The Issuer shall ensure that the social impact report is accessible to the sukukholders.</p>
Step 14	The Obligor shall issue a purchase undertaking in favour of the SPV under which the Obligor undertakes to purchase the sukukholders' interest in the trust assets upon declaration of a dissolution event or the maturity date, whichever is earlier, at the market value of the trust assets and enter into a sale agreement for such purchase.

Step 15

- Upon the declaration of a dissolution event or upon the maturity date, the sukuk shall be redeemed and the proceeds from the relevant *wakalah* Portfolio made up of the Exercise Price, outstanding deferred sale price (subject to Ibra') and any returns generated shall be paid to the sukukholders to redeem the sukuk.
- The sukukholders shall have the right to endow, either all or partial principal amount of the sukuk *wakalah*.
- Any surplus exceeding the nominal value and any accrued but unpaid expected periodic distribution Amount of the sukuk *wakalah* shall be waived by the sukukholders and retained by the Issuer as an incentive fee upon full redemption of the sukuk *wakalah*.
- Upon full payment of all amounts due and payable under the relevant sukuk *wakalah*, the trust in respect of the relevant *wakalah* Investment Portfolio will be dissolved and the sukuk *wakalah* held by the sukukholders will be nullified.

4.3. Key Parties and Their Responsibilities

Additionally, the key parties involved in the sukuk *waqf* issuance and implementation are identified in Table 4.3 together with their respective roles and responsibilities. A clear understanding of these roles is essential to ensure the effective implementation, management, and governance of the sukuk programme.

Table 4.3: Key parties involved in the sukuk *waqf* programme

Party	Role and responsibility
Principal adviser / Lead Arranger	<ul style="list-style-type: none"> • Advise on the most appropriate funding plan • Coordinating all parties, monitoring timeline • Arrange, coordinate, and participate in the DD Exercise • Review of the relevant regulatory submissions • Liaise with the credit rating agency to ascertain credit perspective • Review the transaction documents and IM • Roadshow logistics / presentation • Pricing, settlement and closing
Legal Counsel	<ul style="list-style-type: none"> • Advise on legal and regulatory requirements • Conduct legal and business DD Exercise • Drafting and reviewing of SC lodgement kit, transaction documents and IM
Reporting Accountant	<ul style="list-style-type: none"> • Conduct financial DD Exercise on the financial information of the Issuer and the cash flow projection
Facility agent	<ul style="list-style-type: none"> • Responsible for the disbursement of funds in relation to the sukuk issuance, such as profits and principal payments
Sukuk Trustee	<ul style="list-style-type: none"> • To protect the interest and rights of the sukukholders • Hold the benefit of the security documents and security under the sukuk Programme, if applicable, for the benefits of the sukukholders for so long as the sukuk amounts remains unpaid
Majlis Agama Islam Negeri	<ul style="list-style-type: none"> • To administer and protect <i>waqf</i> funds from misuse, misappropriation, or any form of unauthorized use
Rating agency	<ul style="list-style-type: none"> • To evaluate the creditworthiness of issuers and assign credit ratings to the sukuk issuance • To provide rating reports and ongoing monitoring to help investors assess risk

External validator	<ul style="list-style-type: none"> To independently assess and validate the outcomes and impact of the social programs funded by the <i>waqf</i> fund
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4.4. Main Documents and Deliverables

Lastly, the primary documents and deliverables required for the issuance and implementation of the sukuk *waqf* programme are outlined in Table 4.4 below. These deliverables serve as the foundation for achieving the programme's objectives and maintaining compliance with regulatory and market standards.

Table 4.4: Documents required for the sukuk *waqf* Issuance

Document	Description
Information Memorandum	A disclosure and marketing document that describes: <ol style="list-style-type: none"> Terms and conditions of the sukuk Programme Details about the Issuer, including its business activities, financial performance, and management team
Legal Opinions	A written statement prepared by legal counsels which confirms: <ol style="list-style-type: none"> The legality and enforceability of the terms of the sukuk The accuracy of the information in the offering document Due diligence exercise The compliance with conditions precedent
Trust Deed	An agreement to be entered between the Issuer and the sukuk Trustee which governs: <ol style="list-style-type: none"> The terms and conditions of the sukuk issuance The rights of the sukukholders The rights and obligations of the Issuer and the Obligor
Facility Agreement	An agreement to be entered into between the issuer, lead arranger and facility agent that formalize the terms of the financing facility and ensure that the issuance of the sukuk proceeds smoothly and in accordance with the agreed-upon terms.
Subscription Agreement	An agreement to be entered into between the Issuer and the Investors who agree to subscribe the sukuk

Islamic Transaction Documents	Relevant documents to be entered into between the issuer and the relevant parties to reflect the underlying Islamic transaction
<i>Waqf</i> Deed and Other Related Documents	A legal document that establishes the <i>waqf</i> , detailing the assets being endowed, the purpose of the endowment, and the rules for its administration.
Credit Rating Report	A report issued by a credit rating agency providing an assessment of the creditworthiness of the Issuer and the sukuk.
Social Impact Report	A document that provides an assessment of the social outcomes and impacts achieved through the use of the sukuk proceeds.

CHAPTER

05

Issues and Challenges in Issuing Sukuk *Waqf*



CHAPTER 5: ISSUES AND CHALLENGES IN ISSUING SUKUK WAQF

5.1. Operational Issues

5.1.1. Which Entity Should Be Established as the Issuer?

The first question addressed during the FGD was whether the sukuk *waqf* structure should utilize a Special Purpose Vehicle (SPV) as the issuing entity. According to the SC's Guidelines on Unlisted Capital Market Products Under the Lodge and Launch Framework (LOLA), a sukuk issuer must be an incorporated company. Given that MAINs do not qualify as corporate entities, the establishment of an SPV would be necessary, as highlighted by an investment banker during the FGD:

*"If it is going to be the Majlis or Yayasan raising the funds, they will need to establish an SPV as a funding conduit to issue the sukuk to comply with the SC's guidelines under the LOLA. It must be an **incorporated company**."* (IB)

Accordingly, this study proposes that the issuer of the sukuk *waqf* programme be a SPV wholly owned by the obligor, which may include institutions such as MAINs, Yayasan Waqaf Malaysia (YWM), or Pelaburan Hartanah Berhad (PHB).

For instance, in Pulau Pinang, the subsidiary of the state's MAIN has established its own SPV, namely, WPP Joint Development Sdn. Bhd., which has the potential to become a sukuk issuer. However, it has not yet obtained the necessary approvals to develop land or to issue any financial instruments, as noted by its representative.

A legal expert suggested that, in the event credit enhancement is needed, the SPV could be established as an independent entity rather than a subsidiary of MAINs:

*"Actually, the structure is very much driven by credit considerations and the risk related to the allocation of the revenue. If there is no issue with that (i.e., revenue allocation or credit strength), the SPV can be a subsidiary. However, **if there is a need to enhance credit, it might be better to have an independent SPV** rather than having it as a subsidiary, as this could look better structurally. At the end of the day, I think, it really comes down to how the structure is designed to enhance the credits of the papers."* (LE)

It was also suggested by a policymaker that the SPV could be jointly owned through a partnership between MAINs and corporate entities to enhance the credit strength of the structure:

*“...the SPV could be **co-owned** by MAINs and entities like property developers because we are trying to rely on their credit as well rather than relying solely on a government guarantee.” (P)*

As for YWM, it may leverage its subsidiary, Perbadanan Wakaf Nasional Berhad, which has been incorporated since 2009, for the purpose of issuing sukuk. Meanwhile, PHB has prior experience of issuing sukuk directly without the use of a SPV.

5.1.2. What Are the Criteria for Being an Obligor?

A key consideration regarding the obligor is whether it possesses the ability to generate sufficient revenue to meet its sukuk obligations, ensuring the programme’s overall success. This aspect is crucial in securing the confidence of potential investors to subscribe to the sukuk *waqf*.

This prerequisite was exemplified in the case of a sukuk structure involving the Malaysian Islamic Economic Development Foundation (YaPEIM), as explained by the Principal Researcher:

*“That was exactly what happened with YaPEIM. Even though YaPEIM is a foundation, they also have a cooperative entity under them, Koperasi YaPEIM. What we did was to establish an SPV as the issuer, but **the payment obligations were backed by cash flows or receivables** coming from financing issued by Koperasi YaPEIM. That was how the structure was designed and worked at that time.” (PR)*

He then added that a similar capacity was also demonstrated in the case of MUIS’s sukuk *musharakah*:

“MUIS, at that time, their cash flow was good. Adding to that, they strategically sold some of their assets to generate proceeds. They went through the necessary to obtain Istibdal approval. They sold, for example,

*buildings that were not particularly appealing but were in prime locations. With proper rehabilitation, these assets can be workable. So what happened is that they sold some of the assets and Warees, acting as the SPV, issued sukuk and raised additional proceeds. These two amounts were combined to develop and refurbish the building. **The repayment for the sukuk came entirely from the project's revenue, with no single cent coming out from MUIS.** This is to show how strong the project was. In fact, the returns from that single project were substantial enough to sustain MUIS's operations for an entire year. That is the beauty of the structure.” (PR)*

5.1.3. How Will the Sukuk Waqf Be Rated?

Considering the capacity of MAINs to create revenue streams, an important question emerges: can the sukuk *waqf* issuance achieve a favourable rating if it were to be issued by MAINs?

To provide context for addressing this question, sukuk can be rated through two primary approaches depending on its structure: project-based or issuer-based ratings. In the case of project finance sukuk, the primary focus lies on the project's ability to generate sufficient cash flows to meet its financial obligations. For instance, sukuk structures like sukuk *ijarah* rely heavily on the performance and cash flow generation of specific projects, such as infrastructure developments or real estate ventures. Apart from the stability and predictability of the cash flows, execution risk also plays a critical role in influencing the rating, as mentioned by a representative from a credit rating agency:

*“I will give an example of a highway project. Take SUKE, for example. Before and during the construction phase, there was not any incoming cash flow. No payments and whatnot. But, **what we look at in terms of the execution risk of that highway project is the contractor itself.** Prolintas already had a strong track record with multiple highways completed. So, when it comes to execution risk, we look at the EPC (i.e., Engineering, Procurement, and Construction) contractors, whether they are viable to complete the project within that timeline. We also look at whether they have past experience, their history of performance, and whether there have been any EOTs (i.e., Extensions of Time) granted.” (RA)*

In contrast, issuer-based sukuk ratings focus on the overall creditworthiness of the entity issuing the sukuk. This approach evaluates the issuer's financial strength and its historical performance in servicing debt and meeting obligations. Issuer-based sukuk ratings may also benefit from credit enhancements, such as guarantees from governments, parent companies, or third-party institutions.

Initially, the proposed sukuk *waqf* is intended to be assigned a stand-alone credit rating, determined by the financial profile of the obligor, as outlined in Table 4.1 and noted by a rating agency representative:

*“So, here you are probably looking at it from the perspective of **rating the issuer**, and it does not matter what the issuer uses the money for.” (RA)*

This approach is preferred because project finance ratings are generally more intricate than issuer-based ratings. Project finance assessments involve long-term considerations on feasibility, risk profiles, cash flow generation, and dependency on external factors, making the rating process inherently more laborious and demanding, as opined by the Principal Researcher and agreed by an investment banker:

*“...in my opinion, **we try to avoid a project finance kind of rating because it is more hectic**, in terms of looking at the cash flow, and the mechanism will be different.” (PR)*

“Yeah, it has to be watertight and cash flow ring-fenced” (IB)

Nonetheless, if an issuer-based rating is applied, the MAINs would need to exhibit strong financial capacity, a criterion that currently appears uncertain. This concern was expressed by a rating agency representative regarding whether MAINs could generate adequate operating revenue to make the sukuk *waqf* programme sufficiently attractive to investors. He further argued that if the operating revenue is weak, the structure may require a financial guarantee, a topic discussed in greater detail in the next subsection:

*“You mention YaPEIM several times and, of course, they have good operating revenue. But, in the case of MAINs, **do they have sufficient operating***

revenue? Because if there is no adequate operating revenue, then a guarantee becomes crucial.” (RA)

In light of these constraints, the feasibility of operating the sukuk *waqf* as a project finance was deliberated during the FGD session. As pointed out by the rating agency representative, the proposed arrangement is adaptable to both rating methodologies:

*“But this structure is **flexible** enough to accommodate either option.” (RA)*

This flexibility is made possible by the present concept and structure of sukuk *waqf*, as depicted in Figure 4.1, which does not mandate that the underlying projects be exclusively undertaken by MAINs or confined to *waqf* lands. Instead, the contributions made by sukukholders take the form of cash *waqf*, which is subsequently invested in projects or financial assets. This point was once again emphasised by the Principal Researcher:

*“...But the question I want to ask is: when you are talking about project financing, what types of projects are we talking about? Would it be projects that are run by the MAINs on their *waqf* land? Or it could be any project?” (B)*

“It could be anything.” (PR)

*“So, **it is not limited to projects by MAINs**. Then, it could feasibly be that the use of proceeds is directed toward a solid project, perhaps building a highway in one of the states by the state government.” (B)*

*“Yeah, because the structure can use a *wakalah* portfolio that is not a *waqf*. That is the flexibility here. **We do not say that the *wakalah* investment portfolio must be a *waqf* asset, not necessarily**. That is why we refer to it as cash *waqf*...” (PR)*

Furthermore, if the sukuk *waqf* programme were to take a project finance route, it could benefit from the involvement of an offtaker. The offtaker would commit to purchasing the output or services produced by the project financed through the sukuk *waqf*, thereby ensuring

a stable and predictable revenue stream. This advantage was suggested by an investment banker, who said that:

*“It is either the assets are owned by a credible entity with strong credit, like PHB, which is currently rated triple-A, or you develop a project, and it will eventually be sold to a party like PHB as an offtaker. So, **it does not really matter whether the project involves building hospitals, aged care facilities or whatnot, the key factor is ultimately who is the offtaker.** That offtaker will address the issue of redemption. It would, essentially, mitigate the risk of not having enough funds to pay off the principal at maturity.” (IB)*

This suggestion was supported by a legal expert, who emphasized that the presence of an offtaker can serve as an effective risk management tool in sukuk issuance:

*“...But the strength is actually in terms of the offtaker. So once you have that as a credit enhancement or guarantee of the issuer, **you shift that credit allocation risk to the offtaker,** then. That is a goal from the start.” (LE)*

He drew this parallel to the case of Menara Bank Islam, where the construction financing was entirely undertaken by Lembaga Tabung Haji, while Bank Islam Malaysia Berhad gave a commitment to becoming the anchor tenant of the building. The project was developed on *waqf* land, with Majlis Agama Islam Wilayah Persekutuan (MAIWP) acting as the sole trustee of the land.

However, which entities would ideally serve as, and be willing to become, the offtaker? This subsequent question prompted various suggestions from the participants. One proposal, offered by an investment banker, was that state governments, through their owned entities, should participate in the sukuk structure as the offtaker:

*“Maybe another way to look at it is that all Majlis Agama fall under (the jurisdiction of their respective) state. So, **maybe we need to get the state to have some skin in the game,** whether they come in to provide a guarantee or they act as the offtaker. Each state typically has its own company, like Selangor has PKNS (i.e., Perbadanan Kemajuan Negeri Selangor). So maybe these state-owned companies could step in to help out on the*

structure...Because at the end of the day, this (sukuk waqf) is meant for Majlis Agama.” (IB)

This suggestion corresponded with the views of a representative from an investment company, who elaborated on the possible sukuk *waqf* structure, involving state-owned companies as the offtaker:

*“...So, they are the offtaker in a way. They are the obligors as well. However, they do not need to be part of the SPV. The SPV can be maintained at MAINs’ level. I would suggest **they can become the portfolio manager, ensuring that the whole project will go through.** They will get their portion, sukukholders will get their portion too, and the excess will be allocated toward social impact programs...” (IC)*

5.1.4. Is It Possible to Secure a Government Guarantee?

Next, as attention turned to the original structure of the proposed sukuk *waqf* programme, which incorporates the need for a government guarantee to enhance the sukuk’s rating (see Step 5 in Figure 4.1), several questions were raised during the FGD.

To begin with, there is an uncertainty whether the government would be willing to provide such a guarantee for the sukuk *waqf* issuance, as mentioned by an investment banker:

*“I think the big question mark here is **whether the government would be more than willing to extend a guarantee considering the current fiscal condition...**Going to the government to ask for a guarantee nowadays is not easy.” (IB)*

Having said that, the government may have an incentive to provide a guarantee for the proposed sukuk *waqf* due to its unique proposition, which combines aspects of socio-economic development and financial sustainability. By offering a guarantee, the government could not only attract a wider range of investors to take part in the national development agenda, but also demonstrate its commitment to supporting *waqf* initiatives, which resonate strongly with the aspirations of the Muslim and Bumiputera communities. This point was highlighted by the Principal Researcher:

“Or otherwise, maybe we can try to convince the government to issue, they themselves issue a government guarantee but with a specific objective to actually develop all these (waqf assets).” (IB)

*“I see the potential because the government would no longer issue GG (i.e., government guarantee) for other things. Because they do not see any specific or niche areas. But, for waqf, they might. Why? **Because these are a niche, untapped area, and a territory that we never enter.** So, the potential for us to get it is there.” (PR)*

Another important lesson from the discussion is that, even if the government were to issue a guarantee, it must be assured that the sukuk *waqf* structure and its underlying assets possess sufficient financial strength to ensure the repayment of both principal and returns. This requirement was discussed among the participants:

*“The government also wants some certainty that, **if I were to give you the guarantee, the project itself would be able to sustain on its own** and would be able to pay off the entire principle and profit as well.” (IB)*

“Precisely, I agreed. I think structure has to be very robust with or without government guarantee” (P)

“They would still look at the ability of the issuer to be able to pay without having triggered the government guarantee. That is for sure.” (IB)

“That is a normal situation. It means that the government has no preference whether it is a GG for the issuer or for the project, as long as the underlying can give a sufficient comfort level of return.” (PR)

“To get a government guarantee, you need to prove you do not need a government guarantee.” (B)

Following this, let us consider the scenario in which a government guarantee cannot be secured. The pertinent question is how the rating of the sukuk *waqf* would be affected in such a case. Given their nature and mandate, could MAINs still achieve a favourable rating if they were to issue the sukuk, based on the perception or expectation that the government may intervene to ensure the repayment of principal and profit, even without a formal or explicit guarantee? This concept of “implied” government guarantee was explored in a discussion between the Principal Researcher and a representative from a rating agency:

“Let us take an example: Majlis Agama Islam Pulau Pinang (MAIPP). For the sake of discussion, let us assume the Penang state government has a good credit rating. If MAIPP incorporates an SPV to issue sukuk and takes on the role of the obligor, assuming they are allowed to do so, can that obligation be considered an implied guarantee by the Penang state government?” (PR)

“No, it is not that straightforward. We need to assess the type of commitment the state government is willing to provide in supporting MAIPP’s financial obligations. In many cases, such commitments are either unstated or ambiguous. The general assumption is that if something goes wrong, the state or sovereign might step in—but that is just an assumption. We cannot assume that there definitely will be assistance in the event the need arises.” (RA)

In short, the rating ultimately hinges on the financial strength of the issuer or the underlying revenue-generating projects in the absence of a government guarantee. A similar condition applies if the sukuk *waqf* issuer were to secure a corporate guarantee:

“Can we go for a corporate guarantee? Instead of taking GG, we ask for a guarantee from companies like banks. What do you think?” (PR)

*“Financial guarantee? **Possible, but it goes down to the strength of the project.** It must be able to service the debt that the bank contingently extends a guarantee on. It will be assessed as project finance.” (IB)*

5.1.5. What Are the Procedural Challenges of Converting Sukuk Holdings into Waqf?

The process of converting the principal and returns into *waqf*, as illustrated in Steps 7 and 10 in Figure 4.1, raises significant concerns regarding cost implications and procedural complexities. First, the facility agent of the sukuk *waqf* would play a critical role in facilitating the conversion of sukuk holdings into *waqf*. This includes ensuring proper documentation, signing off on conversion requests, and communicating with the trustee for record-keeping. However, the involvement of a facility agent introduces additional costs to the sukuk *waqf* issuance, as noted during the discussion by an investment banker:

*“So that will be something that the facility agent will then have to facilitate. This includes overseeing the signing and related procedures. The documentation must follow a prescribed format as part of the program documents. Each time any sukuk holders wish to exercise the conversion, they must sign the required documents and submit them to the facility agent, with a copy sent to the trustee to ensure they are also aware of. So, it may incur **additional fees** if we adopt this kind of structure.” (IB)*

Another key concern lies in whether the nominal value of the sukuk can remain after conversion into *waqf*. While the research team initially proposed for the nominal value to remain intact, the experts advised that, from a technical perspective, it would be canceled or written off upon conversion or redemption. This is because the sukukholders will no longer have a motivation or reason to continue holding the outstanding amounts after they have been endowed, as there would be no future payments or returns due to them. Meanwhile, from a Shariah point of view, retaining returns while endowing the principal was deemed impermissible. In other words, if sukukholders choose to convert their principal, they must also forgo any returns generated from it.

To maintain continuity post-conversion, it was proposed that a separate entity could be established to ‘receive’ the converted *waqf* principal. This entity would hold this value and ensure the sukuk benefits are utilised for the intended *waqf* purpose, adding administrative layers to the sukuk *waqf* structure.

5.1.6. Are Social Impact Programs Costly to Run?

Lastly, there is also a concern associated with the potential for high administrative costs in managing and executing the social impact programs funded by the endowed capital and

returns, as outlined in Step 12 of Figure 4.1. These programs often require comprehensive planning, monitoring, and implementation, which involve multiple layers of coordination among stakeholders, including *waqf* trustees, facility agents, and project managers. These activities incur operational expenses, which may diminish the overall funds available for the intended beneficiaries and potentially outweigh the social benefits of the programs.

The complexity of managing endowed sukuk holdings, particularly when directed toward diverse social impact initiatives, necessitates robust governance frameworks and reporting systems. Ensuring transparency and accountability in fund allocation and utilization further increases costs, as regular audits, third-party validations, impact assessments, and compliance checks must be conducted.

If these administrative expenses are not meticulously managed, there is a risk that the actual impact delivered to the beneficiaries will be significantly marginalised, undermining the primary objective of the sukuk *waqf*.

5.2. Market-Related Issues

5.2.1. How Should the Sukuk *Waqf* Be Distributed?

The next segment of the FGD focused on addressing the distribution and pricing mechanisms for sukuk *waqf* in the market.

To provide context, there are three common methods, or modes of issuance, through which sukuk or bonds are offered and distributed to investors. The first is price discovery, which enables the issuer to evaluate investor demand and establish a market-driven price or yield that aligns the issuer's funding needs with investor expectations. This process involves active engagement with potential investors through methods such as book building, auctions, and roadshows, to gather insights into their preferences and investment thresholds.

The second method is a bought deal, where an underwriter commits to purchasing the entire issuance from the issuer at a pre-agreed price and subsequently resells it to investors, assuming full market risk. This approach provides the issuer with immediate funding and pricing certainty but transfers the distribution risk to the underwriter.

The third is private placement, a targeted approach in which sukuk or bonds are offered directly to a select group of institutional or qualified investors. This method requires minimal regulatory compliance and is often exempt from public disclosure requirements.

The participants were asked which of these modes would be suitable for the proposed sukuk *waqf* programme, and they expressed their view that the issuance could be conducted through either a price discovery process or private placements:

“Mode of issuance, which do you think is most appropriate? A direct deal or something else?” (PR)

*“I think it ultimately depends on what would be the final structure. **If it is a structure that we feel robust enough for us to take to the market, then we can actually do it via price discovery mode.** That would be the best. That is how you get an optimised pricing. Otherwise, if it is not up to market expectations, maybe what we can consider a limited, targeted marketing. Then with that targeted marketing, we will eventually do it via private placements.” (IB)*

“Your intention is to offer this as a wholesale issuance, or are you planning to offer it to retail [investors] also?” (MR)

“It can go both ways. I would say, at least for the time being.” (PR)

“For retail, you will have other considerations. You would need to involve Bursa Malaysia and others. For now, I think it is better to keep it to sophisticated investors.” (MR)

5.2.2. How Should the Sukuk Waqf Be Priced?

The discussion progressed to address whether the sukuk *waqf* issuance should include periodic coupon payments or be structured without them. Considering the unique feature of sukuk *waqf*, which provides sukukholders the opportunity to exercise their option to convert a portion or all of their returns into *waqf* contributions, it was suggested that the sukuk *waqf* should incorporate periodic coupon payments:

“Should we structure it with periodic or zero coupons?” (PR)

“Looking back at the structure we discussed earlier, how do you plan to measure the impact of the programs? Have you estimated how much will be needed? It seems challenging to do so without some kind of periodic flow.” (MR)

“Exactly, **without periodic flows, you do not have the element for conversion** when there is no coupon, only the principal amount accredited at the end of maturity.” (IB)

Moreover, coupon payments play a critical role in ensuring a steady flow of cash is directed toward the social impact programs, as highlighted in Step 11 of Figure 4.1. In contrast, if the sukuk were issued as a zero-coupon instrument, no returns would be distributed during its tenure, eliminating the opportunity to allocate returns as *waqf* within this period. This point was emphasized by a member of the research team:

“And I think the purpose of coming up with this innovative structure is to ensure **the liquidity for the social programs.**” (R)

One participant suggested that a zero-coupon issuance could also be a viable option, with returns accumulated and the conversion into *waqf* occurring at a later date, post-maturity. He further emphasized that sufficient cash flows would be essential to ensure the repayment of the principal and the accumulated returns intended for endowment:

“I think a zero-coupon could work. If you provide the optionality to convert at the end, then, for instance, if this sukuk is a *waqf* sukuk from the beginning, you offer the option at maturity. **The cash flow would accumulate until the end, and then investors could choose whether to convert or not.** If they decide not to convert, it functions like a normal sukuk, and they receive their principal back. If they choose to convert, the proceeds—or part of them—are allocated to *waqf*. However, it is important to distinguish between the zero-coupon payments to sukuk holders and the project’s cash flow, which would still be generated. That cash flow could be utilized for social impact programs during the sukuk’s tenure. However, you have to ensure that sufficient funds

are available at maturity to redeem both the principal and the accumulated profit.” (IC)

However, it is important to note that a zero-coupon sukuk would need to be issued at a discounted price, resulting in lower proceeds being raised. Besides, a zero-coupon structure may be more expensive to issue, as the delayed returns (i.e., the absence of periodic coupon payments) would accrue and compound over time. This concern was highlighted by an investment banker:

“It will also be a problem because how do we utilize it? If we do not declare any profit, there is no money available for waqf. So, I do not think a zero-coupon structure is ideal.” (PR)

*“And then, **zero-coupon issuance is expensive because the returns are accumulated and compounded** over time.” (IB)*

“It is actually expensive, depending on the yield to maturity (YTM). For those unfamiliar with sukuk, a zero-coupon structure is essentially as if you have paid them in advance; they repay you later, but the returns are accumulated and compounded together with the unpaid dividends. That is how it works.” (PR)

“Plus, zero-coupon sukuk are issued at a discount. So, for example, if you issue RM100 million, you will not receive RM100 million in proceeds—you will get a discounted amount, which will be less.” (IB)

5.2.3. What is the Appropriate Tenure for the Sukuk Waqf?

Another key question related to market acceptance is determining the appropriate duration for the sukuk *waqf*. Should it be structured as short-term, medium-term, long-term, or even perpetual? One conclusion from the discussion was that the sukuk’s duration largely depends on the capacity of the underlying assets or projects to generate sufficient cash flows to repay the principal. Based on preliminary estimations, a duration exceeding 10 years may be appropriate, considering the typical nature and timelines associated with *waqf* projects:

“So, how many years do you think we should consider for tenure? For the IsDB’s (Islamic Development Bank) sukuk, we went for ten years.” (PR)

“If I work out the math in my mind, it would have to be ten years or more to adequately cover the cash flow.” (IC)

“Should not it be perpetual?” (MR)

“If we go for a perpetual structure, the rate would likely be more expensive.” (PR)

“That is true because of the nature of a perpetual (sukuk) being subordinated in terms of cash flow servicing. So, it will definitely be more expensive. **I think the question of whether the tenure should be 10 or 15 years depends very much on the structure and the cash flows.** If the lease we are considering is for ten years, then a ten-year sukuk could make sense. In the case of IsDB, I would imagine it was raised at the corporate level, not tied to specific assets, which makes deciding on the tenure much easier. However, here, if we are specifically funding a waqf project, we need to consider the duration of the lease agreement. It must align with the servicing requirements for the sukuk.” (IB)

However, a concern was raised regarding the potential impact of a long maturity period, particularly for the first issuance. Investors are often cautious about investing in novel financial instruments and prefer to observe their performance and success before committing further. This sentiment echoes the adoption curve for non-financial products, such as electric cars, where initial skepticism was replaced by widespread acceptance following early success stories.

A banker opined that a maturity period of 10 years, while common for some sukuk structures, might be too lengthy for first-time sukuk *waqf* issuances. Investors may adopt a “wait and see” approach, holding back until the first issuance demonstrates a proven track record of success. If the maturity is too long, it prolongs the feedback loop for demonstrating success, which

could hinder the momentum needed to encourage further participation in subsequent issuances.

Even successful examples like the sukuk *musharakah* issued by Singapore's MUIS underscore the importance of creating lasting confidence. The Principal Researcher noted that despite its success and global recognition, no similar sukuk *musharakah* structures have been replicated, illustrating the cautious approach taken by market participants. A failed sukuk *waqf* issuance, however, could have an even more detrimental effect, potentially discouraging efforts in this area for decades.

5.2.4. How Does the *Waqf* Option Impact Liquidity?

The *waqf* option, as described in Section 3.2.2, which allows sukukholders to endow their principal and returns during the sukuk tenure has raised a concern regarding the tradability of sukuk *waqf*. This feature, while designed to enhance flexibility and promote social impact, may create challenges in maintaining market dynamics and liquidity.

As one investment company representative commented, if a significant proportion of investors choose to convert their principal during the sukuk tenure, the remaining tradable sukuk volume would become so small that it might deter other potential investors from entering the market. This reduced liquidity could compromise the appeal of the sukuk, especially for institutional investors who require a certain level of market activity to facilitate entry or exit from their positions:

*“They might be worried about the liquidity of the sukuk because, by definition, sukuk are usually tradable. So, if for instance, after the first year, 90% of the investors decide to convert their principal into waqf, then **the issue size in the market could become so low that it may affect liquidity**, and some (other) investors are not able to invest in the sukuk.” (IC)*

The income distribution component, on the other hand, was viewed as less problematic. Investors converting returns into *waqf* does not directly impact the principal or the tradable volume of the sukuk.

5.2.5. Are Investors Willing to Sacrifice Financial Returns for Social Impact?

With the terms and features outlined above, it is crucial to anticipate the potential acceptance of the proposed sukuk *waqf* by investors. While traditional investment decisions are often driven by returns and risks, there is growing awareness among certain investor groups of the importance of social impact as a key consideration. Instruments like sukuk *waqf*, which combine financial viability with societal benefits, have the potential to appeal to both conventional profit-driven investors and those motivated by social responsibility.

The discussion concluded that for retail investors, returns are a primary consideration, regardless of the instrument's social impact, as confirmed by representatives from investment banks.

However, greater emphasis was placed during the FGD on gauging the appetite of institutional investors for instruments that incorporate elements of social responsibility, such as the proposed sukuk *waqf*.

The feedback received highlighted that, ultimately, returns remain the critical factor. The underlying assets and projects must demonstrate commercial viability, with the potential to generate at least market-average returns. This perspective was echoed by representatives from government-linked investment entities, including Employees Provident Fund (EPF) or Kumpulan Wang Simpanan Pekerja (KWSP), Lembaga Tabung Haji, and others. Their responses reinforced the importance of aligning the sukuk *waqf* with market expectations to attract institutional interest:

*"I think, you know and are aware that returns really matter in this. **I think that within the mandate we have, we are committed to delivering a return.** So, of course, returns are critical in this context."* (IC)

"That is on the table, definitely. We cannot compromise on returns." (PR)

"Even with the structure, as long as it is commercially viable, it should not be an issue. In fact, the way you mentioned earlier—whether the asset can be charged or not—normally, investors will look at receivables. Assigning or charging receivables is something investors can work with. Leasing, charging, or taking an assignment of lease rentals, for example, are not an

issue, but the project must be commercially viable. **When we talk about fixed income, it is more about ensuring commercial viability.** It is about knowing what you give and getting back your agreed returns. But coming back to the situation faced by Majlis Agama earlier, they mentioned having many projects in the pipeline but being unable to raise funds. They approached MOF for funding, but MOF asked for collateral. This comes back to proving whether the project is commercially viable. If it is, you would not have to knock on doors; people will knock on yours.” (IC)

An additional consideration was raised regarding whether institutional investors would be willing to sacrifice a portion of their returns if the investment were to deliver significant social benefits. Such a decision could enhance the institution’s reputation and public image, positioning it as a champion of social impact among investors and the broader community, as suggested by an investment banker:

“Would institutions like EPF or Tabung Haji be willing to forgo some of the returns? I meant, would they accept a lower rate for the sake of supporting social initiatives? Are they willing to take a discount for this purpose?” (PR)

“We do not usually approach investments from that perspective. However, **we do consider the multiplier effects of our investments, which indirectly contribute to socio-economic growth.**” (IC)

“So, there could be scenarios where you might accept a lower rate if the investment creates significant multiplier effects in other areas. As we mentioned earlier, companies have to meet SRI objectives. Perhaps, if there are incentives, such as tax benefits or enhanced SRI exposure that aligns with your reporting requirements, this could also be an attractive proposition. You might not get the typical market return, but you would gain in other meaningful ways.” (PR)

“There is also the potential publicity angle, especially if EPF or Tabung Haji were to anchor the first ever waqf sukuk issuance. The waqf project itself is

a social impact initiative. This could drive decision-making. I would imagine that institutional investors like EPF or Tabung Haji would still prioritize returns. But, of course, other considerations would still come into picture that need to be deliberated by the investment committee.” (IB)

5.2.6. Are Tax Incentives Available for Sukuk Waqf Subscription?

One potential strategy to attract investors to subscribe to the sukuk *waqf* is through the provision of tax incentives. This approach was illustrated by an example provided by the Principal Researcher:

“For example, if I have RM200 million and I invest it in sukuk, and I want to allow it to be used for waqf purposes for only five years. During those five years, can I get a tax exemption for this? After five years when I get my capital back, only then the RM200 million will be taxed again.

The answer to this is that currently, income tax regulations do not recognize this kind of instrument.

*What would entice me is similar to the appeal of investing in real estate investment trusts (REITs), which is the non-taxability of the returns. For example, if I invest here and earn 3.75%, even if it is 50 basis points lower than the market rate, **it is still acceptable because the returns are not taxed during that time.** That is a strong proposition...*

*What we should aim for is to go to the MOF and the Inland Revenue Board (IRB) to ask for **tax incentives for both issuers and investors.**” (PR)*

Nevertheless, requesting tax incentives, whether in the form of deductions or exemptions, from the Lembaga Hasil Dalam Negeri (LHDN) presents significant challenges, as highlighted during the FGD. Two primary reasons were identified.

First, there is currently no regulatory framework that specifically supports the issuance of sukuk *waqf* and establishes its eligibility for tax incentives. While the sukuk *waqf* could potentially be issued under the SC’s SRI Sukuk Framework provided that its proceeds are used

for the development of *waqf* assets, the tax incentives under this framework are limited. Specifically, the framework provides tax deductions only for issuers to offset expenditure incurred in the issuance of SRI sukuk. It does not extend explicit tax incentives to subscribers of such sukuk, as highlighted by a market regulator:

“The current framework we have does not limit or restrict investors if they choose to waqf either the principal or the coupon. As it stands, even under the current sukuk framework, if, for example, EPF willingly decides to waqf their portion of the sukuk, they can do so.” (MR)

“But that wouldn’t be prearranged (i.e., automated)—it would be at the individual’s discretion. However, they would not receive any incentive for doing so, am I right?” (PR)

*“Currently, there is no incentive available. So, when we talk about incentives for waqf, the only incentive we have is under the SRI framework, and that is **limited to the issuer.**” (MR)*

To underscore the significance of tax incentives in encouraging subscriptions from private investors, whether retail or institutional, an investment banker shared his experience managing the Sukuk Prihatin issuance by the Government of Malaysia in 2020. This sukuk was designed to support the nation’s efforts in addressing the economic and health impacts of the COVID-19 pandemic. The sukukholders were provided with the option to waive their principal and returns, either partially or fully, during the tenure or upon maturity. If they did so, they were eligible for tax deductions and the waived amounts were channeled to the national COVID-19 fund:

*“We gave that option to entice investors to agree to it, and we requested the government to offer tax deductibility. This was important because we knew we were dealing with the capital market, and **we could not afford to lose the buy-side participation.**” (IB)*

Second, from a practical perspective, it would be challenging to confirm and assign tax incentives due to the optionality of converting returns into *waqf*. A key question raised was whether tax incentives should still be granted if investors later decide not to endow their

investments. Furthermore, if investors choose to endow their principal, what mechanism could be implemented to facilitate the claim for tax incentives? These complexities were anticipated by a market regulator, who observed:

“Just to touch on the tax deduction incentives we discussed earlier, if the intention is to keep this sukuk waqf flexible—where it can at any point become a normal fixed-income instrument, a perpetual sukuk, or a temporary waqf—then the tax deduction would, of course, be tied to the instrument itself. However, for those investors who do not opt to convert their investments to either temporary or permanent waqf, would the tax incentive still apply? If the answer is yes, we will be having a tough time convincing the MOF and the IRB.

At the end of the day, IRB will rely on the SC to confirm whether the instrument is indeed a sukuk waqf. **If the option to convert is not exercised during or after the tenure, it will be difficult to argue that the instrument qualifies as a sukuk waqf from a tax perspective.** The incentive is always tied to the nature of the instrument itself. For it to qualify as sukuk waqf, it must remain as such. If the option to convert is not exercised, it is technically no longer a sukuk waqf. Because the definition is so broad, it would be difficult for us to justify to the MOF why tax incentives should still be given when the option is not exercised.

...Because when they come to SC and get into the LOLA, there must be clear evidence to prove that this is a sukuk waqf...During the tenure or at maturity, the situation might change, making it quite difficult to revisit IRB to justify the instrument.

Like our SRI sukuk incentives, tax deductions are given for SRI sukuk issuance. But, if the program is a combo, meaning it combines normal sukuk and SRI sukuk within the same program, then the program does not qualify for tax incentives. This is because, for the IRB, the program must be a full-blown program. The same principle would likely apply here. If you want to

qualify as sukuk waqf, you need to ensure that throughout the tenure, up to maturity, the naming, features, and behavior of the instrument remain aligned with sukuk waqf principles for the tax incentives to be applied.” (MR)

A suggestion was proposed regarding the effective implementation of tax incentives through the use of tax vouchers, drawing inspiration from the case of sukuk Ihsan, Malaysia’s first SRI sukuk issued by Khazanah Nasional Berhad. Tax vouchers could be issued to investors who qualify for tax benefits due to their participation in the sukuk *waqf* or upon exercising their *waqf* option. These vouchers would enable investors to claim tax deductions by submitting them during their tax filings, thereby reducing their taxable income by a certain eligible amount.

*“It should not be a blanket approach because not all investors are the same, and it is challenging on the buy-side. It is difficult to conclude that this instrument will appeal to all investors, especially fixed-income investors. Because of that, there needs to be a choice provided. The current definition is quite robust and flexible, allowing investors to choose between different options. However, **for those investors who choose to convert or waive their returns, tax vouchers should be available as an added incentive.**” (P)*

In the absence of tax incentives, an alternative route was suggested for investors to contribute to *waqf* without experiencing adverse or unfavourable financial and accounting consequences. Under this strategy, the issuer would first pay the principal or returns in full to the investors, maintaining a transparent transaction process. Subsequently, the investor would then transfer the intended amount back to *waqf* through a standing instruction (SI). This strategy could potentially bring the intended benefits through several ways. First, by recording the full principal repayment to the investor before the *waqf* transfer, the process circumvents the need to record the waived amount as a loss, thereby addressing concerns over accounting treatment. For example, if an investor invested RM1 million and intended to *waqf* RM100,000, the issuer would return the full RM1 million, and the RM100,000 would be recorded as a charitable expense rather than a principal loss. Second, while the proposed mechanism addresses the accounting challenges, it helps secure tax incentives to further motivate investors. More specifically, under current regulations, individuals or corporations making donations to *waqf* registered under MAIN may receive tax deductibility, which could apply to the amounts transferred to *waqf* (i.e., through the SI) in this mechanism.

However, such a route is argued to defeat the purpose of sukuk *waqf* itself, which intends to embed the philanthropic element directly into the sukuk structure, where contributions are seamlessly integrated into the payment mechanism. The detachment could shift the perception of sukuk *waqf* from being a purpose-driven Islamic capital market instrument into a normal sukuk with an optional charitable overlay. This could dilute the unique value proposition of sukuk *waqf*, potentially discouraging participation from investors seeking impact-driven investments.

5.3. Legal Issues

5.3.1. Does the Instrument Legally Qualify to Be Labelled as “Sukuk Waqf”?

The proposed flexibility in the sukuk *waqf* structure, which allows for the partial or complete conversion of principal and income into *waqf* at any stage, also introduces potential legal ambiguities. These conflicts with legal clarity could emerge both at the time of issuance and during the sukuk’s tenure.

By law in Malaysia, *waqf* assets must be owned and managed by the respective MAINs as the sole trustee. The term “sukuk *waqf*” itself may inherently suggest that the instrument is an immediate *waqf* upon the date of issuance and, thus, subject to the purview of the MAIN. However, this perception may not align with operational realities if the sukuk is structured and issued as a normal sukuk with a *waqf* feature that is rather optional or deferred. In such scenarios, the principal and returns remain non-*waqf* at the outset but may be converted into *waqf* at a later stage, behaving just like an ordinary commercial sukuk. This conflict was highlighted by a rating agency representative during the FGD:

“I have a question. My understanding is that, in Malaysia, all waqf assets must remain under the purview of Majlis Agama.” (RA)

“Correct, it is a must.” (PR)

*“So, if we call this sukuk waqf, **then obviously, at the point of issuance, the sukuk will not stay with Majlis Agama.** It cannot. So, if we are calling it sukuk waqf, are there any legal implications?” (RA).*

Similarly, a legal incongruence may arise if investors opt not to endow their returns or principal at any point during the tenure of the sukuk or upon maturity. This flexibility

introduces legal complexities, including the challenge of determining whether the instrument retains its classification as a sukuk *waqf* if no conversion to *waqf* takes place, as pointed out by a legal expert:

Assuming no one opts to convert, because the option is provided, what happens if none of the sukukholders convert the principal or income into waqf? Does it still qualify as a sukuk waqf or not? (LE)

Therefore, it is imperative to establish a clear legal definition of sukuk *waqf*. A vague and broad definition would undermine transparency, potentially resulting in misinterpretations that could erode investor confidence:

*“That is why the definition is so important. If the definition explicitly states that the instrument itself is already waqf, then you have a legal issue. **But if the terminology implies that it is just a name, and in essence, the instrument is not waqf, then it should not be a problem.** This is something that requires careful consideration.*

Now, from an optical perspective. The challenge is not just legal; perception is equally important. Certain terms may mean different things to different people. If the definition of sukuk waqf inherently creates waqf upon issuance, then you will face legal issues regarding ownership because, as you mentioned, all waqf assets must be vested with their respective authority.”
(LE)

5.3.2. Can the *Waqf* Assets Be Owned by Private Companies?

Another legal issue discussed pertains to the ownership of *waqf* land. A key question arises regarding whether private entities can hold ownership of *waqf* land, or if ownership must remain exclusively with the MAIN as the sole trustee. This issue is particularly relevant to sukuk *waqf* structures where the underlying project involves the development of assets, such as buildings, attached on *waqf* land. For instance, private companies, such as property developers and investment companies, interested in acquiring such buildings may raise proceeds through sukuk *waqf* issuance. However, doing so may trigger legal challenges concerning ownership of the *waqf* land. Under Malaysian law, including the National Land

Code, there is no separation made between the ownership of land and any structures attached to it. Following this, both the land and the building are *waqf* assets from a legal point of view.

One potential solution advised by a legal expert is a beneficial transfer of land, where the beneficial interest or usage rights of the land are transferred to private entities, while legal ownership remains with MAIN. This allows developers to benefit from the land's use without contravening *waqf* regulations:

“From a legal point of view, can we detach the ownership of the land from the property?” (PR)

*“If we were in Mongolia, maybe we could, as they have a separation between building and land ownership. However, under our National Land Code, that is not possible unless you execute **a beneficial transfer**.” (LE)*

However, this approach may not be appealing to some project developers who prefer full ownership of the land to secure their investment and operational control.

Alternatively, as suggested by the Principal Researcher, an interpretation of the existing *waqf* regulations can be made whereby the MAINs could remain the sole statutory trustee of *waqf* land, as stipulated in the respective state's *waqf* enactments, without necessarily holding legal ownership of the land. Under this interpretation, other entities could assume ownership of the land, while the benefits derived from it would be designated for the beneficiaries. MAINs, in their trustee role, would be responsible for ensuring the proper delivery of these benefits in accordance with the principles and objectives of *waqf*:

*“An initial study on *waqf* suggests that if the Majlis Agama agrees to hold the land as mentioned in the law as the sole trustee – the key word being “sole trustee” – it could mean that the land's ownership could belong to someone else while being placed in trust with the Majlis Agama. It could be done in that manner too. So, the **organization holding ownership of the land does not necessarily need to be the Majlis Agama**.” (PR)*

5.3.3. Which MAIN Should Serve as the *Waqf* Trustee?

Next, a significant concern arises in determining which state, and therefore which MAIN, should act as the trustee for the endowed principal and returns when it comes to financial instruments like sukuk. This uncertainty stems from the fact that Malaysian states' *waqf* enactments were initially drafted based on the traditional Shafi'i school of thought, which does not recognize *waqf* in a form of cash. The enactments primarily address immovable *waqf* assets, such as land and buildings, and stipulate that the trustee should be determined based on the physical location of these assets. However, this framework does not explicitly cover cash or financial instruments that lack a physical attribute.

This ambiguity creates legal uncertainty, especially when the sukuk issuance spans multiple states or involves financial instruments not tied to a specific geographic location. For example, if sukuk *waqf* is issued in Kuala Lumpur but intended to benefit a project in Penang, questions arise about which MAIN should assume the trustee role.

This issue is further complicated by the absence of clear legal provisions or Shariah interpretations that address the “situated” nature of cash or financial instruments, as mentioned by a legal expert:

*“Okay. I’m going to address the subject matter of waqf. Here, we’re specifically talking about cash. From a Shariah perspective, **what is the interpretation regarding where that cash is considered to be situated?**”*

This is relevant because, under the various state enactments, when it comes to property situated within a specific state, the law stipulates that it is vested with the corresponding authority in that state.” (LE)

The concept of cash *waqf* has gained public acceptance only in recent decades, influenced by the Hanafi school of thought. However, the relevant laws have yet to be updated to reflect this evolving understanding.

This lack of alignment between contemporary practices and traditional legal frameworks necessitates a re-evaluation of the *waqf* enactments. Amending these laws to account for cash *waqf* and other financial instruments could provide much-needed clarity and ensure that jurisdictional disputes over trusteeship are resolved. Until then, determining which MAIN

should act as the trustee for endowed principal and returns of sukuk *waqf* will remain a contentious issue.

5.3.4. What Happens if MAIN Revokes Its Role as *Waqf* Trustee?

Following the successful conversion into *waqf*, where the sukuk principal and returns are channelled to the *waqf* fund as outlined in Steps 7 and 10 of Figure 4.1, a concern raised regarding the possibility for the MAIN, as the sole trustee of *waqf* assets by law, to revoke its agreement and role during the sukuk tenure. If MAIN decides to withdraw its involvement due to changes in leadership, policy shifts, or other reasons, this could derail the sukuk *waqf*'s management and undermine investor confidence.

A legal expert added that while contractual agreements can legally bind MAIN to fulfill its role as a trustee for a specified period, enforcing such agreements could prove impractical. Legal recourse against MAIN may involve complex litigation, which could further erode trust and confidence in the sukuk *waqf* framework.

Revocation by MAIN, however, would not necessarily collapse the entire sukuk structure. Instead, it would require the appointment of a new entity to assume the trustee role. However, this transition might result in delays, mismanagement, or additional administrative costs. Furthermore, revocation could create perceptions of instability, making future issuances less attractive to investors. To mitigate this, a robust *waqf* deed should clearly outline the obligations of MAIN or any appointed Mutawalli (trustee), ensuring that agreed terms cannot be unilaterally altered.

5.3.5. Does the Ownership Title of the Asset Need to Be Transferred to MAIN During the Temporary *Waqf* Period?

Lastly, a question was raised whether the ownership title of the asset has to be legally transferred to the respective MAIN during the temporary *waqf* period. The Principal Researcher clarified that, based on current practices in states like Perak and Terengganu, the ownership remains under the investor's name during the *waqf* period. A formal letter is issued to indicate the temporary *waqf* status of the asset, ensuring a legal documentation of the arrangement. This letter would provide clarity and prevent disputes, ensuring that all parties honour the terms of the temporary *waqf* until its maturity.

A Shariah scholar further raised concerns about the legal implications if the investor passes away during the *waqf* tenure. For example, if an investor who subscribed to a five-year

temporary *waqf* arrangement dies in the third year, would the *waqf* agreement still be honoured? The Principal Researcher explained that the *waqf* agreement remains binding until the *waqf* period ends. Any inheritance of the asset would only occur after, and the division would consider the heirs at the time of maturity, not at the time of the investor's death.

5.4. Shariah Issues

5.4.1. Does Sukuk Align with the Perpetual Nature of *Waqf*?

The first key concern regarding the Shariah permissibility of sukuk *waqf* lies in the apparent discrepancy between the principle of perpetuity inherent in traditional *waqf* and a modern capital market instrument like sukuk that has a fixed tenure, after which the principal and returns may be reallocated or redeemed, asked by a market regulator:

"I understand it is perpetual, but if the sukuk has a tenure, how would that work?" (MR)

The proposed sukuk *waqf* structure addresses this by conceptualizing the sukuk as an investment into cash *waqf* rather than asset-based *waqf*. In this framework, when the sukuk matures, the principal is returned in a form of cash, which can then be reinvested into new projects or initiatives, allowing the *waqf* to perpetuate through successive cycles, as clarified by the Principal Researcher:

*"No issue. Our definition is that when you invest in the sukuk, you are not buying the sukuk; **you are investing as cash waqf**. So, when the tenure ends, it will be realized back in the form of cash, which can then be continued for other purposes after." (PR)*

A subsequent question was raised regarding the valuation of the principal, whether its potential appreciation should also be treated as *waqf*. Using an example, the Principal Researcher explained that only the initial principal amount (e.g., RM200 million) is considered as *waqf* (i.e., *waqfun nuqud wa laisa waqful usul*), regardless of any increase in the underlying asset's value. For instance, if the asset appreciates to RM300 million, the additional RM100 million would be treated as a return or gain separately, rather than as part of the *waqf* itself. This approach recognises and differentiates cash *waqf* from Asset *waqf*, drawing its basis from the rulings of the Hanafi school of thought.

In contrast, according to the Shafi'i school, when an asset is created or acquired using the proceeds of a *waqf*, the entire value of the resulting asset becomes part of the *waqf*. For instance, if an individual *waqfs* cash and that cash is used to purchase an asset, the entire value of the purchased asset, including any subsequent appreciation, is deemed to be part of the *waqf*. Considering the same example, if the *waqf* contribution of RM200,000 is used to acquire an asset that later appreciates to RM300,000, under Shafi'i view, the full RM300,000 is considered *waqf*.

However, this approach (i.e., Hanafi view) introduces ongoing debates about whether inflation or time-value adjustments should be factored into the definition of cash *waqf*. The research team acknowledged that, for now, the structure does not account for inflation or indexation when defining the *waqf* value. This remains a point of contention in Shariah discourse, raising questions about the preservation of real value in cash *waqf* over time and its implications for sukuk *waqf*.

5.4.2. Is Endowing Sukuk Principal and Returns on a Temporary Basis Permissible?

Another potential discrepancy may arise from the proposed flexibility for sukuk *waqf* to be endowed on either a temporary or perpetual basis. In traditional Islamic jurisprudence, *waqf* is typically understood as a perpetual endowment, meaning the asset or value designated as *waqf* remains perpetually, with its benefits allocated to the intended beneficiaries. However, the concept of *waqf muaqqat* (temporary *waqf*) allows for the endowment to exist for a finite period, after which the asset or value can revert to its original owner. This flexibility is critical in modern sukuk *waqf* structures but raises questions about its compliance with the Islamic teachings.

This concept was explained by a MAIN representative, who mentioned that the sukuk can be channeled as a *waqf* asset from the beginning, but the intention can either be temporary or perpetual. Upon sukuk maturity, investors who opted for *waqf muaqqat* can reclaim the principal after the returns generated during the sukuk tenure have been allocated for *waqf* purposes. Conversely, those choosing *waqf muabbad* (perpetual *waqf*) allow their principal and returns to remain perpetually endowed. However, as noted, the implementation of *waqf muaqqat* requires renewed fatwas from MAINs to ensure its operational viability.

5.4.3. Can the *Waqf* Option Be Exercised After an Investor's Demise?

Next, one important concern regarding the implementation of the *waqf* option in sukuk *waqf* is whether the option can still be validly exercised after an investor's death. This issue arises

when an investor, during their lifetime, commits to endowing their returns or principal at a future date but passes away before the specified time.

According to Shariah, an individual's relationship with their assets ceases upon death, with the assets subsequently distributed in accordance with *faraid* (i.e., Islamic inheritance laws). As such, any future commitments involving their wealth, including *waqf*, are rendered void if they are not executed during their lifetime. For instance, if an investor declares in the first year after entering the sukuk that he will exercise the *waqf* option in years three to five but passes away in year two, his commitment to *waqf* becomes invalid.

Interestingly, this issue may also extend to institutional investors in cases of insolvency. If a corporate entity commits to a *waqf* option but becomes insolvent before the option exercise date, Shariah principles suggest that the *waqf* commitment would similarly be invalidated. Insolvency effectively terminates the entity's control over its assets, mirroring the situation of an individual's death.

The above scenarios underscore the need for the *waqf* option to be exercised immediately at the time of commitment rather than deferring them to a future date. Allowing deferred declarations that are dependent on an investor's survival creates legal and operational uncertainties, particularly in cases of death and insolvency.

5.4.4. Can *Waqf* Investments Be Commingled with Non-*Waqf* Investments?

Additionally, a concern regarding the permissibility of commingling *waqf* investments with non-*waqf* investments arises when endowed funds are placed into a *wakalah* Investment Portfolio. This issue centers around whether Shariah allows for such blending and how the ownership and accountability of the *waqf* portion are maintained within the portfolio.

It was discussed that such commingling could be managed by applying a proportional ownership approach (i.e., *waqf musha'*). This means that the *waqf* portion is recognized as a percentage of the entire commingled investment portfolio:

“Now, again just to clarify on the Shariah position. In the event that the waqf crystallizes during the life of the sukuk, let us say during the third year when the option is exercised—would the amount of money be considered as having already been given away as Infaq (charitable endowment) in the form of waqf? Now that amount, if it goes to the wakalah Investment Portfolio which

translates to another type of asset, it is no longer cash, and actually you buy that **co-mingled with the non-Waqf money**, so to speak.

“Alright, from the Shariah perspective, do we consider it only as a percentage of the commingled funds?” (LE)

“Correct.” (PR)

“Okay, so it doesn’t have to be separated?” (LE)

“No, it does not.” (PR)

“Alright, so you just take a percentage?” (LE)

“Yes, this is what we refer to as **waqf musha’, or prorated waqf**.” (PR)

Another concern is how losses in the *wakalah* portfolio would be allocated between *waqf* and non-*waqf* funds. The prorated method was again identified as a possible solution, meaning losses would be shared in proportion to the *waqf*’s percentage of the portfolio. While this approach provides a mechanism for managing commingling, it raises additional questions about the sustainability and preservation of *waqf* funds, which are traditionally intended to provide perpetual benefits.

5.4.5. Can Non-Muslim Investors Participate in Sukuk Waqf?

Lastly, a question was raised regarding whether non-Muslim investors are permitted to invest in sukuk *waqf*. From a Shariah perspective, there is no prohibition or restriction preventing non-Muslims from participating in sukuk *waqf*, provided the use of proceeds aligns with Shariah principles. The permissibility for non-Muslims to invest in sukuk *waqf* fosters inclusivity and broadens the potential investor base. It allows institutions and individuals, regardless of their religious background, to contribute to social impact initiatives funded by *waqf* while benefiting from the returns of a financial instrument. This flexibility of *waqf* distinguishes it from other Islamic philanthropic arms such as zakat, which are specific to Muslims.

CHAPTER

06

Policy Recommendations



CHAPTER 6: POLICY RECOMMENDATIONS

6.1. Key Thrusts for a Successful Issuance of Sukuk *Waqf*

This report provides policy recommendations to facilitate the issuance and implementation of sukuk *waqf*, focusing on four key thrusts: (i) enhancing operational and legal clarity; (ii) promoting robust governance and transparency; (iii) advancing knowledge and capacity building; and (iv) fostering effective collaboration among relevant stakeholders. Several targeted initiatives and efforts are proposed under each pillar to address the identified challenges associated with sukuk *waqf* issuance, as discussed in the previous chapter.

6.2. Enhancing Operational and Legal Clarity

Establish Dedicated Market Guidelines for Sukuk *Waqf* Issuance

- There is a need to establish dedicated market guidelines to address the unique characteristics and operational and legal requirements of sukuk *waqf*.
- These guidelines should provide a framework for issuing and managing sukuk *waqf*, ensuring effectiveness, efficiency, and alignment with existing market regulations and Shariah principles.

Standardize Operational Definition of Sukuk *Waqf*

- A key component of these guidelines would be the development of an operational definition of sukuk *waqf*.
- The definition should specify conditions under which sukuk qualifies as sukuk *waqf*, including the clarification of how the proceeds are to be utilized and the *waqf* features.

Amend *Waqf* Enactments to Include Contemporary Financial Assets

- As financial markets evolve, there is a pressing need to revise state *waqf* enactments to explicitly recognize financial instruments as *waqf* assets.
- This would expand the legal definition of *waqf* to include modern financial assets such as cash, shares, and sukuk.
- Such a redefinition would align state regulations with contemporary Shariah interpretations that support cash and financial *waqf*, thereby enabling innovative solutions such as sukuk *waqf* for financing social and economic development programs.

- The amendments should also provide jurisdictional clarity for financial *waqf* assets. Unlike immovable assets, financial assets do not have a fixed physical location. Therefore, the enactments must define how the jurisdiction is determined for financial *waqf* and establish the authority of the respective MAINs over such assets.

Set Clear Criteria for Issuers and Obligors of Sukuk *Waqf*

- Additionally, the guidelines should specify eligibility criteria for sukuk *waqf* issuers and obligors, consisting of financial institutions, government bodies, and *waqf*-related organizations.
- These criteria should evaluate the issuer's financial viability and capacity to manage *waqf* funds effectively.

Standardize Documentation for Issuance and Operation of Sukuk *Waqf*

- The guidelines should further mandate standardized documentation, such as offering circulars and trust deeds, tailored to reflect the unique attributes of sukuk *waqf*, including the conversion of sukuk holdings into *waqf*.

Streamline Conversion of Sukuk Principal and Returns into *Waqf*

- Furthermore, clear procedures for converting sukuk principal and returns into *waqf* should be established.
- These procedures must address timing, prerequisites, and mechanisms for the effective management of endowed funds.
- Furthermore, they should comprehensively address potential legal challenges, including ownership transfer complexities.
- Such measures are essential to safeguarding the integrity of sukuk *waqf* while maintaining its strict adherence to state-specific *waqf* enactments.

Secure Credit and Liquidity Enhancements

- Provisions to strengthen the credit profile of sukuk *waqf*, such as through guarantee from government or corporate entities should be explored.
- Besides, it is suggested that state-owned companies could act as offtakers for sukuk *waqf* issued by an SPV owned by MAINs.
- Additionally, provisions to enhance the tradability of sukuk *waqf* in the secondary market should be developed.

- The focus of these provisions includes addressing concerns about liquidity, especially if investors convert their holdings into *waqf* during the sukuk's tenure.

Incorporate Tax Incentives for Sukuk *Waqf* Issuance

- Lastly, measures to incentivize participation in sukuk *waqf*, such as tax deductions or exemption for issuers and investors need to be proposed.
- The guidelines would need to clearly define how these incentives apply, especially in cases where investors choose to endow their sukuk holdings partially or fully.

6.3. Promoting Robust Governance and Transparency

Define the Roles and Responsibilities of Stakeholders

- The proposed dedicated guidelines should also outline the roles, responsibilities, and accountability mechanisms of all stakeholders in Suk *waqf* issuance and management, such as issuers, sukukholders, trustees, and beneficiaries, thereby eliminating ambiguity and bolstering investor confidence.

Establish an Oversight Committee

- A specialized oversight committee comprising financial experts, Shariah scholars, and legal advisors should be formed to monitor the implementation of sukuk *waqf* programs.
- This committee would ensure compliance with both Shariah and legal requirements and provide guidance to navigate intricate market issues as well as jurisdictional disputes.

Implement Periodic Reporting System

- Issuers and trustees should provide comprehensive reports detailing the allocation and utilization of sukuk *waqf* proceeds.
- The reports should be provided at regular intervals, such as quarterly and annually, to ensure stakeholders are consistently informed.
- Periodic updates should cover both financial and non-financial aspects of the sukuk *waqf* programs, offering a holistic view of their progress and impact.
- In addition, the reporting system should track and disclose the performance metrics of social impact programs funded by the sukuk *waqf*.
- These metrics could include the number of beneficiaries reached, measurable improvements in societal well-being, or tangible outputs such as infrastructure built.

- Incorporating a standard framework for impact assessment, such as the United Nations' Sustainable Development Goals (SDGs) and the Principles for Responsible Investment (PRI), would provide a globally recognized benchmark for evaluating success.
- These performance reports should be made accessible to investors and other stakeholders to foster trust and demonstrate accountability.

Enforce Third-Party Validations and Independent Reviews

- To ensure the integrity of sukuk *waqf* operations, all reports on the performance of social impact projects should be subjected to independent review and verification by an independent third-party organization.
- This step ensures the accuracy and reliability of the information provided, strengthening stakeholder trust.

6.4. Advancing Knowledge and Capacity Building

Enhance MAINs' Competence on Professional Investment and Fund Management

- As the primary custodians of *waqf* assets, MAINs must develop a deep understanding and familiarity of contemporary financial products and practices to effectively optimize the utilization of endowed funds and achieve sustainable socio-economic outcomes.
- To achieve this, specialized training programs tailored for MAINs and other *waqf*-related institutions should be developed, focusing on areas such as advanced investment strategies, risk management, and business analytics.
- These programs should also incorporate real-world scenarios and case studies, providing practical insights and equipping participants with the skills needed to address legal and operational challenges in sukuk issuance and management effectively.

Amplify Research and Development

- Research and development are pivotal in creating actionable insights, innovative solutions, and best practices to address the unique complexities of sukuk *waqf* while ensuring alignment with Shariah principles and market dynamics.
- To achieve this, collaborative initiatives should be fostered among universities, research institutions, market regulators, and MAINs. These partnerships can drive multidisciplinary research focusing on critical areas such as *waqf* governance, risk

management in sukuk *waqf*, and the socio-economic impacts of *waqf*-based financial instruments.

- Pilot programs can also be implemented to assess the effectiveness and real-world impact of sukuk *waqf* issuance, providing valuable data for refining structures and processes.
- The findings from these research efforts should be widely disseminated through publications, conferences, and workshops to ensure they are accessible to policymakers, industry practitioners, and academics.
- Furthermore, a dedicated research fund can be established to support continuous innovation in sukuk *waqf*, enabling the development of new models and frameworks that enhance its scalability, transparency, and impact.

Promote Awareness Among Investors and Public on Social Impact Investing

- A key strategy to encourage greater subscription to sukuk *waqf* is to raise awareness among investors about the importance of prioritizing social impact alongside financial returns.
- This can be achieved through targeted educational initiatives such as campaigns, seminars, and workshops designed to showcase the benefits of innovative financial instruments like sukuk *waqf* in addressing critical economic and societal challenges.
- These initiatives should aim to cultivate a deeper understanding among both retail and institutional investors of how sukuk *waqf* uniquely combines profit-driven and ethical finance.
- Integrating Shariah principles of wealth distribution and ethical investment into these campaigns can resonate strongly with purpose-driven investors, further enhancing the appeal of sukuk *waqf* as a socially responsible investment option.
- Case studies demonstrating successful implementations of similar instruments can serve as powerful tools to highlight tangible social benefits, such as poverty reduction, healthcare advancements, and infrastructure improvements. By directly linking financial performance to measurable social impact, these efforts can bolster investor confidence and foster increased participation.
- To maximize outreach and effectiveness, regulators and issuers should collaborate with financial institutions, MAINs, and academic institutions to develop informative materials and host impactful programs.

6.5. Fostering Effective Collaboration Among Relevant Stakeholders

Encourage Public-Private Partnerships

- It is essential to foster partnerships between public institutions and private entities across diverse sectors, including Islamic banks, asset management firms, and property developers, to pool resources and expertise in facilitating the issuance of sukuk *waqf*.
- For example, establishing a SPV to issue sukuk *waqf* can involve ownership by institutions such as MAINs, YWM, or collaborative arrangements with corporate entities. This joint ownership structure would not only enhance the creditworthiness of the sukuk *waqf* but also strengthen governance and operational efficiency, ensuring alignment with both financial and Shariah objectives.

Appoint Professional Fund Managers to Oversee *Wakalah* Investment Portfolios

- The sukuk *waqf* issuer should consider appointing professional fund managers to oversee the *wakalah* investment portfolios associated with sukuk *waqf*.
- Their role would involve conducting thorough market analyses, implementing sound investment strategies, and monitoring performance to maximize returns for social impact programs.

Strengthen Collaboration between Market Regulators and MAINs

- MAINs, as the custodians of *waqf* assets, must work closely with regulators such as the Securities Commission and Bursa Malaysia to ensure that sukuk *waqf* instruments comply with both Shariah principles and financial market regulations.
- Regulators can provide technical support to MAINs, helping them navigate complex legal and regulatory frameworks, while MAINs can offer valuable insights into *waqf*-specific operational requirements.

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APPENDICES

Appendix 1: Open-ended questions drafted for the focus group discussion

Part 1: Understanding the Concept of Sukuk Waqf

1. How would you describe sukuk *waqf*?
2. What do you think distinguishes sukuk *waqf* from other Islamic financial instruments like traditional sukuk or *waqf*-featured investments?
3. Why do you think sukuk *waqf* is significant for addressing social and economic development needs?
4. What do you think would motivate an organization to issue sukuk *waqf*?
5. Are there other potential benefits for issuers or stakeholders that might encourage the issuance of sukuk *waqf*?

Part 2: Evaluating the Proposed Sukuk Waqf Structure

1. Structures and salient terms and conditions
 - a. Should the structure use SPV as the issuing entity?
 - b. Should the Special Purpose Vehicle (SPV) owned by Majlis Agama Islam Negeri (MAIN) be established as the issuer? If not, which entity would be more suitable and capable as the issuer?
 - c. It is proposed that the obligor for this sukuk *waqf* issuance is MAIN. How feasible is this arrangement? Would MAIN's status as a government-related entity be favorable for achieving a high credit rating?
 - d. What are the salient terms and conditions that you think must be incorporated in the issuance of sukuk *waqf*?
 - e. Are there any specific terms that you find unclear or that may pose challenges in issuance of sukuk *waqf*?
 - f. What needs to be considered to achieve a good rating for sukuk *waqf*?
 - g. What measures could be taken to enhance the credit rating of the sukuk *waqf* issuance?
 - h. Would incorporating a financial guarantee be necessary or beneficial to improve the rating of the issuance?
 - i. Is it feasible to consider a government guarantee (GG) instead of or in addition to other options?
 - j. Other than the mentioned uses, are there additional potential utilisations of the proceeds that should be considered?
 - k. What would be the most appropriate mode of issuance for this sukuk *waqf*?
 - l. What are the potential securities or collateral that could be utilized for this issuance?
 - m. What are the underlying assets suitable for the sukuk structure?

- n. Given the current features of the proposed sukuk, would it be classified more appropriately as a common sukuk issuance or as project finance?
 - o. Should the issuance be structured exclusively as a sukuk with periodic returns, or would it be beneficial to also consider issuing it as a zero coupon sukuk?
 - p. What are the potential tax implications for the sukuk *waqf* issuance, both for the issuer and the investors?
 - q. What are the suggestions to be proposed regarding the tax implications?
 - r. Should we consider issuance of sukuk *waqf* on a programme basis on one off issuance, or should we adopt flexibility depending on the nature of the issuance?
2. Transaction flows
- a. Are there any stages in the transaction flow that you feel could be improved to enhance attractiveness and compliance of the proposed sukuk *waqf* issuance?
 - b. Should a specific ratio be established for the composition between *waqf* properties (physical assets) and financial securities invested?
 - c. Would it be advisable for MAIN to appoint an Investment Manager to oversee the management of *waqf* assets and investments in Shariah-compliant green or social projects?
 - d. What mechanism should be employed to facilitate the conversion of either the entire principal amount or a specified portion thereof into *waqf* during the tenure of the sukuk *wakalah*?
 - e. After the redemption of the sukuk, who will assume ownership of the underlying assets and investments—MAIN or another entity?
 - f. At maturity, who will own the asset?
 - g. Should the endowment of principal take place prior to or following the maturity of the sukuk? Should we accord flexibility in this aspect?
3. Key parties and their responsibilities
- a. Are there any additional stakeholders you think should be included to ensure the success of the sukuk *waqf* program?
 - b. Are the roles and responsibilities of the key parties clearly defined and appropriate?
4. Main documents and deliverables
- a. Do the proposed main documents cover all necessary legal, operational, and compliance requirements for the sukuk *waqf* issuance?
 - b. How do you evaluate the adequacy of the documentation in ensuring transparency and accountability throughout the sukuk *waqf* lifecycle?
5. Others
- a. What modifications would you suggest to enhance the feasibility and robustness of the sukuk *waqf* program?
 - b. How can the structure be better aligned with the expectations of stakeholders, such as investors, regulators, and beneficiaries?
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Part 3: Identifying the Challenges in Issuing Sukuk Waqf

1. What legal or regulatory obstacles do you anticipate in the process of issuing sukuk *waqf* in Malaysia?
 2. What are the potential challenges that might be faced by MAIN as sukuk Issuer / Trustee?
 3. What Shariah compliance challenges might arise when structuring a sukuk *waqf*?
 4. What are the primary difficulties in structuring sukuk *waqf* to achieve both financial returns and social impact?
 5. What operational challenges do you foresee in managing the underlying assets linked to sukuk *waqf*?
 6. What factors might affect the acceptance of sukuk *waqf* in the market compared to more traditional sukuk?
 7. What risks do you associate with the issuance of sukuk *waqf*, and how can they be mitigated?
 8. Are there any barriers to entry that could deter potential issuers or investors from participating in sukuk *waqf*?
 9. Are there specific areas where a lack of knowledge or expertise could hinder the issuance of sukuk *waqf*?
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Part 4: Developing Action Plans to Facilitate Sukuk Waqf Issuance

1. What measures can policymakers implement to reduce the complexity and administrative costs associated with issuing sukuk *waqf*?
 2. Could tax benefits, subsidies, or other financial incentives help attract issuers to the sukuk *waqf* market? If so, what type of incentives would be most effective?
 3. What strategies could be employed to increase the market acceptance and appeal of sukuk *waqf* among investors?
 4. How can industry stakeholders promote knowledge-sharing and best practices related to sukuk *waqf*?
 5. How can strategic partnerships among relevant stakeholders and agencies be leveraged to encourage sukuk *waqf* issuance in Malaysia?
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Appendix 2: List of participants of the focus group discussion

No.	Name	Position	Affiliation
1	Dr. Ridzwan Bakar	Chief Executive Officer	Yayasan Waqaf Malaysia
2	Nur Syaffina Ab Rahim	Manager, Policy and Development	Yayasan Waqaf Malaysia
3	Mohd Fazdli Rosli	Senior Executive, Fund Management	Yayasan Waqaf Malaysia
4	Dato' Andri Badri	Partner	Kadir Andri & Partners
5	Hamizah Abd Razak	Associate	Kadir Andri & Partners
6	Arshad Mohamed Ismail	Group Chief Executive Officer	Malaysian Rating Corporation Berhad
7	Haziq Najmuddin Johan Zainuddin	Analyst	Malaysian Rating Corporation Berhad
8	Yusri Isahak	Board Member	Wakaf Pulau Pinang
9	Ahmad Rizal Abd Hamid	Board Member	Wakaf Pulau Pinang
10	Nurul Syafiqah Shahanuddin	Executive, Research and Social Sustainability	Wakaf Pulau Pinang
11	Dr. Ayaz Ismail	Director, Islamic Wholesale Banking	CIMB Islamic Bank Berhad
12	Dr. Muhammad Issyam Ismail	Assistant Vice President, Islamic Wholesale Banking	CIMB Islamic Bank Berhad
13	Mohd Zamerey Abdul Razak	Chief Shariah Officer	Bank Kerjasama Rakyat Malaysia Berhad
14	Nurul Balqis Mohamed Othman	Vice President, Shariah (Banking Operations)	Bank Kerjasama Rakyat Malaysia Berhad
15	Mohd Hanafiah Mohd Nawawi	Vice President, Shariah (Non-Banking Operations)	Bank Kerjasama Rakyat Malaysia Berhad
16	Wan Nurliza Binti Wan Ramli	Manager, Shariah Research, Governance and Training	Bank Kerjasama Rakyat Malaysia Berhad
17	Muhammad Hafizullah Mustafa	Executive, Shariah Research, Governance and Training	Bank Kerjasama Rakyat Malaysia Berhad
18	Siti Dayana Zawani	Executive, Shariah Research, Governance and Training	Bank Kerjasama Rakyat Malaysia Berhad
19	Husni Abdul Rahman	Shariah Manager	Pusat Pungutan Zakat MAIWP
20	Dr. Azrul Azlan Iskandar Mirza	Deputy Director, Islamic Capital Market Development	Securities Commission Malaysia
21	Zureena Mohamed	Deputy General Manager, Islamic Capital Market Product	Securities Commission Malaysia

22	Tengku Ariff Azhar Tengku Mohamed	Officer-in-Charge and Chief Operating Officer	Maybank Investment Bank Berhad
23	Sarina Dalik	Head, Debt Capital Markets	Maybank Investment Bank Berhad
24	Mohamed Ridza Abdullah	Managing Partner	Mohamed Ridza & Co.
25	Zulkifli Ishak	Chief Executive Officer	PHB Asset Management Berhad
26	Muhammad Zikri Kamardin	Head, Corporate Strategy Department	Pelaburan Hartanah Berhad
27	Dato' Syeikh Zakaria Bin Othman	Chief Executive Officer	Lembaga Zakat Negeri Kedah
28	Dr. Mohd Faisal Bin Mustaffa	Deputy Chief Executive Officer (Operation)	Lembaga Zakat Negeri Kedah
29	Azhar Ahmad	Head, Capital Market Department	Kumpulan Wang Simpanan Pekerja
30	Muhammad Fairuz Nazmi	Executive Director, Investment	Lembaga Tabung Haji
31	Mohd Najib Nordin	Senior Manager, Fixed Income Division	Lembaga Tabung Haji
32	Mohamad Safri Shahul Hamid	Chief Executive Officer	International Islamic Liquidity Management Corporation
33	Dr. Yussuf Adam Al Badani	Shariah Officer	International Islamic Liquidity Management Corporation
34	Datuk Prof. Dr. Mohamad Akram Laldin	Professor	INCEIF University