

THE DEVELOPMENT OF WAQF VIA SUKUK FINANCING: THE CASE OF KHAZANAH “SRI SUKUK”

Siti Nur Sathirah Fasha
Omaima Eltahir Babikir Mohamed
Mohd Yaziz Bin Mohd Isa
Zulkifflee Bin Mohamed

ABSTRACT

The paper analyzes evolvments of a type of waqf framework that incorporates sukuk as one of its financing instruments. As mentioned earlier, most waqf assets need to be further developed to maximize its potential in order to be able to accelerate the Islamic economies. However, the development will not be possible without available funding and proper management of the waqf initiatives. Since there are various issues in development and management of the waqf development fund, sukuk issuance is now seen as one of the favorable sources of the waqf development fund. By the issuance of the Khazanah SRI Sukuk, Khazanah can be seen as stepping up and leading the initiatives as one of the pioneers in the SRI ecosystem. The SRI Sukuk is also seen as the alternative way to enable further diversifications on financing instruments of waqf development and initiatives

Keywords: *Waqf property, financing, cash waqf, Sukuk development*

Background

Khazanah Nasional Berhad (Khazanah) is the strategic investment fund of the Government of Malaysia. The role of Khazanah includes being entrusted to hold and manage the commercial assets of the Government and to undertake strategic investments on behalf of the nation. Khazanah was incorporated under the Companies Act 1965 on 3 September 1993 as a public limited company and began operations a year later. Except for one share owned by the Federal Lands Commissioner, all the share capital of Khazanah is owned by the Minister of Finance Incorporated (Khazanah, 2015). Since its incorporation, Khazanah has played a catalytic role in driving various strategic industries and national initiatives by nurturing their development in pursuit of Malaysia's long-term economic interests. Acting on the capacity as the Secretariat to the Putrajaya Committee on Government-Linked Companies High Performance (PCG), Khazanah has manage to drive shareholder value creation, heighten efficiency gains and enhance corporate governance in companies controlled by the Government(al) or commonly known as Government-linked Companies (GLC). Axiata Group Berhad, CIMB Group Holdings Berhad, Tenaga Nasional Berhad, Telekom Malaysia Berhad, Malaysia Airports Holdings Berhad, IHH Healthcare Berhad and UEM Sunrise Berhad are the key listed companies in Khazanah portfolio which can be identified as some of Malaysia's largest and most important companies. (Khazanah, 2015)

Alongside the vast profit generating portfolio, Khazanah is also known for being one of the most active government linked company which participated in waqf activities. Based on Khazanah annual review in 2016, as part of Khazanah drive towards long term social impact, RM3 billion endowment funds have been channelled to Yayasan Hasanah, its very own foundation. Through Yayasan Hasanah, the initiative focuses on 5 core areas which include education, community development, environment, art, heritage and culture and knowledge development. From the same report, Khazanah also announced that they have successfully issued a RM100 million seven-year Sustainable and Responsible Investment (SRI) Sukuk which will be further discuss in later section.

Currently, the SRI Sukuk is on its second tranche. The first tranche of RM100 million SRI Sukuk was issued in 2015, whereas the second tranche was launched by Second Finance Minister of Malaysia, Datuk Seri Johari Abdul Ghani on 13 June 2017. Proceeds from this second tranche will fund the rollout of Yayasan AMIR's (YA) Trust Schools Program to at least 20 schools.

Introduction

“You will never attain virtue until you spend something you are fond of; while God is Aware of anything you may spend” Qur'an (Al-Nahl, 16:92)

In Islam, waqf is a special type of voluntary charity. The growth and development of Islamic civilization was always boosted by the growth and development of waqf. Waqf activities create a permanent, cumulative, and ever-increasing capital base and infrastructure for benevolent activities (Musari, 2016). Most of the waqf assets are in the form of property, therefore in order to transform those assets into useful benefits for the ummah, a development funds needs to be raised and managed efficiently. Due to this rational, sukuk is seen by many as the most popular choice to finance the development of those waqf assets.

Sukuk frequently refers to the Islamic equivalent of bond. However, unlike conventional bonds, which only confer ownership of a debt, Sukuk grants the investor a share of an asset, along with the commensurate cash flows and risk¹ (IDB, 2010). Islamic law principles became the basis for Sukuk securities, making it Shariah compliance.

¹ isdb.org

According to Khoutem, 2014, issuance of sukuk is beneficial in three significant ways. First, Sukuk can help to establish an efficient Islamic capital market and reinforce the “added value” of Islamic finance to economic growth. Secondly, Sukuk are a growing instrument to mobilize and raise funds and thirdly they offer a significant opportunity to finance economic development projects. These benefits can further increase the popularity of sukuk securities as one of the waqf financing tools.

Some other factors in favour to sukuk financing are sukuk incorporate elements of investment cooperation, risk sharing and engagement of assets or the real projects as its underlying issuance (Musari, 2016). From the Islamic Development Bank website, isdb.org², Sukuk issuance have increased from US\$ 14.9 billion in 2008 to US\$ 23.3 billion in 2009, with Asia as the strongest market. Huge potential for growth can also be seen for Sukuk market with the current growth rate of 10-15% in global financial markets.

Today, the development of waqf which integrate sukuk as its financing instruments has been wide spread implemented in various countries including Saudi Arabia, Singapore and Malaysia.

Methodology

The research methodology used in this paper is a qualitative method. Secondary data collected from various sources such as articles from journals and case studies that have been reviewed which include Khazanah Annual reports, news articles and other report from different organization to get a better understanding of the whole sukuk and waqf eco-system that is currently being implemented by Khazanah.

From the secondary data and journal review, a descriptive analysis was made. There are various key points that have been realised from the analysis which includes the Khazanah SRI Sukuk objectives, Khazanah SRI Sukuk framework, Khazanah SRI Sukuk transaction structure, application and implementation of the said framework.

Khazanah SRI Sukuk Objectives

According to Mogul (2014), SRI Sukuk can be defined as an investment process that combines investors’ financial objectives and concerns towards issues of environment, society and governance (ESG). In Malaysia, the issuance of the first SRI Sukuk was very much anticipated by SRI investors.

The major objective of Khazanah SRI Sukuk is to facilitate the financing of sustainable and responsible investment initiatives by Khazanah Nasional Berhad. The issuance of SRI Sukuk will also be able to meet the demand from the retail and corporate investors to access a wider range of investment products and therefore further increase the number of participation in the sukuk market. Since SRI Sukuk caters to projects that will have environmental and social impacts, it is identified as the best alternative for investors that have increasing awareness on governance and ethical issues in a business organization. By investing in SRI Sukuk, investors are also seen as participating in a conducive SRI eco-system (Haneef, 2016).

Collectively, the objective of the issuance of the sukuk and Yayasan AMIR (YA) are in line with Khazanah’s mission to further enhance human capital development in creating future leaders, focusing on social equitability along social grids. The program also intends to improve accessibility of quality education in Malaysian Government schools through a Public-Private Partnership with the Ministry of Education (the MoE). Through YA, students are provided with opportunities to flourish and become knowledgeable Malaysians who think critically and creatively and they will be better equipped with leadership and communication skills. It aims to mold the young generations to be a student who is a clear thinker, articulate, is academically strong as well as has a strong civic and moral consciousness.

Khazanah SRI Sukuk Framework

Khazanah SRI Sukuk was issued by Ihsan Sukuk Berhad (Ihsan). Ihsan is a special purpose vehicle which was initiated by Khazanah. The first tranche, which was exclusively offered to institutional investors, was launched on 18th May 2015 by Deputy Prime Minister and Education Minister of Malaysia. The sukuk was offered and priced at RM100 million which was established under the “Sustainable and Responsible Investment” Sukuk framework. It was the first SRI sukuk program approved by the Securities Commission Malaysia. The offering tenure is for seven years and investors are given an option to convert their investment into a donation at any point during the tenure. Various groups of investors have participated in the sukuk program which includes foundations, corporations, banks, pension funds and asset management companies.

The proceeds from the sukuk issuance is channelled to YA. YA, is a non-profit organization initiated by Khazanah in 2010. Its main objective is to manage Khazanah’s cash flow for the deployment of the Trust Schools Program. The Trust Schools Program is an initiative of Public-Private Partnership with the government of Malaysia with the main objective of improving accessibility to quality education in Malaysia. The SRI sukuk follows a “pay for success” structure which measures impact through several Key Performance Indications (KPIs) throughout a 5- year period. Prior to its maturity date, an independent auditor from Ernst & Young, Klynveld Peat Marwick Goerdeler (KPMG), PricewaterhouseCoopers, or Deloitte, shall evaluate the KPIs of the sukuk and provide a KPI evaluation report for the sukuk trustees, facility agent, and sukuk holders.

KPIs used to assess the performance of the sukuk are:

- i) A minimum of 20 schools are selected under YA Trust Schools Program for a five (5)-year intervention period (the 5–Year Intervention Period) during the term of the First Sukuk Ihsan (Identified Schools)
- ii) At least fifty per cent (50%) of the teachers of the Identified Schools are rated at the Establishing level or above in their observations after the end of their respective Identified Schools’ 5-Year Intervention Period
- iii) At least fifty per cent (50%) of the senior leadership of the Identified Schools are rated at the Establishing level or above in their observations after the end of the irrespective Identified Schools’ 5-Year Intervention Period.

If at maturity the KPIs are fully met, Sukuk holders will forgo or contribute up to 6.22% of the nominal value due under the Sukuk, which in effect will reduce the yield to 3.5% p.a. The adjustment is considered as part of Sukuk holders’ social obligation in recognizing the positive social impact generated by YA. If KPIs are not or partially not met, Sukuk holders will receive up to the nominal value due under the Sukuk as agreed at issuance (CIMB, 2016). Table 1 below shows the summary of terms and conditions of the offering.

Table 1: Khazanah SRI Sukuk, Term Sheet

Issuer	Ihsan Sukuk Berhad
Obligator	Khazanah Nasional Berhad
Principle Adviser/ Lead Arranger	CIMB Investment Bank Berhad
Joint Shariah Advisers	CIMB Islamic Bank Berhad and Amanie Advisors Sdn. Bhd.
Facility	RM1.0 billion in nominal value Sukuk program established under the “Sustainable and Responsible Investment Sukuk” framework
Facility Tenure	Twenty five (25) years of the date of the first issuance
Offering Size	TBD
Offering Tenure	Seven (7) years
Issue Price	100%
Periodic Distribution Payment Frequency	Annual basis
Rating	Initial rating of AAA(s) by RAM Rating Service Berhad
Islamic Principle	Wakalah Bi Al-Istithmar
Use of Proceed	Ihsan: To purchase the Sukuk investment Khazanah: To fund Yayasan AMIR’s Trust School Program for 2015
Governing Law	Law of Malaysia

Khazanah SRI Sukuk Transaction Structure

The sukuk are structured in accordance to the Islamic principle of Wakalah bi Al-Istithmar. The structure of Khazanah SRI Sukuk transaction is as follows:

1. The sukuk holders will appoint Ihsan as Wakeel
Ihsan will then appoint Khazanah as Investment Wakeel to invest the Sukuk proceeds.
Ihsan will then issue Sukuk Ihsan to the sukuk holders.
Sukuk proceeds then are handed over to Ihsan for further investments.
2. Khazanah acting as the Investment Wakeel will invest and manage the funds. The funds will be invested in various sukuk investment projects which include investment in tangible assets and Commodity Murabahah.
3. The proceeds of the investment will then be periodically distributed to Ihsan and the sukuk holders.
4. Upon maturity of the sukuk, Khazanah will then purchase an undertaking from CIMB Islamic Trustee Berhad which was appointed earlier as the Sukuk Trustee. At the end of the period, CIMB Islamic Trustee Berhad will then distribute the dissolution amount to the sukuk holders.

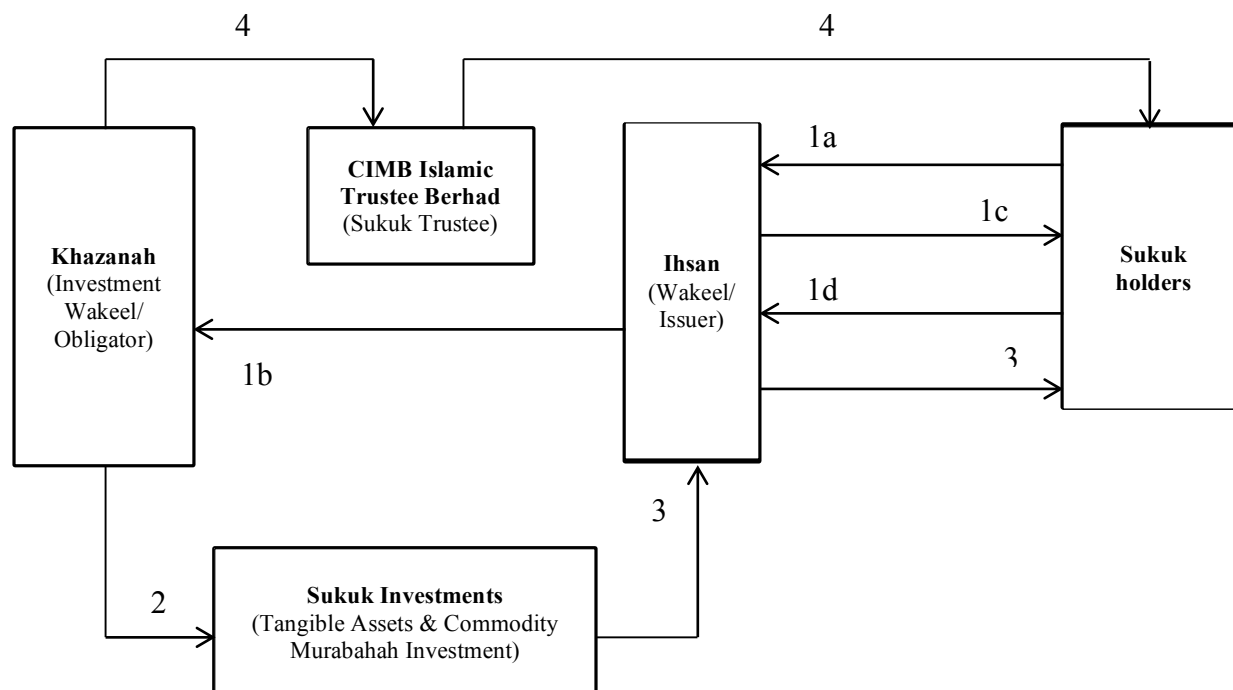


Figure 1: Transaction structure
Source: CIMB

Application and Implication of Khazanah SRI Sukuk

Khazanah efforts towards national development go a very long way. Not only does Khazanah focus on value creation in financial and strategic sphere, Khazanah also has shown various efforts that contribute to the greater good of the nation and its citizen. As part of the role in helping Malaysia to achieve developed nation status without forgetting the needy, Khazanah has centred its sustainable and responsible initiatives to six major categories. They include education, art, heritage and culture, public spaces, community development, knowledge and environment (Khazanah, 2016).

As part of Khazanah's on-going effort, four major initiatives were highlighted in the education category. From The Khazanah Report 2016³, the first out of the four initiatives are Teach for Malaysia (TFM), which aims to reduce educational inequality in Malaysia. In 2016, 83% of TFM Fellows was rated as effective by 56 principals based on 2016 School Satisfaction Survey. In the same year, there were 98 TFM Fellows stationed in 53 secondary schools which impacted 14,700 students and 31% out of 221 alumni of TFM stayed on as teachers in school.

The second highlighted activities are through Yayasan Khazanah (YK). Aspire to nurturing tomorrow's leader, YK have awarded a total of 111 scholarships in 2016. Since 2006, YK has awarded a total of 646 scholarships made up of 296 Khazanah Global Scholarship, 140 Khazanah Watan Scholarship, 137 Asia Scholarship and 73 Khazanah Bestari Scholarship.

Connecting rural schools to corporate Malaysia is the mission of the third activities depicted in the Khazanah's education initiatives of 2016. As part of this aspiration, Pintar Foundation have manage to reached milestones of adopting 483 school within the year of 2007 to 2016 with 172 active schools in 2016. Pintar Foundation also manages to impact 724,000 students since its inception and was rated a solid 99% in school satisfaction rate for its Pintar School Adoption Program.

The fourth and the most recent initiatives done by Khazanah in enhancing the overall national education system is by engaging heavily in YA. As a non-for-profit organization which was incorporated in 2010, YA aim's to raise the nation's educations standard. This is done through its on-going effort of the Trust School program. With collaboration with Khazanah, the proceeds from the SRI Sukuk will be channelled to YA for further utilization towards improving the accessibility of quality education in Malaysian government school.

As of June 2017, there is over 65,000 students from 83 selected trust school across 10 states have benefited from this program. The Trust School program incorporates a 5-year implementation strategy. The strategy started with pre-program stage of school

³ http://tkr.khazanah.com.my/2016/tkr2016_en.pdf

selection, followed by transformation stage at year 1 and year 2, solidifying stage in year 3 where trust school culture is being cultivated and transition stage at year 4 and year 5 where the performance of trust school is monitored and further support is given to maintain the trust school culture. At the end of the 5 year strategy and in order to maintain and further improve the performance and culture of the trust school, a post accreditation process will be taken place.

The performance of the Trust School program is measured through four main criteria which include:

- i. The number of trust school - minimum of 20 schools during the term of the SRI Sukuk
- ii. Senior Leadership – minimum of 50% of senior leadership team of the trust school are highly proficient in enabling positive and relevant learning environment
- iii. Teachers – minimum of 50% of the teachers of the trust school are at establishing level or above
- iv. Students – minimum of 50% of the student from the trust school demonstrate positive value and at least 75% of the student population are able to pass the national literacy and numeracy test

With the aim to transform “the education system through a paradigm shift, with the end goal of maximizing students’ potential, utilizing the existing resources”⁴, the Trust School program focuses not to create a new educational structure, but to improve students’ outcomes within the existing system. The Ministry of Education maintains control over the overall responsibility for teaching and funding of every Trust School. Based on size, location and performance, the allocation for funding the schools are the same as any other government schools. YA on the other hand are responsible and held accountable for learning practice and curriculum delivery which focuses mostly on learning and developing teaching skills among the staff.

From a report on Malaysian Trust School⁵, The Trust School program started with a total of ten schools with diverse background ranging from religious, vernacular language and poorly performing institutions to the country’s top performers. Five schools were chosen in Johor and five in Sarawak. The reason behind these is to test the approach under a variety of situations and to create a network of schools from which existing public institutions could learn. Later, three schools from Kuala Lumpur joined the program, followed by schools from Sabah and Perak including one of the elite schools, the Malay College Kuala Kangsar.

The four broad goals of each Trust School are to develop high quality leadership, improve standards of teaching and learning, maximize student potential and strengthen engagement with parents, communities and other outside parties. Autonomies given to the Trust School however only relates to curriculum, teaching and timetabling. Other autonomies still lie on Ministry of Education. The six autonomies of the Trust School are:

1. Curriculum. Schools can introduce new subjects on top of the existing curriculum and determine the most effective pedagogical approach.
2. Timetabling. Schools can determine the minimum weekly timetable allocation for each subject and add teaching days in consultation with parents.
3. Finance. The school leadership can manage the operational budget in line with the school improvement plan. In other words, they can allocate money to the areas where they think it is most needed.
4. Human Resources. A trust school can hire additional teachers.
5. Pupil Admission Policies. Up to 20 per cent of the intake can be selected.
6. Procurement. Each school has the ability to manage and enter into contracts with outside suppliers and service providers.

Apart from having its own autonomies, each Trust School will also have their own set of targets. It can be divided into institutional, principal, teacher and every student target. The goals are mostly interconnected to ensure all have a stake in the progress of the Trust School program. From the same report, academic performance account to only 20% of the overall assessment, the program is also aimed not only to focus on academic performance but also skills that relate to problem solving, critical thinking and ethics. The progress of the Trust School will be monitored throughout the five years period. Any failure to meet the set target will be given a new target for improvements and will be re-evaluated.

Conclusion

The study describes the implementation of Islamic financial tools as a source of fund for a waqf initiatives by a conglomerate. From the descriptive analysis that has been made, a considerable amount of input has been realised. This has open up ways to use Sukuk in an innovative style. We understand previously, the source of funding for a waqf initiatives always come from a direct contribution and voluntary contribution from individuals and organization. From this study, other methods might as well be used and might suggest a more conducive implementation in the Islamic economics environment.

Previously, Khazanah has been known for its various philanthropic and impressive involvements in the National agenda especially in the education sectors. Since Khazanah have the right foundation and experience, its active participation and as a leader in the Trust School Program together with Ministry of Education should be seen as a role model for other conglomerates. The participation of Khazanah can be seen as not only as leader and adviser to the Trust School Program but also improving the financing of the program by coming up with ways to fund the program through an innovative and distinct way.

Khazanah has successfully implemented an innovative way to fund the Trust School Program by incorporating sukuk as one of its financing instruments. As mentioned earlier, most waqf assets need to be further developed to maximize its potential in order

⁴ Yayasan Amir chairman Raja Arshad Raja Tun Uda, 2013 Trust Schools Programme Progress Report, 6

⁵ Jeffrey Cheah Institute on Southeast Asia

to be able to accelerate the Islamic economies. However, the development will not be possible without available fund and proper management of the waqf initiatives.

Khazanah has also shown a tremendous result where they have manage not only to gain funding from the issuance of the sukuk but also have manage to execute the waqf initiatives in a very well organized ways by having special SPV and subsidiaries to pull off all the efforts impeccably. Since they are various issues in development and management of the waqf development fund, sukuk issuance is now seen as one of the favourable source of waqf development fund. By the issuance of the Khazanah SRI Sukuk, Khazanah can be seen as stepping up and leading the initiatives as one of the pioneer in the SRI ecosystem. The SRI Sukuk is also seen as the alternatives way to enable further diversifications on financing instruments of waqf development and initiatives. However, further study need to be made to fine tune the existing framework implemented by Khazanah so that it will be available to be used by other conglomerates in a wholesome manner.

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Authors details:

Siti Nur Sathirah Fasha
Bank Rakyat School of Business and Entrepreneurship (BRSBE)
Universiti Tun Abdul Razak
fashawho@gmail.com

Omaima Eltahir Babikir Mohamed
Associate Professor, Bank Rakyat School of Business and Entrepreneurship (BRSBE)
Universiti Tun Abdul Razak

Mohd Yaziz Bin Mohd Isa
Assistant Professor Bank Rakyat School of Business and Entrepreneurship (BRSBE)
Universiti Tun Abdul Razak

Zulkifflee Bin Mohamed
Professor Bank Rakyat School of Business and Entrepreneurship (BRSBE)
Universiti Tun Abdul Razak