ISLAMIC COMMERCIAL LAW REPORT 2018

An Annual Publication Assessing the Key Issues and Global Trends in Islamic Social Finance

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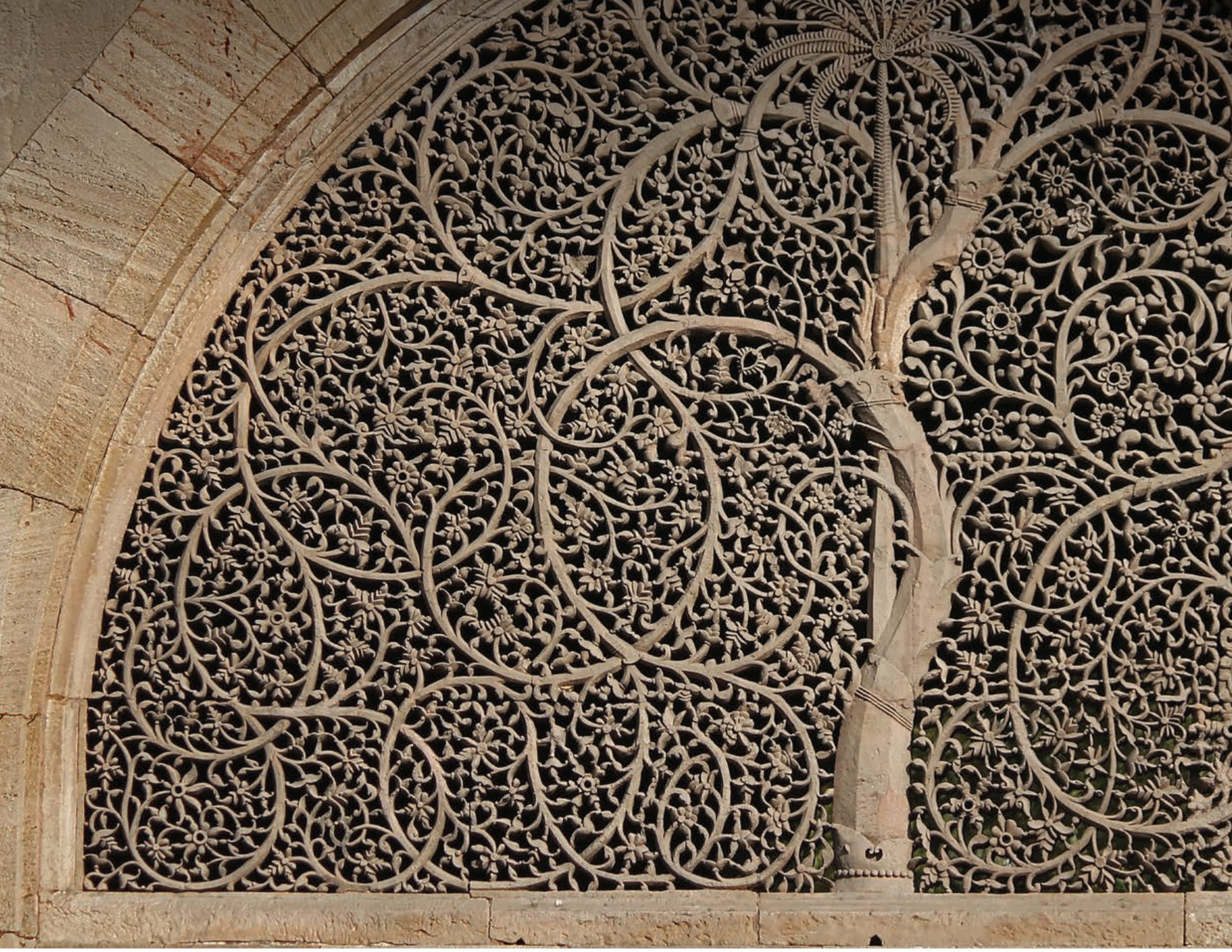

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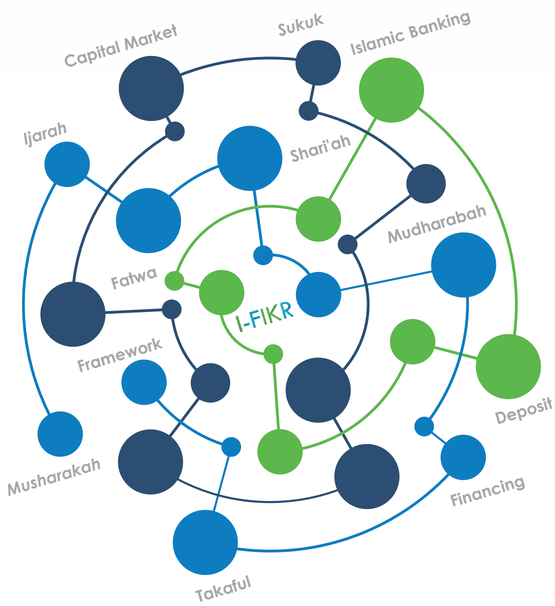

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In the Name of Allah, the Most Merciful, the Most Beneficent.

Foreword

The principles and rulings of Islamic law (Shari'ah) are inseparable from ethical and social values that Islam promotes in a definite fashion. Islamic finance, a Shari'ah-compliant financial system, does not only follow the legal rulings of Shari'ah. It also seeks to promote its ethical and social values by default. These values provide the basis for the ethical and social dimensions of Islamic finance, which have always been conceptually integrated in its practice.

Despite the inherent emphasis of Shari'ah on social and ethical aspects, Islamic finance has generally followed and imitated the social finance movement in the conventional sector, which has become popular in past decade since the 2008 financial crisis. This movement believes that the financial system can play a pivotal role in serving society's needs and ameliorating poverty. However, this role is already closely incorporated with the principles of the Islamic legal system. It is plain that Islamic finance should champion social finance as a key aspect of its mission, instead of merely being a follower of global trends.

With firm, transcendent social and ethical values as its foundational concept, Islamic finance can offer a unique perspective and a value-based approach to finance. This approach totally incorporates Islamic social and ethical values—what is right and wrong and what is beneficial and detrimental for all mankind. It thus exercises social responsibility by taking into consideration the real economic and financial problems faced by society and attempting to solve them in an efficient manner.

To help promote this concept, the International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, in strategic partnership with the Islamic Research and Training Institute (IRTI), are immensely proud to present the third consecutive series of Islamic Commercial Law Report 2018, focusing on the theme of *Islamic Social Finance*.

This report effectively highlights and analyzes various issues and dimensions of social finance from the perspective of Islamic commercial law. Expanding upon its fundamental concepts and institutions, it covers key Shari'ah rulings on several current problems, legal and regulatory conditions, the latest innovations in structuring and developing products, and other interesting case studies. Our authors, from both academic and business backgrounds, provide us with a wide range of opinions and experience that allows the report to characterize the broader challenges and the way forward for Islamic social finance.

Thanks to the inestimable expertise and sincere efforts of our writers, reviewers and the editorial team, we strongly believe that this report will serve as an influential reference for the latest scholarship on this subject. We have designed it to promote dialogue and understanding between various stakeholders on the topic of social finance from the perspective of Islamic commercial law.

Finally, we would like to take this opportunity to thank all the contributors to this report. We would also like to congratulate the production team from ISRA, Thomson Reuters and IRTI for this great achievement. It would not have been possible to produce this report without their earnest support.

Thank you.

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Executive Director
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Islamic Social Finance Outlook

Islamic social finance has gained prominence in recent years as an affiliated practice of Islamic finance. This trend seeks to achieve the economic ethics inherent in the principles of Shari'ah by promoting charitable initiatives among Islamic financial clients as well as providing financial services to the unbankable. The growing interest in Islamic social finance sheds light on various financial problems faced by the less privileged and on the ways Islamic social finance instruments can help solve these issues.

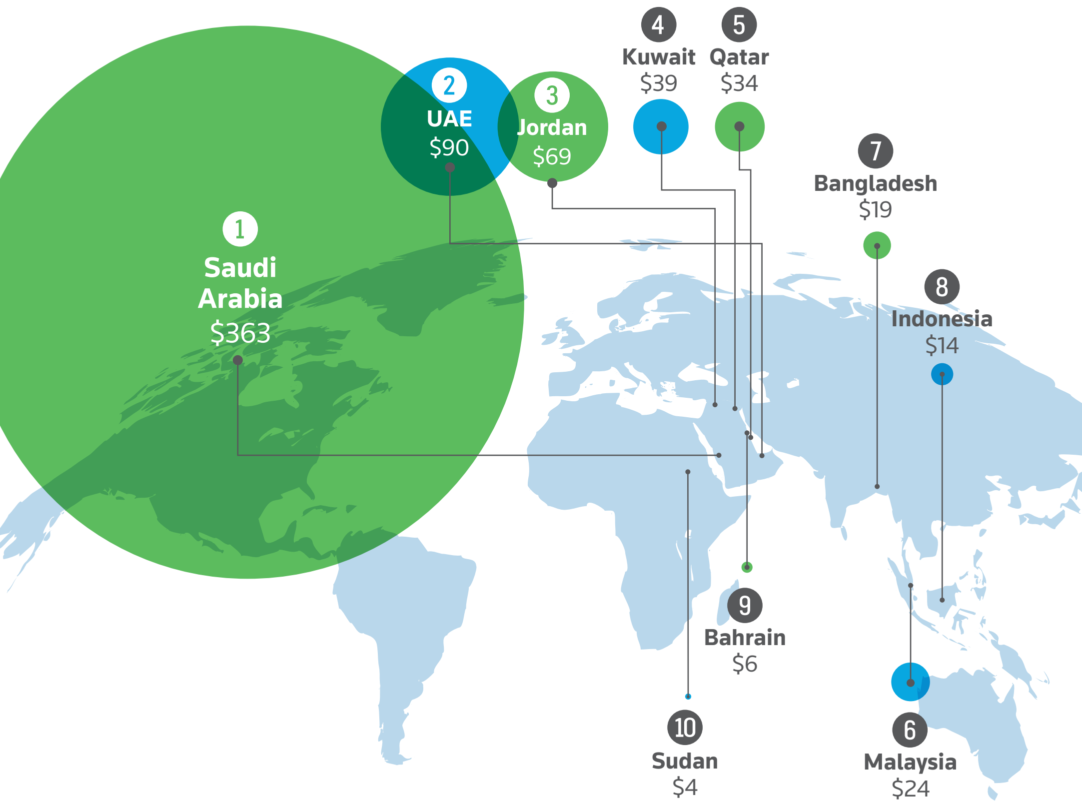
One of the challenges in expanding the scope of Islamic social finance is a lack of research on the Islamic commercial legal issues surrounding the practice. This report aims to initiate a dialogue between Islamic legal experts and industry and market professionals on the roles of Shari'ah and state law in this field.

The report begins with an examination of the different Islamic social finance instruments available in the market and the principles guiding them. It reviews contemporary Shari'ah rulings on Islamic social finance as they are used in instruments such as the cash *waqf*, trusts and *zakah*. It also considers diversity across jurisdictions in the regulation of Islamic law and finance as they apply to the operation of Islamic social finance institutions.

In its final parts, the report details a range of innovative ideas that will enhance Islamic social finance and that represent the way forward for the industry. It concludes with recommendations for ways governments, financial institutions, international organizations and philanthropic organizations can promote the further development of Islamic social finance.

We hope the report will provide stakeholders a bird's eye view of Islamic social finance and encourage them to consider and adopt some of its concepts and initiatives to the benefit of the industry.

SECTOR OVERVIEW OF ISLAMIC SOCIAL FINANCE AS OF 2016



TOP 10 COUNTRIES DISBURSING ISLAMIC CSR FUNDS (US$ MILLION)

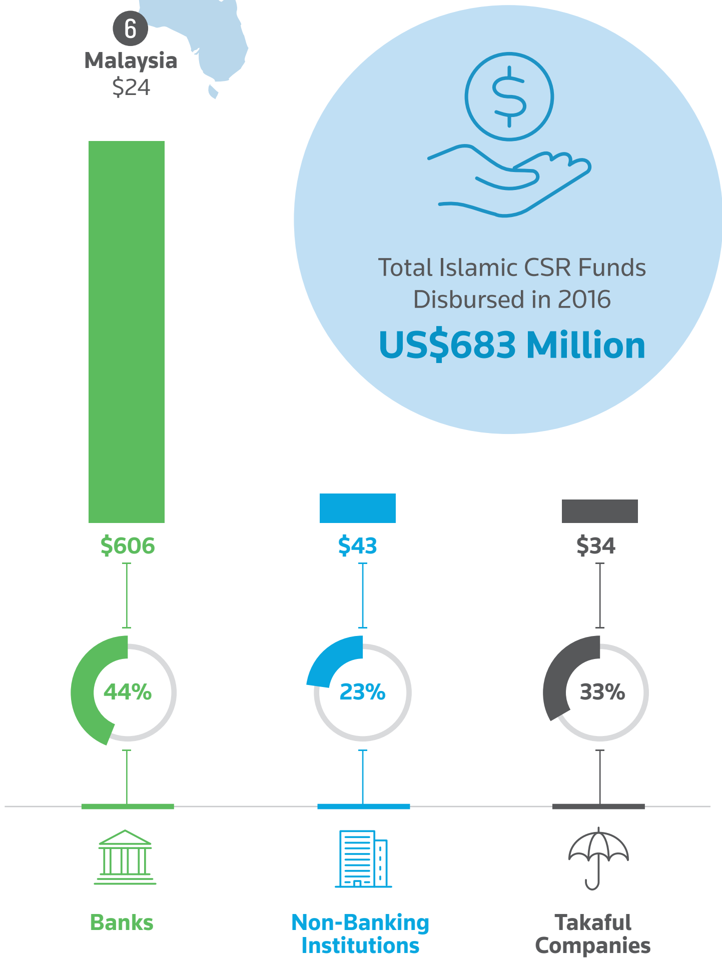
Saudi Arabia leads in Islamic corporate social responsibility (CSR) funding with a total of US$363 million disbursed in 2016, primarily in mandatory *zakah* payments collected by the General Authority of Zakat and Tax (GAZT). Islamic financial institutions have taken the initiative in organizing CSR funds in the United Arab Emirates (UAE), Jordan and Kuwait, which disbursed US$90 million, US$69 million and US$39 million, respectively.

ISLAMIC CSR FUNDS DISBURSED IN 2016 BY INSTITUTIONS (US$ MILLION)

In 2016, Islamic financial institutions disbursed a total of US$683 million globally in *zakah*, *qard hasan* and charity funds. A total of US$606 million was disbursed by Islamic banks, US$43 million by non-banking institutions, which comprise consultancy firms, asset management firms, investment advisory firms, private equity firms, real estate investment trusts (REITs) and Islamic credit unions, and US$34 million by takaful companies.

TYPES OF INSTITUTIONS REPORTING ISLAMIC CSR ACTIVITIES

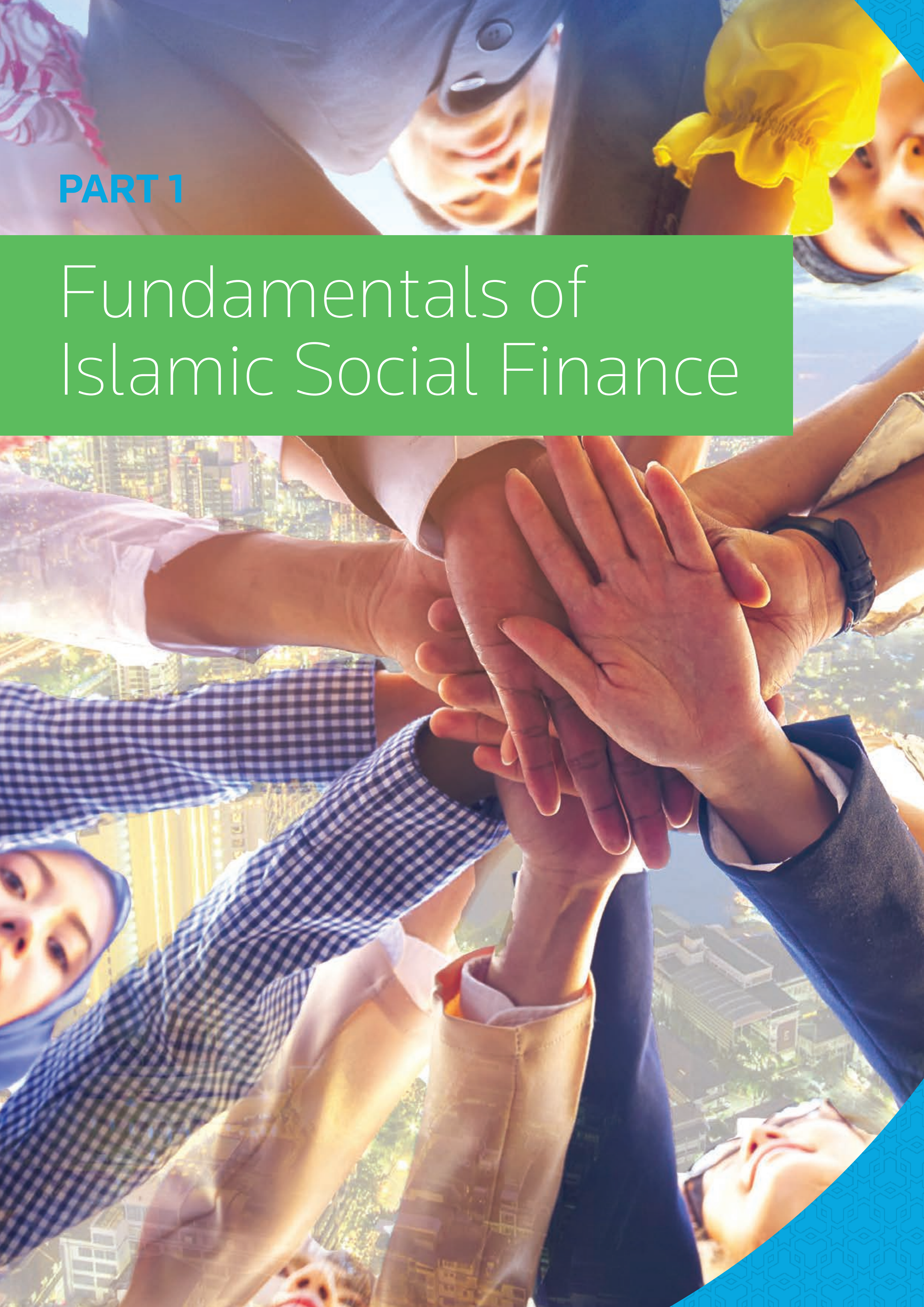
In terms of the total number of Islamic financial institutions disclosing CSR initiatives, Islamic banks lead the field. Almost 50% of such institutions are banks, compared to smaller numbers of non-banking institutions and takaful companies.



Source: Thomson Reuters Islamic Finance Development Indicator Report 2016

PART 1

Fundamentals of Islamic Social Finance



Summary

Since the 1970s, economic trends worldwide have resulted in a huge increase in the flows of capital, goods, services and labour, known as globalization. While this liberalization has undeniably resulted in a huge overall increase in wealth and efficiency, it has also resulted in the polarization of wealth and income between rich and poor nations and populations. Although most states in the world sponsor basic welfare services, increasing wealth and income inequality has greatly expanded the scope and need for private philanthropic action. However, even successful charitable initiatives are not generally coordinated by a guiding philosophy or spirit. They usually rely on the unplanned initiative of the very wealthy, or various tax incentives adopted by one or another government at various times.

Islam is the only global religion in which a spirit of charity embracing the entire community has survived as one of its pillars of faith. Indeed, the renaissance of religious observance among Muslims in the past half-century has resulted in a huge demand for the revival of the institutions of Islamic social finance. These institutions have had a distinguished fifteen-century history of social service before their disruption by the adoption of European codes of law and contemporary state bureaucratic structures.

The institutions of *zakah* (almsgiving), *sadaqah* (voluntary charity), *hibah* (gift), *waqf* (Islamic endowment), *qard hasan* (interest-free loan), among others, are well suited to the contemporary economic environment. They reflect the social *maqasid* (objectives) of Shari'ah (Islamic law) in a way relevant to current conditions. The classical Islamic state did not seek to interfere excessively with Shari'ah and the operation of Islamic legal institutions. Rather, it relied on the social harmony the Shari'ah independently produced to ensure social and political stability. Islamic social finance institutions have the ability today to legitimate and coordinate private charitable initiatives in a way that can redouble their effectiveness.

Of course, the current complexity of economic life means that these institutions require careful encouragement and development. Islamic financial institutions (IFIs) are ideally situated to build the platforms and provide the services necessary to spread the application of Islamic social finance. They are already adopting and going beyond current practices in corporate social responsibility (CSR) to establish Islamic finance at the forefront of private social development initiatives. Finally, Islamic social finance will also benefit from international cooperation and best standards. Islamic financial institutions are also engaging with global benchmarks for social development such as United Nations Development Programme's (UNDP) Sustainable Development Goals (SDGs) and United Nations' Principles for Responsible Investments (UNPRIs) to craft management and investment strategies.

THE APPROACH OF QUR'AN AND SUNNAH TO ISLAMIC SOCIAL FINANCE

Prof. Dr. Mohamad Akram Laldin and Dr. Sa'id Adekunle Mikail

The Qur'an and Sunnah are the primary sources of Shari'ah and the core references for its rules and guidance for the wellbeing of humanity. Muslim jurists affirm that justice, public interest and the removal of hardship are the injunctions of the texts of the Qur'an and Sunnah, and these sources have placed well-structured mechanisms for addressing entrenched social problems and bringing stability to the lifestyle of the *ummah* (Muslim community and humanity). For example, the history of Madinah as a young Muslim community after the *hijrah* (migration) of Prophet Muhammad (SAW) from Makkah offers a practical demonstration of the multi-faceted approaches of Islam towards poverty alleviation through community-based social financing. This article discusses the important principles and doctrines set by the Qur'an and Sunnah for Islamic social finance, both through the integration of a strategic and long-term approach and the recognition of social justice and shared values.

STRATEGIC APPROACH FOR ISLAMIC SOCIAL FINANCE

Mindset Changes

Since one's habitual mental attitude plays a profound role in the manner one interprets and responds to situations, the Qur'an and Sunnah first influenced the existing mindsets of the companions of the Prophet (SAW) to ensure Islamic social finance was received in good faith. This guaranteed a greater brotherhood of spirit and care in the Muslim environment. The establishment of a faith-based brotherhood between the Muhajirun (emigrants) and Ansar (local Muslims of Madinah) and relief for the dwellers of Suffah (a welcoming point for new converts or destitute in the Prophet Mosque in Madinah) were important strategic approaches that the Prophet (SAW) employed to tackle entrenched social problems. The Prophet (SAW) was not only the role model for good ethics and value but he did his best to inspire His companions. The Qur'an says:

> All believers are brothers, therefore seek reconciliation between your two brothers, and fear Allah, so that you may be blessed with mercy (Qur'an, 49:10).

The Prophet (SAW) says:

> The example of the believers in their mutual empathy, mercy and sympathy, is like the [single] body, when one organ feels pain the rest of the organs join it in the pain through sleeplessness and fever (Muslim, *hadith* no. 4696).

This atmosphere of brotherhood changes the mindset of Muslims toward one another: first of all, it contradicts a primitive understanding of brotherhood, which mostly revolves around ties to blood relatives and by marriage. Hence this mindset change created strong bonds among the early Muslims, which was deeper, better interconnected and integral to their society beyond what anyone could have imagined. They felt each other's pain and shared happiness in the same way. The Qur'an and Sunnah also increased a feeling of concern for each other in every member of the Muslim society. This helped to a large extent entrench the notion of Islamic social finance in the early generation of Islam.

Furthermore, in a *hadith* by 'Aishah (RA), the Prophet's household slaughtered a ram and distributed it to the needy people. The Prophet (SAW) then asked 'Aishah (RA), "what is left of it"

> *Changes in mindset, the inculcation of social values and principles such as cooperation, justice, and public interest... and the development of Islamic social finance instruments such as zakah, sadaqah and waqf are the key legacies of the Shari'ah for addressing entrenched social economic problems.*

(i.e. the part that remains undistributed), 'Aishah said, "All has gone, only shoulder part remains." The Prophet (SAW) replied, "All remains, only the shoulder is gone" (al-Tirmidhi, *hadith* no. 2470).

It is inferred from the *hadith* that the Prophet (SAW) corrected the prevailing wrong perception that whatever has been spent for the sake for Allah is "gone" and whatever was kept "remains" to the correct perception that whatever has been spent in the cause of Allah such as *zakah*, *sadaqah*, or *waqf*, remains and what was kept to oneself is gone. With this change in mindset, the Prophet (SAW) was able to inspire His companions to embrace Islamic social finance.

Inculcation of Social Values and Principles

The Qur'an and Sunnah instituted a set of principles to address social needs. The following principles are fundamental in the development of Islamic social finance.

The Principle of Cooperation (*Ta'awun*)

The principle of *ta'awun* involves mutual assistance and a shared responsibility to provide welfare services to all creatures, humans, animals and others. The Qur'an (5:2) says: "Help one another in righteousness and piety; but do not help one another in sin and transgression." This includes all aspects of mutual cooperation, including the provision of financial support to needy people irrespective of their religion, sex, race, class and colour.

The Principle of Justice (*'Adalah*)

The Qur'anic injunction on justice can be best captured in this verse: "Allah enjoins *adl* (justice) and *ihsan* (kindness) and generosity to relatives, and forbids all that is shameful, evil and oppressive…" (Qur'an 16:90). This verse provides two fundamental bases for human interactions, which are justice and kindness. Justice refers to moderation and adherence to the truth (Abdul Mun'im, n.d., 2/483). Thus, justice in Islam covers all human conduct and interactions, including the economic, social and environmental. Similarly, economic justice in Islam ensures everyone in the society is treated fairly and justly. Human beings are equal in the eyes of Shari'ah with no preference or privilege given to one over the other. The Prophet (SAW) said: "Human beings are as equal as the teeth of a comb" (Ibn 'Asakir, *hadith* no. 8338). Hence, justice in Islam does not differentiate between people in its implementation. Therefore, all forms of injustice and exploitation, such as *riba* (usury), *maysir* (gambling), *gharar fahish* (excessive uncertainty) and *rishwah* (bribery) are strictly forbidden, based on textual authorities from the Qur'an and Sunnah.

The Principle of Public Interest *(Maslahah 'Ammah)*

This principle refers to giving emphasis to the wellbeing of society in all human interactions, including economic relationships. Thus, it is the duty of each individual to meet mandatory and voluntary social responsibilities that ensures peaceful co-existence in the society. In fact, this principle holds that public interest forms an important basis of Islamic legal rulings. Therefore, the Shari'ah introduces social finance instruments i.e. *zakah*, *waqf*, *sadaqah* and others to ensure economic justice is maintained in the public interest.

The Principle Removal of Hardship *(Raf' Al-Haraj)*

This principle forbids any conduct that may lead to difficulty or harm to body, life or property at present or in the future. The Shari'ah gives high priority to human well-being and ensures that its rules can be implemented within human capabilities. The Qur'an testifies to this principle when it says: "…Allah has not laid on you any hardship in your religion…" (Qur'an 17:27).

RECOGNITION OF UNIVERSAL SOCIAL JUSTICE AND SHARED VALUES

This concept means that social justice in Islam is not only confined to Muslims, but includes both Muslims and non-Muslims. This is demonstrated in the following verses of the Qur'an:

> O mankind! We have created you from a male and a female, and made you into nations and tribes, that you may know one another. Verily, the most honourable of you with Allah is that (believer) who has *taqwa*… (Qur'an 49:12).

> O you who believe! Stand out firmly for Allah as just witnesses and let not the enmity and hatred of others make you avoid justice. Be just: that is nearer to piety, and fear Allah. Verily, Allah is Well-Acquainted with what you do (Qur'an 4:8).

> And the earth He has put down (laid) for the creatures. Therein are fruits, date-palms producing sheathed fruit-stalks (enclosing dates). And also corn, with (its) leaves and stalk for fodder, and sweet-scented plants (Qur'an 55:10-12).

The above verses in the Qur'an emphasize that the Shari'ah recognizes non-Muslims as fellow humans who share common values with Muslims, and they enjoin Muslims to implement justice in dealing with non-Muslims. Meanwhile, the third verse affirms that the Qur'an recognizes shared values, i.e. the value of the earth itself and all that it gives to both Muslims and non-Muslims.

The Prophet (SAW) says: "Anyone who wrongs a non-Muslim living under the protection of a Muslim territory (*dhimmi*) or undermines him or overburdens him, or takes his wealth unjustly, I will fight with him on the day of resurrection." (Abu Daud, *hadith* no. 3052).

In addition, non-Muslims can also be the beneficiaries of Islamic social financial instruments, particularly *waqf* and *sadaqah*, because Islam is not confined to Muslims only, but it aims to help the entire universe, including non-Muslims.

CONCLUSION

The Qur'an and Sunnah, as the primary sources of Shari'ah, have effectively addressed social needs by integrating both a strategic approach and revolutionary change in influencing society. Thus, changes in mindset, the inculcation of social values and principles such as cooperation, justice, public interest, and the removal of hardship, and the development of Islamic social finance instruments such as *zakah*, *sadaqah* and *waqf* are the key legacies of the Shari'ah for addressing entrenched social economic problems.

Meanwhile, the establishment of faith-based brotherhood and daily relief for dwellers of Suffah in Madinah set another incredible standard of best practices and practical approaches for achieving far-reaching Islamic social finance practices. Recognition of social justice and shared values between all creatures, and the inclusion of non-Muslims as beneficiaries in Islamic social finance instruments, represent the main objectives of Shari'ah —the wellbeing of humanity. The well-structured and comprehensive approach of the Qur'an and Sunnah to social finance can never be overemphasized, particularly considering the steadily increasing socioeconomic needs of the present day that affect not just the *ummah* but humankind itself.

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THE SOCIAL RESPONSIBILITY OF ISLAMIC FINANCE

Dr. Beebee Salma Sairally

The notion of corporate social responsibility (CSR) is harmonious with Islamic finance. Islamic financial institutions (IFIs) aim to institutionalise Islamic ethical values set by the Shari'ah to promote socio-economic welfare. This article examines how the dimensions of faith and *taqwa* (God consciousness) are expected to influence the actions of the Muslim individual, and by extension IFIs, to pursue self-interest alongside social responsibility. It also briefly highlights the debate on attributing social responsibility to IFIs and whether there is a need to rethink the overall structure of IFIs to enable them better integrate CSR activities within their operations. Alternatively, it is questioned whether it is the role of the Islamic social finance sector to take charge on the aspect of social responsibilities and community development.

FAITH AND *TAQWA* DRIVING SOCIAL RESPONSIBILITY

In the Islamic economic model, the dimensions of faith and *taqwa* should influence the life of a Muslim so that the individual exhibits responsibility towards himself, his family, society and ultimately, accountability to God. Assuming the roles and responsibilities as God's servant and vicegerent, the Muslim individual is expected to behave altruistically and to understand that man is merely a trustee of all the wealth he possesses to pursue his self-interest within the bounds of social interest. By internalizing the concept of social responsibility, individuals should thus be driven to make careful use of limited resources, to deploy financing for socially responsible projects, to care for the environment, and to fulfil their social obligations.

This concept is consistent with the Shari'ah, which stipulates and advises people (and IFIs) to uphold their social responsibility to promote productive activities and to shun harmful actions. Islamic finance thus promotes socio-economic goals such as the ethical creation of wealth, the fulfilment of basic human needs, the optimal use of natural resources, and the establishment of economic and social justice. These goals inevitably have recourse to and are meant to achieve the *maqasid al-Shari'ah* (objectives of Islamic law), which promote the well-being of all mankind.

THE SOCIAL RESPONSIBILITY OF IFIs

IFIs are said to exist as a collective religious obligation of the larger community (*fard kifayah*) and thus as special vicegerents, they are accountable for their actions to God and play an important role in enjoining good and forbidding evil (AAOIFI, 2010: 89–91). On this basis, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) published its Governance Standard for Islamic Financial Institutions No. 7, titled *"Corporate Social Responsibility: Conduct and Disclosure for Islamic Financial Institutions"* in 2010. IFIs are assigned both mandatory and recommended CSR attributes and levels of disclosure, as delineated in Table 1.

The social responsibilities assigned to IFIs by AAOIFI (2010) in fact align with one of the widely accepted definitions of CSR. Carroll (1979) utilized a sophisticated approach in defining CSR in

> *Although IFIs are not charitable organizations, the Islamic philosophical foundations underpinning their establishments require that profit is not their sole business objective.*

Table 1: Mandatory and Recommended CSR for IFIs

Mandatory Conduct and Disclosure Requirements Applicable to *"all IFIs irrespective of their legal form, country of incorporation or size"*	**Recommended Conduct and Disclosure Requirements Applicable to** *"IFIs which have the capacity, financial or otherwise, to carry out or comply with such activities"*
Include those responsibilities that IFIs should comply with to ensure that their operations are conducted in a Shari'ah -compliant manner, e.g. develop policies for:	Include those responsibilities not codified in law (ethical responsibilities) and social duties over and above the religious, economic, legal, and ethical responsibilities (discretionary responsibilities), e.g. develop policies for:
Screening clients	*Qard hasan* (interest-free loan)
Responsible dealing with clients	Reduction of adverse impact on the environment
Earnings and expenditure prohibited by Shari'ah	Social, development and environment-based investment quotas
Employee welfare	*Par excellence* customer service
Zakah (almsgiving)	Micro and small business and social savings and investments
	Charitable activities
	Waqf (Islamic endowment) management

Source: AAOIFI (2010: 71)

terms of four responsibilities that society expects corporations to shoulder: economic, legal, ethical and discretionary. These are explained in Figure 1.

Indeed, IFIs as Shari'ah-compliant entities are not only responsible to strictly apply the textual directives of Islamic law. Shari'ah compliance also requires abiding by the spirit of the *maqasid al-Shari'ah*. Although IFIs are not charitable organizations, the Islamic philosophical foundations underpinning their establishments require that profit is not their sole business objective. In this respect, an integral and explicit socio-economic role is assigned to them above the principle of profit maximization.

This view endorses the social contract theory that governs the relationship between businesses and society. If businesses neglect their social responsibility, they will have to pay a price in the long run in terms of increased regulatory compliance, fines, lost business and an adverse corporate image. This view also takes into account the profit potential arising from social commitments, in terms of increased market share, positive customer ratings and loyalty. It further considers IFIs to be not only responsible vis-à-vis their shareholders but accountable to a variety of stakeholders, including the larger society. It is known as the 'stakeholder' approach to CSR.

Figure 1: Carroll's Broader Definition of CSR

THE DEBATE ON ATTRIBUTING SOCIAL RESPONSIBILITY TO IFIs

While Carroll (1979) supports the stakeholder's view of CSR, the traditional view of CSR espoused by Friedman (1970) believes that the only social responsibility of businesses is to increase profits for their shareholders. Friedman rather assigns social responsibilities to individuals. In the case of businesses, shareholders in their private capacities should shoulder social responsibilities, not corporations, which Friedman treats as independent entities. This view only emphasizes the costs that businesses incur for social involvement. It fails to bring to the fore the benefits of CSR. It is often referred to as the 'economic' approach to CSR.

In line with this economic view, some academics as well as practitioners question the necessity of CSR programs at IFIs. For example, asking IFIs to adopt welfare-type objectives is considered unjust, as they are, after all, private businesses. Social duties, such as *waqf* management, charitable activities and *qard hasan*, are instead generally relegated to social and charitable organizations. Assigning CSR attributes to IFIs is thus seen as being too big a role for them to assume. This view is usually held by those who consider IFIs to belong to the commercial sector and only responsible for economic and financial transactions.

To make explicit the two prevailing views on CSR, Figure 2 summarizes both the stakeholder and economic views discussed above.

Figure 2: Stakeholder View vs. Economic View on CSR

Stakeholder View

IFIs are institutions with multi-purpose goals including profit maximization and socio-economic objectives. They should aim at maximizing stakeholders' interests. These are in line with acting within the objectives of Shari'ah.

The business policy on CSR is taken as an integral part of the wealth creation process and pursued to increase the competitiveness of the business and the value to society.

Economic View

IFIs are part of the commercial sector and only responsible for economic and financial dealings. Their key responsibilities are towards their shareholders and depositors and not the larger society.

CSR is not taken as an integral part of the core business. It is pursued as a philanthropic exercise on an adhoc basis as they become profitable, viable and sustainable.

CHALLENGES: INTEGRATING CSR WITHIN IFIs OR CREATING ISLAMIC SOCIAL FINANCE?

According to a study by Sujana (2015), who explored the extent of CSR engagement in 16 Malaysian Islamic banks, local and foreign banks differed significantly in terms of their engagement in CSR-based activities, CSR reporting, CSR communication and CSR supervision by the board of directors. These banks largely focused on publicizing the information related to community initiatives in their reports whilst they neglected other aspects of CSR such as principles of equality, inclusion and workplace-related CSR activities.

Another study by Sairally (2013) assessed the corporate social performance of a sample of 46 IFIs globally, revealing that the CSR practices of IFIs worldwide also had a limited scope. Their CSR activities focused on being "not socially irresponsible" rather than being proactive and "socially responsible." In general, CSR was practiced as a peripheral activity by the IFIs (e.g. related to donations and *qard hasan*) as opposed to being an integral, well thought-out and deliberate policy decision of management.

To this end, there is an ongoing debate whether integrating CSR within the Islamic finance sector will require a rethinking of the structure of IFIs altogether. It would be necessary, in one view, to build a culture where IFIs actively engage with the society in which they operate, to attach greater emphasis on a socio-economic mission, to design products and services to achieve a greater social impact, and to take policy decisions where the objective is to do more than merely avoiding prohibited activities.

An alternative view is for IFIs to continue to operate as commercial entities with limited CSR involvement. Instead, it promotes the Islamic social finance sector so it supports *awqaf* (Islamic endowments), charitable and *zakah* institutions in focusing on the aspects of social responsibilities and community development.

There is certainly space for different types of institutions to thrive within the Islamic financial system. Currently, both commercial Islamic banks and Islamic social finance entities can operate side-by-side. The ultimate goal is for Islamic businesses to stand as God's vicegerents, contributing in their own way towards the welfare of the larger society.

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INSTITUTIONS AND INSTRUMENTS FOR ISLAMIC SOCIAL FINANCE

Prof. Dr. Nasim Shah Shirazi

Islamic social finance comprises instruments and institutional structures that are rooted in philanthropy. The broad instrument of Islamic philanthropy is *sadaqah* which can be divided into two main categories: (i) compulsory *sadaqah* on well-to-do Muslims, which is known as *zakah* (almsgiving); and (ii) voluntary *sadaqah* (charity) which is optional and has no fixed rate and can be spent on any deserving person or institution. Unlike voluntary *sadaqah*, *zakah* can only be used for specific purposes clearly mentioned in the Qur'an.

Zakah collection, management and distribution require a system for administration, the establishment of which is the responsibility of the Muslim ruler. Voluntary *sadaqah*, on the other hand, is solely the responsibility of the individual, although there is no prohibition or ban on the establishment of a system for collecting optional *sadaqah*, provided it is free of all elements of force, compulsion and coercion. In fact, the goal of voluntary *sadaqah* is to create the habit of doing good and seeking to attain spiritual happiness.

When the *sadaqah* results in flows of benefits that are expected to be stable and permanent (such as by the endowment of a physical property), it is called *sadaqah jariyah* (continuous charity) or *waqf* (Islamic endowment). *Hibah* (gift), on the other hand, is the giving of some *mal* (property) without any long-term material consideration. It is intended to cultivate love and cooperation among citizens. Similarly, *qard hasan* (interest-free loan) is another instrument of social finance for the poor and the needy. The next few pages provide a general overview of the importance of these institutions in the Islamic social finance.

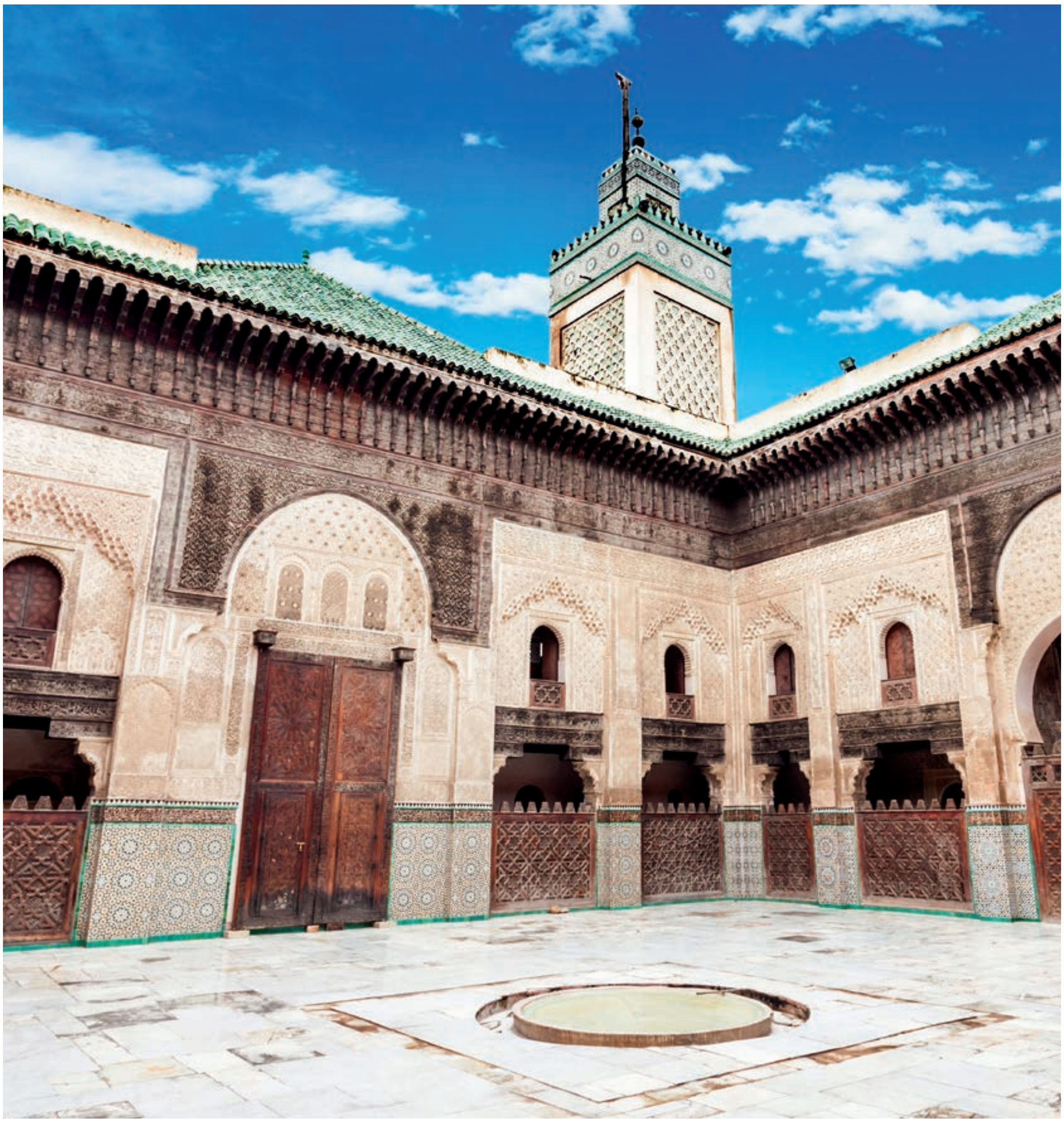
ZAKAH

Zakah is one of the five pillars of Islam. Literal meanings of *zakah* are growth and purification (Qur'an 9:103). In practical terms, it is an obligatory transfer by a Muslim of the ownership of wealth that has reached a prescribed threshold (*nisab*), as defined by the Shari'ah, to eight eligible categories of *zakah* beneficiaries: the poor (*faqir*), needy (*miskin*), *zakah* personnel (*amil*), people whose hearts are inclined toward Islam (*muallafatul qulub*), those in bondage (*fi al-riqab*), indebted people (*gharimin*), wayfarers (*ibn al-sabil)* and those in the path of Allah (*fi sabilillah*).

Zakah is levied on savings that account for part of the wealth of an individual. It is also levied on forms of wealth that are characterized as stocks, such as gold, silver, trade inventory and livestock. However, contemporary Muslim scholars are of the view that *zakah* can also be deducted from net returns of manufacturing concerns and building rents and from net savings from salaries. Furthermore, Malikis view that the *zakah* base includes buildings and other fixed assets, except those assigned for personal and family use.

Rates of *zakah* vary with forms of wealth. With most forms of financial assets, the rate is 2.5%. Nevertheless, *zakah* is not levied on income that is used for consumption and items of wealth that are for personal and family use, such as a house or car. It is also not levied on wealth that is categorized as means of production or capital goods. Thus, the levy of *zakah* results in the transfer of wealth from the rich without adversely affecting their consumption or productive investments.

Unfortunately, *zakah* has been generally neglected as an important institution to fight poverty



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Madrasa Bou Inaniain in Fes, Morocco.

in many Muslim countries or considered only a private affair. Only a few Muslim countries, including Yemen, Saudi Arabia, Malaysia, Libya, Pakistan, Sudan and Iran, have institutionalized some form of centralized *zakah* collection by the government. However, these vary in terms of coverage of *zakatable* items and assets. Other countries have not introduced this system, and it is considered a private affair. *Zakah* collection by governments has been in the range of about 0.4% to 0.6% of GDP of these countries, which is lower than its potential collection.

We firmly believe that if the *zakah* institution is revived and fully implemented, then absolute poverty can be eliminated from these countries. A study by Shirazi (2014) shows that potential *zakah* collection and distribution among the poor can reduce absolute poverty in 23 out of 40 sampled OIC member countries. Furthermore, if an international fund is established to which all member countries contribute their surplus *zakah* proceeds, after meeting the poverty gap of their own extreme poor, then the poor could potentially be lifted out of poverty even in those countries lacking natural resources.

WAQF

Waqf is an important religious and social institution, which has been used for the welfare of the needy, poor, and personal families and society.

> *We firmly believe that if the zakah institution is revived and fully implemented, then absolute poverty can be eliminated...*

Wealth is transferred from private ownership to the collective ownership of specified beneficiaries through this mechanism.

Personal assets or any other belongings can be endowed in *waqf* for religious, educational, or any other benevolent purpose under specific terms and conditions. History shows that for every conceivable enterprise of social benefit, there has been a waqf, such as for mosques, universities, schools, hospitals, orphanages, houses for the poor, food for the poor, the blind, battered or abused women, soup kitchens, wells, aqueducts, fountains, public baths, watchtowers, bridges, cemeteries, salaries, pensions, guesthouses, libraries, books, and animal welfare.

The history of *waqf* for the welfare of the society dates back to when Prophet Muhammad (SAW) instructed his companion Othman (RA) to purchase the well of Ruma in Madinah and make a *waqf* of the same. In the recent past, during the Ottoman period, the society left the financing of health, education and welfare entirely to the *waqf* system (Ali, 2009; Rashid, 2011; Ahmed, 2004).

Waqf goes beyond just fulfilling the needs of the poor toward empowering them in society. This is achieved through the development and continuous assistance in education and health to build the productive capacity of the poor, to improve their access to finance, to innovate and to conduct research to assist them.

No doubt, history tells the rich experience of the role of *waqf* in social development and poverty alleviation, but "with colonialism came misery to *awqaf*. Thousands were abolished or put to other uses and were governed by alien rules." (Rashid, 2011) Keeping in view the importance of *waqf* in recent years, efforts have been made by some countries to organize *awqaf* properties that have been left unattended or misused.

QARD HASAN

Islam provides very strong incentives for lenders to meet the financial requirements of the needy by providing loans without expecting any gain in return from them. The Qur'an states: "Who is it that will lend Allah a *qard hasan*, which He will multiply for him (the lender) many times and for him shall be a generous recompense" (11: 57).

Qard hasan is a loan contract between two parties for social welfare or for short-term bridging finance. Repayment is for the principal amount only. The institution of *qard hasan* can be useful in eradicating extreme poverty by making opportunities available to the poor to create new jobs and business ventures with their merits, skills and expertise.

Qard hasan has been practiced in Muslim societies for many centuries. The formal use of *qard hasan* as a tool for microfinance is relatively new.

In some countries, such as Bosnia-Herzegovina, the Islamic Republic of Iran, Indonesia, Pakistan, and the United Kingdom, *qard hasan* is used for extending microfinance. In the case of Iran, a large number of formal and informal funds have been established in mosques, organizations and rural communities. In addition, the practice of establishing such funds among families and peer groups is widespread. Similarly, Akhuwat, the pioneer Islamic microfinance institution in Pakistan, has successfully established the usefulness of *qard hasan*. Akhuwat is playing a contributory role in the redistribution of resources on a sustainable basis for uplifting the poor.

CONCLUDING REMARKS

Overall, Islamic social finance helps reduce extreme poverty and increase the welfare of the poor (Obaidullah and Shirazi, 2016). A philanthropy-based intervention inherent in the institutions of *zakah* and *sadaqah* could potentially satisfy the basic needs of the extremely poor and destitute and create a social safety net. Another institution of Islamic philanthropy, *waqf*, is ideal for the creation and preservation of assets that can ensure flows of resources to provide education, healthcare and other social goods. *Waqf* may also direct resources toward improving skills and developing human resources through technical assistance and capacity building. The social safety net, technical assistance and capacity building may then be linked to financial assistance such as *qard hasan* by helping to develop micro-enterprises. However, there is a need to revive and develop this institution by creating an enabling environment and encouraging the rich to make contributions.

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ISLAM, ISLAMIC FINANCE AND SUSTAINABLE DEVELOPMENT GOALS

Prof. Dr. Humayon Dar

The objective of this article is to assess whether Islamic and conventional approaches to providing finance to the social sector are compatible. It also attempts to highlight similarities and differences between the two. The United Nations Development Programme's (UNDP) Sustainable Development Goals (SDGs) serve as a benchmark for its recommendations.

Islam, as a religion, and Muslims, as an important faith group in the world, show concern for social causes like poverty reduction, promotion of social justice, and equal opportunities for all.

Islamic banking and finance, a phenomenon of growing importance and influence, has developed into a market-driven system, but it places only a marginal emphasis on social responsibility. It is fair to say that Islamic banking and finance attempts to provide Shari'ah-compliant products and services to mainstream customers–individuals, corporations and governments. A social focus is, at best, only implicitly embedded in these activities.

Consequently, there is now an ever-increasing focus on the centuries-old Islamic institution of *waqf*, philanthropic tools (*sadaqah*, *qard hasan* and *kafalah*) and permanent relief mechanisms like *zakah*. The provision of Shari'ah-compliant microfinance is also a focus. All these institutions, tools, mechanisms and phenomena are studied under the rubric of Islamic social finance.[1]

AN OVERVIEW OF UNDP SUSTAINABLE DEVELOPMENT GOALS (SDGs)

There are 17 SDGs, which can be divided into five groups: namely, [1] poverty and hunger, [2] health and education, [3] sustainable urban development, [4] climate change, and [5] oceans and forests. These goals are summarized in Table 1.

HOW DOES ISLAM LOOK AT SDGs?

Islam, as a humanitarian religion, does not oppose any of the SDGs listed above. In fact, Islam's general teachings and many of its specific tenets attempt to promote these goals. The Islamic approach to these SDGs may well be understood in light of the *maqasid al-Shari'ah* (the objectives of Islamic law), which can be summarized into protection of: [1] faith; [2] life [3] wealth; [4] intellect; and [5] posterity.[2]

The 17 SDGs, in a broad sense, may be considered an explication of the objectives of Shari'ah. There are numerous examples of the use of the institution of *waqf* for the reduction of poverty and hunger and provision of health services and education. *Zakah*, which is one of the five pillars of Islam, attempts to eradicate poverty and directly targets hunger.

The last three categories, namely, sustainable urban development, climate change, and oceans and forests are modern concerns but principles of Islamic teachings are not inconsistent with these goals.

> *There is a definite need to create greater awareness of SDGs among Islamic social financial institutions to harmonize the practices, procedures and products of such organizations with the SDGs.*

Table 1: Sustainable Development Goals (SDGs)

Poverty & Hunger	Health & Education	Sustainable Urban Development	Climate Change	Oceans & Forests
1. No Poverty	1. Good health and well-being	1. Decent work and economic growth	1. Affordable and clean energy	1. Life under water
2. Zero hunger	2. Quality education	2. Industry, innovation and infrastructure	2. Responsible consumption and production	2. Life on land
3. Gender equality	3. Clean water & sanitation	3. Sustainable cities and communities	3. Climate action	
4. Reduced inequalities				
1. Peace, justice and strong institutions				
2. Partnership for the goals				

Consequently, Islamic investment managers are adopting the SDGs for incorporation in the investment processes of Islamic funds. Two notable examples in this respect are the Islamic funds managed by the Saudi-based SEDCO Capital and the Shari'ah-compliant funds managed by Arabesque Asset Management. Such fund managers also subscribe to the United Nations' Principles for Responsible Investments (UNPRIs).

Furthermore, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) identifies 13 CSR activities for Islamic financial institutions to perform. These are presented in Table 2.

Table 2: AAOIFI's CSR Framework for Islamic Financial Institutions

Mandatory Activities	Recommended Activities
1. Policy for screening clients	1. Policy for *qard hasan*
2. Policy for responsible dealing with clients	2. Policy for reduction of adverse impact on the environment
3. Policy for earning and expenditures prohibited by Shari'ah	3. Policy for social, development and environment-based investment quotas
4. Policy for employee welfare	4. Policy for par excellence customer service
5. Policy for *zakah*	5. Policy for micro, small and medium enterprises
	6. Policy for social savings and investments
	7. Policy for management of *waqf* properties
	8. Policy for charitable activities

A Syrian mother and her son receive aid from charitable organizations at a refugee camp in Athens. Nice_Media_PRODUCTION / Shutterstock.com

These CSR activities are directly or indirectly related to the SDGs.

Outside traditional Islamic banking and finance models, financial technology (FinTech) is expected to play a significant role in the promotion of Islamic social finance. An increasing number of Islamic crowdfunding platforms and similar technological interventions are perceived as important stimuli to the development of Islamic social finance. Furthermore, Islamic charitable organizations (e.g. Islamic Relief Worldwide) have also emerged as active players in Islamic social finance.

Consequently, there is a definite need being felt to create greater awareness of SDGs among Islamic social financial institutions to harmonize the practices, procedures and products of such organizations with the SDGs. This remains a challenge, but not one that cannot be addressed effectively.

SOME RECOMMENDATIONS

The SDGs have been drawn from a secular approach to promote inclusive development. From an Islamic perspective, it is imperative that organizations like the United Nations are made aware of the Islamic requirements that must be embedded within the framework of SDGs. For example, the most important omitted reference in the SDGs is the prohibition of *riba* (interest). If the prohibition of interest in all its forms is incorporated in the SDGs, this will make it more comprehensive and all-inclusive, allowing more Islamic social financial institutions to adopt the SDGs without reservations.

By way of suggestion, it is recommended that "eradication of financial exploitation" may be added to the SDGs under Poverty and Hunger, and "protection and preservation of family life" may be added to Health & Education in Table 1. Also, a separate reference to hunger may be omitted, as it is embedded in "no poverty," and gender equality may be classified under reduced inequalities. This will keep the total number of SDGs restricted to 17.

FOOTNOTES:

1 Islamic social finance has been of a separate focus only recently. For example, Islamic Research & Training Institute (IRTI), a member of the Jeddah-based Islamic Development Bank, has only started publishing an annual Islamic Social Finance Report since 2014.

2 In some cases, posterity is replaced with self-esteem.

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PART 2

Shari'ah Rulings on Islamic Social Finance

SUMMARY

Muslim societies have benefitted from a spirit of charity and social equity found in Shari'ah for more than a millennium. However, since many Islamic legal rulings are a result of the *ijtihad* (intellectual reasoning) based on the Qur'an and the Sunnah, careful work by Shari'ah scholars is necessary to introduce Islamic social finance products and practices that give users confidence in their Islamic authenticity.

As many Shari'ah opinions reflect social needs of a time when cash was in far less common usage than the present, several *madhhabs* (schools of law) do not permit its use as the corpus (or foundational asset) for *waqf*, as they consider that exchanging cash for a tangible asset consumes its essence. However, other *madhhabs* and a growing group of contemporary Shari'ah scholars and international organizations now support this institution on the ground that money should be considered a fungible asset, and that permitting cash *waqf* may expand the benefits of the institution in society. These proponents tend to support the temporary cash *waqf* concept for similar reasons—in additon to the fact that it simply encourages a much larger number of contributors to use the institution.

The jurisprudence on *waqf* contains strict rules to protect the survival of *waqf* institutions as perpetual charities. This opens a number of considerations when establishing a *waqf* and choosing between many investment options in the present day. Priority must go to using *waqf* proceeds for the stipulated use in the *waqf* contract, then to proper management and upkeep of the *waqf* asset. Any surplus revenue from the *waqf* should be used either to improve the *waqf*, or it may be invested to produce greater returns in the future. Similar strict rules should also be observed in the investment of surplus *zakah* funds to ensure the rights of eligible recipients are properly safeguarded.

There are a number of ways that Shari'ah-compliant trusts may be established in Malaysia—for example, through *waqf*, gift, bequest or agency. This flexibiliy is a benefit for users with different requirements, as long as it is not used to violate the Islamic law of inheritance.

Success in raising increasingly larger sums of *zakah* and *sadaqah* funds in the wealthier countries of the Muslim world has raised the question of whether *zakah* may be used to help the poor in non-Muslim communities. Although the majority of Shari'ah scholars disallow distribution of *zakah* to non-Muslims for humanitarian purposes, some argue that allocating the surplus *zakah* funds to non-Muslims may be considered, provided that the interests of Muslims community and *zakah* recipients are not jeapordized. A prominent example of the generous utilization of surplus charitable funds is Dubai's Awqaf and Minors Affairs Foundation. Secretary General H.E. Tayeb al Rais has organized donations from the emirate to target a number of foreign aid programs, including the SALMA shelf-stable Halal meal program for distribution in areas with humanitarian crises.

SHARI'AH ISSUES IN CASH *WAQF*

Assoc. Prof. Dr. Said Bouheraoua

One of the fundamental approaches to acts of worship (*'ibadah*) in Islam is the preference for acts with transitive benefits (*al-manafi' al-muta'addiah*), acts that add value to the community and benefit society at large. This is in distinction to acts of intransitive benefit (*al-manafi' al-lazimah*) with benefits that are restricted to the person performing them. This fundamental is manifested in the *hadith* of the Prophet: "The best of people amongst you and the most loved by Allah is the one who brings benefit to people (others)" (Al-Albani, 1995: 2/574).

It is also a core objective of Shari'ah to serve the interests of all human beings and to save them from harm. This principle is well established in the concept and institution of *waqf* as it achieves the concept of transitive benefit. *Waqf* is seen as one of the most important constituents of the charitable and voluntary sector, which contributes to sustainable socio-economic development.

However, some recently proposed arrangements for *waqf* such as cash *waqf* and temporary *waqf* present Shari'ah issues that may make it inconsistent with the concept of transitive benefits. Certain Shari'ah scholars see these new concepts as not achieving the objective of *waqf* as a transitive benefit because of the perishable and non-permanent nature of the transaction. On the other hand, others believe they are still consistent with this concept, owing to the continuity of the benefit. The following is a short examination of these two issues.

CASH *WAQF*

The issue of cash *waqf* has been discussed by jurists under the rubric of *waqf* of "something that perishes by consumption" (*waqf al-mithliyat*), such as *waqf* of foodstuff. The essential purpose of *waqf* is to draw benefits from its usufruct, but to keep the corpus intact. However, in cash *waqf* the corpus (money) is consumed and therefore disappears. What may remain is its equivalent. This has impelled some jurists to reject such *waqf* and made some consider it abhorred (*makruh*). However, some jurists permit it although the corpus is perishable by consumption (Al-Mawsu'ah al-Fiqhiyyah, n.d.: 41/193).

According to Imam Abu Hanifah and Abu Yusuf (a prominent Hanafi jurist), the consensus opinion of the Hanbali and Shafi'i Schools and Ibn Shas and Ibn al-Hajib of the Maliki School, monetary *waqf* is not permissible (Ibn 'Abidin, 1992: 3/374; al-Ramli, n.d.: 5/263; Ibn Qudamah, 1968: 5/374). The reason for this position is that cash cannot be used while its original essence remains, since its usage requires it to perish by consuming its essence. This is in their view contrary to the principle of *waqf*, which is perpetuity.

On the other hand, Imam Malik and the Maliki School of law allow cash *waqf* if it is for the purpose of lending it to those in need. Later Hanbali scholars such as Ibn Taymiyyah (1995) also allow cash *waqf*. The outcome of the view of Muhammad ibn Hasan al-Shaybani is such *waqf* is permissible if it is accepted by custom and practised by people (Ibn Abidin, 1992: 3/37). There is also a narration of Zufar allowing cash *waqf*, and this is the stance of the later Hanafi scholars, who allow cash *waqf* based on the principle of custom and practice.

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Ministry of Endowments and Islamic affairs in foreground, Qatar. Imran's Photography / Shutterstock.com

Contemporary Islamic fatwa bodies have discussed whether cash can be considered a *waqf* asset or not. The overwhelming majority view is that cash *waqf* is permissible on the basis that the classical concept of money is no longer relevant. Proponents of this view include:

- The International Islamic Fiqh Academy of the Organisation of Islamic Cooperation (IFA-OIC) in its resolution issued in Muscat Oman in 2014;
- The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shari'ah Standard No. 33 on *Waqf*;
- Indonesian Act No. 41/2004, Article 12 (3) and Majelis Ulama Indonesia (2002);
- The 77th Conference of the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia held on 10th–12th April 2007.

> *"Allowing cash waqf means considering it a fixed asset that can be used for providing loans or in safe investment, and that it remains intact through the recovery of the principal."*

Many legislative bodies and other prominent scholars hold the same view. They argue that money is a fungible asset (*mal mithli*), and its equivalent can replace it. Hence, allowing cash *waqf* means considering it a fixed asset that can be used for providing loans or in safe investment, and that it remains intact through the recovery of the principal. In their view, this is consistent with the definition of *waqf*—the retention of an asset and the devotion of its profit or products.

Our preferred view is the permissibility of cash *waqf* as it is in line with the core objective of *waqf*: contribution to the improvement of individuals and society and assistance to those who are in need. In addition, the flexibility given by Muslim jurists in terms of types of assets including cash *waqf* generally support its permissibility.

TEMPORARY CASH *WAQF*

Muslim jurists hold two views regarding the temporality of *waqf*, which has in consequence affected their view on the permissibility of temporary cash *waqf*:

The Hanafi, Shafi'i and Hanbali Schools of law support the first view, that perpetuity is a condition for *waqf*. Thus, a condition to make *waqf* temporary renders it void (al-Mawsu'ah al-Fiqhiyah, n.d.: 41/193). Their core justifications are:

- *Waqf* is defined as renunciation of ownership without restrictions. Therefore, it is not to be limited to a specific period.
- Perpetuity was the established practice of the Prophet's companions and the scholars of the early generations.
- Temporality of *waqf* defeats the essence of *waqf* and its objectives.

In a second view, the Maliki School is the only group of jurists who explicitly accepted temporality in *waqf* by virtue of the will of the founder. Abu Yusuf of Hanafi School also permits temporary *waqf*, if supported by custom. It is also accepted by the later Hanafi scholars, Ibn Taymiyyah, and endorsed by the IFA-OIC and AAOIFI Shari'ah Standards. It is also accepted by the majority of contemporary scholars and stated in the regulations of Sudan, Egypt, Iraq, Syria, Iran, Turkey, India, Pakistan, Malaysia, Indonesia and Singapore.

The core arguments in the second view are:

- Perpetuity of the assets is not expressed in legal texts and is not held by consensus.

- Perpetuity has restrictive effects on the development of *waqf*. Therefore, perpetuity should not be the core characteristic of *waqf*.

- There is no reason for invalidating a *waqf* as long as it benefits the institution of *waqf* and the *ummah* as a whole.

- Charity and *ibadah* will be achieved with temporary *waqf*, as it will provide a benefit of usufruct during the temporary period and a benefit to the endower of the property (*waqif*), who may need his property in the future.

- Allowing it will encourage more people to establish *awqaf* and support charitable organizations.

With regards to temporary cash *waqf*, this occurs when the *waqif* lends his money for a specific duration and receives it back at the expiry of the period. The justification for temporary cash *waqf* is the outcome of the justification for the permissibility of cash *waqf* and of temporary *waqf*. It is also based on the permissibility of making conditional *waqf* as mentioned by Muslim jurists. This is in addition to the endorsement of cash *waqf* by the IFA-OIC, AAOIFI and most legislative bodies and prominent scholars.

The view supporting temporary cash *waqf* stands on a solid ground because:

- It does not contravene any explicit texts of the Qur'an and Sunnah.

- It broadens the scope of *waqf* and widens the range of contributors to its cause.

- It is consistent with the latest innovations in the area of charitable propositions.

- Its implementation has shown a great success. An apparent example of its success is the contribution of cash endowments in the overwhelming success of global renown educational and social institutions.

CONCLUSION

Innovation in *waqf* by proposing new approaches, arrangements and instruments that add value and benefit to the Muslim community should be welcomed and encouraged by Shari'ah, as it does not breach its core principles. Temporary cash *waqf* should be considered one of these positive innovations that contribute to the socio-economic sustainable development.

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INVESTING *WAQF* ASSETS: SHARI'AH RULINGS

Dr. Layachi Feddad

Investing *waqf* assets refers to increasing the wealth of endowments, both the underlying assets and the income, using Shari'ah-compliant methods (IFA, 2004). The Shari'ah calls for investing wealth in order to realize the Shari'ah objective of preserving and increasing wealth.

The investment of wealth is obligatory, as indicated by the texts of the Shari'ah and its general objectives. Allah says: "Do not entrust your properties—which Allah has made a means of support for you—to the feebleminded, but maintain and clothe them from it, and address them kindly" (al-Qur'an, 4:25). The phrase "from it" (*fiha*) indicates that guardians are commanded to make the properties of the feebleminded the source of their provision by doing business with it. The provision should ideally come from the profits rather than the capital (Al-Razi, 9:186).

In the same vein, the Prophet (SAW) advised guardians, "Seek [profits] in the wealth of orphans so that it is not consumed by *zakah*." A variant narration is worded, "Invest the wealth of orphans so that it is not consumed by *zakah*" (Al-Bayhaqi, 2003: 4/107). This article explores key rules in *waqf* investments and outlines some parameters for both investing *waqf* assets and proceeds.

RULES REGARDING INVESTING *WAQF* ASSETS

An asset that the endower has specified should be used for the direct benefit of the stipulated beneficiaries

A house for residence, a mosque for prayer, or a graveyard for burial—such endowments cannot be invested. The beneficiaries, whether they have been identified personally or by attributes, should be allowed to make use of the property as per the instructions of the endower (IFA, 2004).

As for the maintenance and repair of an endowment asset of this type, if the endower earmarked funds for maintenance, they should be used accordingly. If he did not make any provisions, then the most reasonable policy is for the maintenance to be the responsibility of the beneficiaries, if they have been specified. That is because they are the ones deriving benefit from the asset. Therefore, they have the duty of fixing whatever stops working in it (Al-Kubaysi, 1977: 2/193).

If the person having the right to reside in a house declines to pay for its maintenance, the judge shall lease it out and spend the rental income on the maintenance (Al-Sarakhsi, 1993: 6/221). If the beneficiary cannot spend resources upon the endowment due to his inability or absence, and it cannot be rented out, the property should be sold and the proceeds spent on another endowment property. The justification in this case is necessity, because of the lack of alternatives (Al-Ruhaybani, 1994: 4/242-243).

If the beneficiaries are not specific persons—for example, the poor in general—the most suitable opinion is that maintenance is the obligation of the public treasury (Al-Ruhaybani, 1994: 4/242-243). If the endowment property becomes useless, the administrator can exchange it for another asset that fulfils the objective and stipulations of the endower. That is in line with the juristic opinion that allows substitution in endowments. It is also possible to restore a non-functional *waqf* property by using the surplus of other endowments that have the same objective (Ibn Bayyih, 2005: 15-16).

> *The prevailing approach is that [waqf revenue] surplus should be invested even if the waqf is for the benefit of a mosque.*

An asset set up as a *waqf* that generates proceeds to be spent according to the endower's instructions

Jurists agree that the primary duty of the *waqf* administrator is to keep an asset functional, whether or not the endower stipulated it. Moreover, his actions regarding it must be limited by the consideration of securing benefit for the intended beneficiaries. That is why we see many jurists giving the administrator the right to act to realize their benefit, even if it means changing the features of the *waqf*, as long as the intention is to increase the benefit of the beneficiaries (Al-Tarabulsi, 1902: 62).

The administrator will not be able to realize the objective of the endower in making the asset inalienable and spending the proceeds on the intended beneficiaries unless he makes it productive. That is what will realize the social and economic benefits of the *waqf*. Jurists drew upon an assortment of evidence to support the permissibility of investing *waqf* assets, and these can be found in the books of *fiqh*.

The endower's stipulation that a portion of the asset's proceeds be invested in the asset to maintain its productivity

This stipulation is recognized by the Shari'ah and does not conflict with the nature and implications of *waqf*. It is similar to an endower's stipulation that the endowment asset be replaced with a productive asset in case it becomes non-functional. This has been confirmed by the resolution of the International Islamic Fiqh Academy of the Organisation of Islamic Cooperation (IFA-OIC) and the resolutions and recommendations of the First Seminar on *Waqf Fiqh* Issues (IFA, 2004; First Seminar, Investment, item 4).

Investing the *waqf* proceeds

The term *ray'* linguistically means growth and surplus as well as proceeds and revenue (Al-Nasafi, n.d.: 146). Technically, it refers to the crops produced by a piece of land, the fruit produced by trees, and the revenue from leasing land or animals (Wizarat al-Awqaf, 23:207). With regard to *waqf*, it refers to the income generated by investment of endowment assets, whether they are land, cash, securities or some other form of wealth.

The investment of the *waqf* proceeds is ruled permissible if the endower stipulated it or did not mention it one way or another. The basis for the latter case is the realization of benefit for the endowment (Ibn Bayyih: 18). If it is a family *waqf*, where the beneficiaries are the progeny of the endower, their permission is required (IFA, 2004). This is what the resolution of the IFA-OIC has affirmed (IFA, 2004).

Investing the surplus *waqf* revenue

The surplus *waqf* revenue is what remains after the proceeds have been distributed to the beneficiaries and the expenses and allocations have been deducted (First Seminar, Investment, item 6). The basic rule for *waqf* revenue is that it should be distributed among the beneficiaries according to the stipulations of the endower. However, a surplus in the *waqf* revenue can arise resulting from the magnitude of the proceeds, a drop in the number of beneficiaries, the disappearance of a stipulated channel for charitable spending, a sharp drop in administrative and maintenance expenses, or for some other reasons.

These factors can result in proceeds that are not fully distributed. The question thus arises: is it possible to invest such funds by purchasing assets similar to the assets of that *waqf* to create another *waqf* whose proceeds are spent for the same purpose as the original *waqf*? Alternatively, should they be spent for other general charitable purposes, which could also be considered an investment of the surplus? Jurists have a number of approaches; however, the prevailing approach is that the surplus should be invested even if the *waqf* is for the benefit of a mosque. The administrator should use it to purchase real estate, and if the ruler decides it should be turned into a *waqf* for a stipulated group of beneficiaries, it will become a *waqf*. This opinion has been transmitted from Imam al-Ghazali (Al-Manawi, 1998: 2/316-317). The resolution of the First Seminar on *Waqf Fiqh* Issues stated that it is permissible to invest the surplus proceeds after the proceeds have been distributed to the beneficiaries and the expenses and allocations have been deducted (First Seminar, Investment, item 6). The previously mentioned resolution of the IFA-OIC affirmed the same (IFA, 2004).

Investing allocations and funds gathered from the proceeds

Waqf allocations are the funds set aside as provisions for the depreciation of the endowment asset, its maintenance and restoration, or receivables owed to the *waqf* but whose collection is doubtful. It comprises a fixed percentage deducted from the revenue in accordance with recognized accounting practices. As for the funds gathered from the proceeds, these are funds whose distribution to the beneficiaries has been delayed for one reason or another.

From this, it is clear that allocations are funds set aside for the maintenance and repair of the *waqf* to enable investment activity achieving the objective of the endower, which depends on the permanent alienation of the asset and the channelling of its revenue for a benevolent purpose. The pooled funds that have not yet been distributed take the same ruling, as do other funds of similar nature, such as the amount fixed for replacement of *waqf* elements that are destroyed or unlawfully seized (Al-Shu'ayb, 2003: 9).

The Parameters for Investment of *Waqf* Assets and Proceeds

To insure efficient and equitable investment of *waqf* assets and proceeds, the IFA-OIC in its First Seminar in 2004 stipulated the following parameters:

1. The investment avenue should be Shari'ah-compliant.

2. Due consideration should be given to the instructions of the endower which restrict the endowment administrator in the way the *waqf* assets are invested.

3. Risky investments should be avoided.

4. The investment portfolio should be diversified in order to reduce risk.

5. Economic feasibility studies should guide the *waqf* projects.

6. Investment formats should be chosen that are consistent with the nature of the endowment in order to achieve the interests of the *waqf* and avoid the beneficiaries' loss of their rights.

7. Effort should be made to realize social benefits from the *waqf* investments without sacrificing the profits that benefit the intended recipients.

CONCLUSION

The Shari'ah sets flexible and proactive measures to investing *waqf* assets. However, it has put in place comprehensive parameters in order to ensure prudent investments of these assets especially assets of public and charitable (orphans') institution. This shows that all innovative approaches to investment are welcomed and well supported by Shari'ah as long as they adhere to these *maqasidi* parameters.

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ZAKAH INVESTMENT: A *FIQHI* PERSPECTIVE

Dr. Marjan Muhammad

Z*akah* investment is a way of managing *zakah* funds to increase *zakah* recipients' (*asnaf*) future benefits. Although *zakah* recipients, *zakah* payers or *zakah* collectors may be involved in investing these funds, this article focuses only on *zakah* investment by the collector, i.e. a government or authorized entity responsible for collecting and distributing *zakah* to recipients. It outlines the Shari'ah rulings and conditions governing *zakah* investment and gives a snapshot of contemporary methods of *zakah* investment.

SHARI'AH RULINGS ON *ZAKAH* INVESTMENT

The ruling on *zakah* requires its immediate distribution to recipients when all conditions are met (al-Nawawi, 2002; Ibn Qudamah, 2009). Hence, scholars have different opinions regarding investing *zakah* funds to maximize their returns (Shabeer, n.d.). The majority of contemporary Muslim scholars, including Mustafa al-Zarqa, Yusuf al-Qaradawi, Abdul Fattah Abu Ghuddah, Abdul Aziz al-Khayyat, Hasan Abdullah Amin, Abdul Salam al-Abbadi, and Muhammad Farooq al-Nabhan, allow *zakah* investment. In 1986, the International Islamic Fiqh Academy of the Organisation of Islamic Cooperation (IFA-OIC) also resolved that *zakah* funds can be used for investment projects subject to certain conditions. The Shari'ah committee of Kuwait Zakat House adopted the same view in 1986, as has the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in its Shari'ah Standard No. 35 on *Zakah* (Para 10/4). Nonetheless, some scholars including Wahbah al-Zuhayli, Muhammad Taqi Usmani, Muhammad Ataa al-Sayyid and Abdullah Ulwan have taken an opposing view.

The proponents of *zakah* investment believe:

1. The practice is allowed, as the majority of scholars (except Shafi'is) are of the opinion that a ruler can allocate the state's entire *zakah* funds to a specific category of recipients only (for example, the poor and needy). Hence, the ruler can also use the *zakah* funds for investment that would secure benefits (*maslahah*) for the recipients with the profits generated from the investment (Haneef, 2013).

2. It is permitted, considering certain jurists (e.g. al-Jassas from the Hanafi School) allow a delay in paying *zakah* to its recipients and prompt delivery is not mandatory, based on several narrations. Al-Bukhari reported that 'Some people from the Uraynah tribe came to Madinah and its climate did not suit them. So Allah's Messenger (SAW) allowed them to go to the herd of camels (given as *zakah*) and they drank their milk and urine (as medicine) (*hadith* no. 577). This shows that the Prophet (SAW) allowed *zakah*, especially in the form of livestock, to be used in a productive manner before its distribution.

3. It is in line with the objectives of Shari'ah that aim to promote a prosperous and affluent Muslim society by all possible means. The Prophet (SAW) said that the needy should be enabled to earn their livelihood on a permanent basis (Abu Dawud, *hadith* no. 86).

4. It is allowable if it does not lead to losses when prudently managed.

On the other hand, the opponents argue:

1. *Zakah* investment contravenes the principle of transfer of ownership (*tamlik*) from the payers to the recipients.

2. It contradicts the majority opinion on immediate distribution of *zakah* funds.

3. It leads to the reservation of *zakah* funds for future needs, denying the present economic needs of recipients.

4. Finally, it may incur losses, which will negatively impact recipients with no one to bear such losses (Shabeer, n.d).

CONDITIONS OF *ZAKAH* INVESTMENT

Based on the above arguments, this article is in favour of the proponents' view, which allows *zakah* investment. However, this allowance should be subject to certain conditions (Mujaini, 2006; Wan Ahmad & Mohamad, 2012; Saad et al., 2016):

1. Only non-distributed or surplus funds can be invested, after allocating the consumptive and functional needs of the recipients.

2. Ownership of the invested *zakah* funds (both principal and profit) should be granted to the recipients. For example, if *zakah* funds are used to purchase tools and machinery for agriculture or manufacturing, they should be granted to the recipients who are able to benefit from them. If the fund is used to build projects that generate specific revenues (such as shop lots), the recipients should own the projects either by self-managing or appointing others to manage them on their behalf on the basis of agency (*wakalah*) or profit-sharing (*mudarabah*).

3. If *zakah* funds are invested in service projects such as schools, hospitals and shelter centres, the following conditions must be observed:

   - only *zakah* recipients can benefit from these services, while others should pay fees, which will eventually be distributed to the recipients; and
   - if the projects are sold or liquidated, the revenues belong to the *zakah* fund.

4. Extra due diligence and prudence should be observed in investing *zakah* to avoid losses of *zakah* funds.

5. Investments should be in accordance with Islamic law.

DIFFERENT MECHANICS FOR *ZAKAH* INVESTMENT

Based on the opinion of contemporary scholars who allow *zakah* investment, there are many suggestions (Haneef, 2013) about ways authorities should invest their *zakah* funds, including:

1. Establishing *mudarabah* ventures between the *zakah* authority (as capital provider) and *zakah* recipients (as working partners/entrepreneurs), where the profits are shared based on an agreed ratio;

2. Giving interest-free loans to the recipients; and

3. Building houses and renting to recipients at a very low cost.

Many Muslim countries have introduced *zakah* systems accommodating investment. For instance, Kuwait *Zakat* House adopts different approaches for its *zakah* investment (Haneef, 2013), including:

1. It keeps *zakah* funds in two types of bank accounts, namely current and savings accounts. Its earnings on savings accounts increases the original funds deposited with the bank.

2. It provides interest-free loans to people in need of money and secures their repayment by way of instalments.

3. It finances vocational training to help the needy become productive citizens (under its "productive rehabilitation scheme").

4. It sponsors poor students' education by offering them interest-free loans.

In Malaysia, *zakah* is managed by the State Islamic Religious Council (SIRCs) or established entities set up by SIRCs for the investment of undistributed or excess *zakah* funds. Different states invest the surplus amount in different ways. For instance, the Islamic Religious Council of the Federal Territories (MAWIP) invests in both financial assets such as fixed-term deposit accounts and unit trusts. Meanwhile, the Selangor Zakat Fund (LZS) invests in projects and programmes which directly meet the needs of different recipients such as individual and cluster capital assistance for start-ups, business expansion and other income-generating projects like lands, shop lots, etc. (Wan Ahmad, 2012).

CONCLUSION

It is undeniable that *zakah* investment enables *zakah* institutions to reach more eligible recipients particularly the poor and needy, as the profits generated can enlarge the pool of *zakah* funds. This can be a means of gradually eradicating poverty, enhancing social development, and promoting community empowerment. Nonetheless, such investments should not transgress the parameters outlined by the scholars to ensure *zakah* funds are distributed according to the Shari'ah, and to avoid any mismanagement. A desire to reap investment profits should not in any way jeopardize the rights of *zakah* recipients.

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DISTRIBUTION OF *ZAKAH* FUNDS AMONG NON-MUSLIMS FOR HUMANITARIAN PURPOSES: A SHARI'AH PERSPECTIVE

Lokmanulhakim Hussain

Islam, as both a religion and a socioeconomic system, considers *zakah* one of its five pillars. *Zakah* is mentioned in the Qur'an more than 100 times, solely or in conjunction with other commandments. In addition to being an act of worship that denotes the connection between a person and Allah (SWT), *zakah* also provides a connection between the giver and the recipient. It helps create a spirit of togetherness in society that plays a vital role in economic development.

As an instrumental tool for alleviating poverty and therefore for achieving social and economic justice, some believe that the distribution of *zakah* funds should not be confined to Muslims only. Rather, charity should transcend the religious belief of recipients, especially in countries that have multiple religious communities. Accordingly, this article analyses whether *zakah* funds can be distributed to non-Muslims for humanitarian purposes if they are categorized as *fuqara'* (poor), *masakin* (needy), *gharimin* (indebted people) or *ibn al-sabil* (wayfarers).

JURISTIC VIEWS AND ARGUMENTS ON THE ISSUE

From the perspective of Shari'ah, *zakah* distribution must be implemented in accordance with the provisions of Islamic legal sources, as *zakah* is included in the category of worship that must abide by the maxim that reads "the basic rule for acts of worship is to limit their rulings to what is prescribed in the divine legal texts, i.e. the Qur'an and Sunnah" (Al-Asqalani, 1379H: 3/54).

Scholars have differing views on the issue of distributing *zakah* to non-Muslims for humanitarian purposes. These include aid to the *fuqara'*, *masakin*, indebted people or wayfarers. The majority of scholars do not allow it. In fact, some scholars like Ibn al-Mundhir (1420H: 48) and Ibn al-Qattan (1424H: 1/224) have cited the consensus of the scholars on its impermissibility. The main evidence supporting the majority's view is the *hadith* narrated by Muadh ibn Jabal, who reported that the Prophet (SAW) said, "Tell them that Allah has made the payment of *zakah* obligatory upon them. It should be collected from their rich and distributed among their poor." This *hadith* orders *zakah* to be distributed to the poor amongst the people from whom the *zakah* is collected. Therefore, it would be against the legal ruling to distribute *zakah* among non-Muslims (Al-Kasani, 1406H: 2/49).

Meanwhile, a minority opinion attributed to al-Zuhri, Ibn Sirin and Zufar from the Hanafi School allows *zakah* to be given to non-Muslims (Al-Imrani, 1421H: 3/441; Al-Sarakhsi, 1414H: 2/202). Proponents of this view cite their interpretation that the words *fuqara'* and *masakin* in the Qur'anic verse (al-Tawbah: 60) are mentioned in general. This may literally be interpreted to include non-Muslims as well. Therefore, some Hanafi scholars argue that this opinion is based on sound reasoning, in which the objective of distributing *zakah* to the poor is achieved through its distribution to both Muslims and non-Muslims (Al-Sarakhsi, 1414H: 2/202).

The opinion that allows *zakah* distribution to non-Muslims is also in line with the Hanafi's methodology on *qiyas*. They consider interpreting the terms *fuqara'* and *masakin* to be specific for Muslims only (i.e. to exclude non-Muslims)

as an addition to the legal text which is regarded as an abrogation (*faskh*) and is thus impermissible. Hanafis claimed that if it were not for the popularity of the *hadith* narrated by Muadh, the minority's opinion on this issue is very strong, to the extent that Al-Marghinani (n.d.: 1/111) said, "If it were not for the *hadith* narrated by Muadh, we would be of the view that it is allowed [to distribute *zakah* among non-Muslims]".

Besides, the minority's opinion is supported by some general evidence permitting Muslims to do good and to deal kindly with non-Muslims, among them a Qur'anic verse that states, "Allah does not forbid you respecting those who have not made war against you on account of (your) religion, and have not driven you forth from your homes, that you deal with them kindly and justly" (Al-Mumtahanah: 7). This verse is generally interpreted as allowing *zakah* distribution among non-Muslims, for such is regarded as "dealing with them kindly". In addition to the above-mentioned arguments, the minority view relies on several weak and disputed narrations that allow distribution of *zakah* to non-Muslims.

PREFERRED OPINION

Premised on the *hadith* narrated by Muadh, which is undoubtedly authentic and clearly provides specific evidence on the issue, this article prefers the majority's opinion since the *hadith* cannot be challenged by the general evidence presented by the opponents.

However, taking into account that the juristic consensus on the issue—as claimed by some scholars—has been disputed by some contemporary scholars such as al-Qaradawi (1427H: 2/715), the minority's opinion can still be adopted and practised. This is especially in the cases of need, where there are surpluses of *zakah* funds, or if allocating a portion of *zakah* funds to non-Muslims would not adversely affect the interest of the general public, particularly the Muslim community and specifically eligible Muslim recipients.

From another perspective, distributing *zakah* to non-Muslims can also be considered a way of attracting them to Islam. If this purpose is taken into consideration, non-Muslim recipients may be categorised as *al-mu'allafah qulubuhum* (those whose hearts are won over), where the majority of scholars opine that the category of *al-mu'allafah qulubuhum* includes non-Muslims who are anticipated to convert to Islam. However, distributing *zakah* to non-Muslims in this category must be implemented in accordance with the objectives of Shari'ah and Islamic government policy (*siyasah shar'iyyah*), so that the very purposes of *zakah* distribution under this category can be achieved.

"*From another perspective, distributing zakah to non-Muslims can also be considered a way of attracting them to Islam.*"

CONCLUSION

In conclusion, there is disagreement among scholars on the issue of *zakah* distribution to non-Muslims. If this distribution is for humanitarian purposes including *al-fuqara'*, *al-masakin*, *al-gharimun* or *ibn al-sabil*, the *zakah* funds are not allowed to be distributed to non-Muslims, except under necessary conditions where the rights of Muslim recipients are fully safeguarded. Nonetheless, for the purpose of preaching Islam, the category of *al-mu'allafah qulubuhum* includes non-Muslims.

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SHARI'AH ISSUES IN ISLAMIC TRUST SERVICES: THE CASE OF ESTATE PLANNING IN MALAYSIA

Munawwaruzzaman Mahmud, Ahmad Firdaus Kadir and Nur Fathin Khairul Anuar

Trust services refer to a fiduciary relationship in which a **trustor** gives the right to the **trustee** to hold the title of a property or asset for the benefit of the **beneficiary**. The application of trust services in the Islamic finance sphere can be observed in the role of trustee in sukuk issuance, unit trusts and fund management, where such trusts are established to safeguard the interest of investors in such instruments. In Malaysia, all trust products and services are governed by the Trust Companies Act 1949. This article explores some Shari'ah issues pertaining to trust services in estate planning in Malaysia and identifies the most appropriate underlying Shari'ah contract for the services and the ruling of revocability.

TRUST SERVICES IN ESTATE PLANNING IN MALAYSIA

Trust services have emerged as an instrument to facilitate financial planning and the financial security of individuals and their families, as well as to protect family estates and legacies. Bad preparation for inheritance may cause significant loss of wealth and family disunity. Shari'ah, in its overarching objectives, seeks the fair distribution of estates to legal heirs. However, estate distributions in Malaysia involve several legal processes and this may hamper smooth distribution. In some circumstances, it may even cause the estate to go unclaimed. Thus, trust services offer an alternative tool in ensuring efficient and effective Islamic estate management that aims at preserving the rights of eligible heirs as well as beneficiaries.

SHARI'AH ISSUES IN ISLAMIC TRUST SERVICES

Some Shari'ah issues pertaining to Islamic trust services are explained below.

Fiqh Characterization (*Takyif Fiqhi*) of Trust

There is ambiguity over the suitable *fiqh* characterization for the structure of Islamic trusts. This is because the concept of Islamic trust services and its application in today's world are considered new and it does not fall under the category of nominated contracts (*'uqud musamma*), which refer to a class of contracts to which Shari'ah has assigned specific names and handled in detailed their respective rules and stipulations. Thus, *fiqh* characterization of the appropriate underlying contract that can be utilized is required for the structuring and execution of Islamic trusts.

Various contracts can be considered in structuring Islamic trusts: these include *wakalah* (agency), *hibah* (gift), *wasiyyah* (bequest), *wisayah* (trusteeship), and *waqf* (Islamic endowment). A trust may also be constructed through a combination of these contracts. As such, adherence to respective contracts' inherent natures and specific requirements must be observed if such contracts are utilized for the structure of Islamic trusts. This is to ensure the validity of trust services' transaction in the eyes of Shari'ah.

In Malaysia, *hibah* is more commonly used in structuring Islamic trusts. However, *hibah* might not be suitable to be used in meeting certain specific requirements of trust services in which the transfer of ownership for the trust assets shall only occur upon the death of the trustor. This

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Double storey luxury terrace house scheme under construction at Sendayan, Malaysia. Aisyaqilumaranas / Shutterstock.com

is because *hibah* takes effect immediately upon execution, such that the ownership of the gift shall be immediately transferred from the donor to the recipient during the lifetime of the donor. If the execution of *hibah* is made conditional (*hibah mu'allaqah*) to the death of the donor/trustor, the rulings of *wasiyyah* shall be implemented, and *hibah* is thus disregarded. Hence, thorough Shari'ah analysis should be done in determining the appropriate underlying financial contract for the structuring of Islamic trust services. This is to ensure the validity of the utilized contracts, while at the same time, to preserve the objectives and requirements of the trust services.

Revocability of Trust

Revocability is also one of the contentious issues to be resolved in the establishment of trust. This is due to the demands of certain trustors who like to have this feature in the trust deed to satisfy their specific requirements and to mitigate uncertainty in the future. For example, the trustor may stipulate that the beneficiaries can only own and enjoy the trust assets if certain conditions set by the trustor are met. If the conditions are not met, then transfer of the said asset shall not occur.

In the event that *hibah* is utilized as the underlying contract, the trust assets cannot be revoked unless they are given by parents to their children, or the contract applies a future condition excluding death. For the former, it is narrated by the Prophet (SAW):

> It is not permissible for a man to give a gift then take it back, except what a father gives to his child. (At-Tirmidhi (1996), vol. 4, pg. 10: 2132)

Imam Al-Mahalli (2013) further explains the related ruling. He explains that the right of revocation for gifts given to a child is not restricted to only fathers and that all of the child's elders (*usul*) that comprise of his mother, grandfathers, and grandmothers from both maternal and paternal sides are also entitled to the same right. Thus, revocability of trust services can only be executed for the said situation if *hibah* is the underlying contract.

> *A trust requires proper governance in its structuring and execution to ensure that the objectives of trust services are achieved without providing room for manipulation.*

Apart from *hibah*, *waqf* can also be utilized to structure trust services. If the trust is developed based on the concept of *waqf*, the trust would then be irrevocable. Hence, to allow revocability, the application of temporary *waqf* permitted by some Maliki scholars may be explored.

Ownership Transfer with the Enjoyment of Certain Benefits Being Retained with the Trustor

Many trustors subscribe to trust because they want a smooth estate transfer process for their heirs, but they wish to continue enjoying the usufruct of their asset throughout their lifetime.

Such a feature denies the concept of *al-milk al-tamm* (complete legal and beneficial ownership) upon the transfer of assets, as this limits the beneficial ownership of the beneficiaries in such a way that they are required to share the rights to benefit from the assets with the trustor for as long as he lives. Thus, this structure might trigger Shari'ah issues, which in turn might affect the validity of trust services from the Shari'ah perspective. Nevertheless, in enhancing the structure, the concept of stipulating conditions in contracts (*al-ishtirat fi al-'uqud*) deliberated by Ibn Taimiyyah can be explored for the purpose of resolving the issue. This concept allows flexibility in setting conditions for the execution of contracts and is reinforced by the following *hadith*:

> It was narrated from Jabir: While I was riding a (slow) and tired camel, the Prophet (SAW) passed by and beat it and prayed for Allah's blessings for it. The camel became so fast as it had never been before. The Prophet then said: "Sell it to me for one Uqiyya (of gold). I said, "No." He again said, "Sell it to me for one Uqiyya (of gold)". I sold it and stipulated that I should ride it to my house (Al-Bukhari, 1993: 2569)

Thus, for the purpose of the establishment of Islamic trusts, the trustor may give the asset to the intended beneficiaries while setting the condition that the asset will still be enjoyed by the trustor, although the legal ownership of the asset has been given to the beneficiaries. Only upon the demise of either trustor or beneficiary will the asset be fully transferred in the former situation or be transferred to the heirs of the beneficiary in the latter.

Manipulation of Trust Services

A trust account does not constitute part of the distributable estate under Islamic inheritance law. Thus, the trustor may allocate a portion of the estate to be held in trust for a particular beneficiary for a particular purpose. Trust accounts are also legally constituted and cannot be challenged.

Notwithstanding that trust services may address the needs of the trustor to pass his wealth to those he believes to be more needing of it, this option can also be used to violate the existing Islamic law of inheritance in order to protect the interests of some but not others. There is possibility that a trustor may set up a trust with the intention of preventing certain heirs from receiving their rightful allocations that have been prescribed by Islam. Thus, a trust requires proper governance in its structuring and execution to ensure that the objectives of trust services are achieved without providing room for manipulation.

CONCLUSION

It is evident that there is no specific Shari'ah requirement prescribed for the structuring of Islamic trust services. Therefore, *ijtihad* (intellectual reasoning) should be made in determining the appropriate underlying contracts that can be utilized for its structure. Utilizing *'uqud musamma*, a combination of them, or even innovative Shari'ah judgments can be considered in establishing the structure of a trust to cater for the specific requirements that a trust may have, within the boundaries of Shari'ah.

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INTERVIEW WITH HIS EXCELLENCY TAYEB AL RAIS

AWQAF & MINOR AFFAIRS FOUNDATION

With the current unrest in Middle East, we are witnessing large numbers of Muslims being displaced from their homes and seeking refuge in other countries, causing a humanitarian crisis in the region.

What are the steps being taken by Awqaf & Minor Affairs Foundation (AMAF) to address this crisis?

The United Arab Emirates (UAE) is a recognized donor nation that responds to humanitarian causes everywhere, and Dubai is home to the International Humanitarian City. Like many Non-governmental organizations (NGOs) and similar government initiatives that interact directly with refugees and displaced populations, we have been actively engaged in humanitarian aid for refugees as well as disaster relief since 2014 Ramadan. At that time, the SALMA Humanitarian Relief initiative (www.salmaaid.com) was launched by HH Sheikh Mohammed bin Rashid. SALMA is a shelf-stable, highly nutritious *halal* food pouch that saves lives used by the Red Crescent, United Nations World Food Program (UN WFP), United Nations High Commissioner for Refugees (UNHCR) and other relief agencies. This year, in Ramadan, we are working with the business community in Dubai to support this strategic initiative.

What are the practical issues in dealing with humanitarian crisis?

Often the greatest difficulty is just to transport and deliver basic needs like food, water and shelter to areas that are often difficult to reach and sometimes close to the conflict zone. The mass displacement of a population means that the people affected have nothing and must start over from zero. It is important to get the essentials of life to them—for instance, in a package like SALMA designed expressly for this purpose.

Through the SALMA Humanitarian relief program, how is AMAF helping to promote Islamic social finance and consequently boost the Islamic economy?

SALMA is one of the key initiatives identified by the Dubai Islamic Economy Development Centre five-year plan. In examining the SALMA program, the centre determined it was an important initiative that may not add directly to the growth of the Islamic economy, but that certainly embodies the spirit of Islam in supporting all who need help. SALMA is a symbol of the commitment by Dubai and the UAE to helping where help is needed.

What are some of the challenges faced by AMAF in distributing aid globally?

As mentioned before, the real challenges are in just getting the aid to where it is required. Fortunately, we can work with specialist agencies and NGOs that do this on a global scale.

One of the main themes for promoting the UN WFP Sustainable Development Goals is to eradicate poverty and eliminate hunger.

How has AMAF sought to support the achievement of these goals?

We are *waqf*-based—*waqf* is in itself a financial system firmly built on the principle of sustainability. We are fully committed to alleviating poverty by fighting hunger. This is a terrible cycle that refugee displacement issues generate immediately. This year we are working with UN WFP to support their school feeding program, which was developed to help keep children in school as long as possible. Better education always means better opportunities—a direct action against poverty.

The Middle East has a significant population of high net worth individuals,some of whom have signed on to the "Giving Pledge" to donate half of their wealth to charity and philanthropic initiatives.

How is AMAF seeking to utilize the pledges of these individuals for social development?

Our experience has shown that every donor often has a special cause that

Our global organization is still in the early formation stages, but we are a channel for the first international dialogue dedicated to promoting waqf and awqaf on a global basis.

touches his or her heart. And sometimes that cause is part of what we do. But our policy is to work with any and all donors—whether they give AED 10 for a SALMA meal, or millions to support education for our minor orphan children. These very generous donors, who have decided to share their wealth and blessings with those in need, are role models for social responsibility.

What is the roadmap in the next five to ten years that AMAF will be working on in terms of global humanitarian development? How does AMAF view its role in elevating Islamic social finance?

As mentioned, SALMA Humanitarian Aid is a key initiative identified by the Dubai Islamic Economy Development Centre (DIEDC) five-year plan as announced this year. Another key initiative identified by DIEDC is the Awqaf International Organization announced last October at the Global Islamic Economy Summit 2016. Our global organization is still in the early formation stages but we are a channel for the first international dialogue dedicated to promoting *waqf* and *awqaf* on a global basis. We are here, we are committed, and we welcome your support.

HE TAYEB ABDELRAHMAN AL RAIS is Secretary General of Awqaf & Minors Affairs Foundation (AMAF) in Dubai. Since 2009, he has led an organization devoted to supporting nearly 2,700 orphans through the investment of *waqf*-based trust funds. A board member of Noor Awqaf (AMAF's private sector arm) and Union Co-op's Fresh and One, he also serves on the University of Wollongong's External Advisory Council. As the Founding President of the Awqaf International Organization, he aims to advance Awqaf organizations on a global scale. After graduating from Toledo Ohio's Engineering College with Honors, he has worked in the Dubai Police, General Motors, and as Managing Director of Liberty Automobiles and COO of Dubai Government's SAMA development group.

PART 3

Legal and Regulatory Aspects of Islamic Social Finance

Summary

Shari‘ah is not the only legal system that governs the operations of Islamic social finance. In the present day, all social finance institutions are also subject to state regulations and legal codes of the jurisdictions in which they operate. Among majority-Muslim countries, there is a significant range in both the state’s stance on the establishment of Islamic law in general as well as its administration of specific aspects of Muslim practice and institutions. For example, certain states govern and administer mosques, religious education and charity more directly, while others leave the management of such matters to the private sector. Proponents of Islamic social finance are working to create frameworks that encourage growth and professionalism in these services around the world in a way that is also sensitive to conditions in any given country.

As a pillar of Islam, *zakah* (almsgiving) is obligatory by law and collected by the government in certain countries such as Saudi Arabia and Malaysia, but it remains voluntary and primarily administered by private organizations in many other Muslim-majority states. In federal states, often times certain provinces have different policies than others. Ultimately, jurisdictions seek to achieve increased *zakah* collections via “sticks” and “carrots.” While various penalties and surveillance characterize the “sticks,” “carrot” incentives such as tax deductions and strong governance and transparency that engage the population and encourage them to donate are generally more productive.

Similarly, there is a wide variety in states’ treatment of *awqaf* (Islamic endowments). Some states manage all *awqaf* directly through government ministries, while others register *awqaf* and regulate their administration by independent trustees. During the colonial era, certain states nationalized much *waqf* property and some still strictly regulate the creation of new *waqf* property. Meanwhile, in minority-Muslim states that do not officially recognize Shari‘ah as a source of law, Muslims have recently established *awqaf* as secular institutions by charter, voluntarily enforcing Shari‘ah. Muslims seeking to establish trusts in different jurisdictions therefore need to be sensitive to both the appropriate state legal forms to follow to establish a secure settlement, and also may consider Shari‘ah-compliant forms outside of *waqf* to achieve the optimal effects. Dr. Aida Othman from ZICOLaw says a crucial factor in encouraging the use of Islamic social finance is the education of Islamic finance professionals who are familiar with both state regulation and Shari‘ah to provide clients with clarity and assurance in these revived financial practices.

LEGAL AND REGULATORY ASPECTS OF *AWQAF*

Dr. Tunku Alina Alias

W*aqf* (Islamic endowment, pl. *awqaf*) has been the preferred vehicle by which Muslims ensure continuing posthumous merit. According to classical Islamic traditions, there were two categories of *awqaf*: (i) *awqaf* which exist by operation of divine law, i.e. mosques, and (ii) *awqaf* that are created by declaration and endowment, i.e. endowments giving rise to colleges, residential colleges for students, shrines, public benefit facilities such as travellers' lodgings, hospitals, bath houses, soup kitchens, and later, family *awqaf*. A third category of more recent times is the *jam'iyyah*, an association of individuals from a family or status group that pursue a common goal.

In the 16th century, cash *waqf* was introduced, referring to the endowment of cash by one person whereby the revenue from the investment of the cash would be used towards charitable purposes (Cizakca, 2004). Recently, this has evolved into the endowment of shares in incorporated joint-stock companies, resulting in a *waqf* of stock.

REGULATORY LANDSCAPE

Broadly, today there are three models of *waqf* regulation throughout the world:

1. State controlled *awqaf*, whereby *waqf* assets are vested in and administered by centralized state agencies;

2. State registered *awqaf*, with an oversight ministry or agency supervising the day-to-day management of *waqf* assets by a private or state-appointed administrator (*nazir*) or trustee (*mutawalli*); and

3. Incorporated *awqaf* existing under state charter. These include both de jure *awqaf* and de facto *awqaf* established under state law as organized institutions.

A fourth model is the absence of regulation, but where *awqaf* have been completely expropriated by the state.

STATE-CONTROLLED *AWQAF*

Countries adopting this model have a centralized government ministry or agency in which all *awqaf* are vested and are thus governed. Depending on the country, either federal or regional (including state or provincial) governments might be responsible for *awqaf*. Generally, the countries that inherited this model were previously colonized by the British, such as India, Pakistan, Singapore and Malaysia (except Johor[1]), or were British protectorates or mandates. Governments (whether federal or provincial/state) are self-supervising and, although required to manage the revenue and expenses of their administrative machinery, they often do not publish financial accounts for *awqaf*. Thus, there is a lack of transparency and accountability, leading to opacity in governance standards.

STATE-REGISTERED *AWQAF*

This regulatory model reflects the classical Abbasid (Persian) form of *waqf* administration. Usually, there is an oversight body (in the form

of the *qadi* courts or a ministry) supervising autonomous trustees, who manage the respective *waqf* on a day-to-day basis. These trustees are required to submit periodical reports and accounts to the oversight body. This model is used in Bangladesh, Indonesia, Iran and the state of Johor in Malaysia. In Indonesia, a cash *waqf* is required to be maintained with specified deposit takers, such as one of the numerous Baitul Mal wat Tamwil (BMT) and Shari'ah-compliant banking institutions only. In Iran, trustees are required to prepare accounts and endowment funds are to be held in a separate account from that of the trustee's account which that are audited by the Endowment and Benevolent Affairs Organisation (EBAO).

INCORPORATED *AWQAF*

Muslims living in civil law and common law jurisdictions often establish *awqaf* by charter, incorporating them as secular institutions such as charities, charitable companies by guarantee, foundations or associations. A review of these institutions in USA, Spain, Brazil, South Africa, New Zealand, Labuan[2] (offshore Malaysia) and mainland Malaysia (for example Al-Bukhari Foundation) itself will reveal *awqaf* in spirit, albeit not in form. Turkey, because of its European accession plans, has modernized its laws pertaining to *awqaf*[3] whereby two forms are recognized: association (suitable for community *waqf*) and vakif (for *awqaf* by endowment). Governance and accountability standards are compulsory in these jurisdictions.

EXPROPRIATED PUBLIC *AWQAF* AND ABOLISHED PRIVATE *AWQAF*

Countries that came under the French sphere of influence adopted the anti-substitution (trusts) approach to abolish *awqaf* completely or in part. *Waqf* properties and lands were expro-

> *Muslims living in civil law and common law jurisdictions often establish awqaf by charter, incorporating them as secular institutions such as charities, charitable companies by guarantee, foundations or associations.*

priated by the state. These countries include Syria, Lebanon, Morocco, Tunisia and Algeria. In former Ottoman regions that later became socialist or communist countries, such as in Egypt, Greece, western regions of Russia and Bosnia-Herzegovina (as part of Yugoslavia), *waqf* lands were nationalized.

DEVELOPMENT OF *WAQF* ASSETS AND INVESTMENTS

Programs for the development of *waqf* assets are evident in some of the state-controlled regulatory models. Singapore, through its Majlis Ugama Islam Singapura (MUIS) has been at the forefront of *waqf* assets regeneration and sustainability utilising loans from Baitulmal or the General Endowment Fund, as well as *waqf* sukuk, REITs and cash *waqf*.

In Malaysia, access to funding poses a great challenge to the State Islamic Religious Councils (SIRCs) in their efforts to develop *waqf* lands, although financial support is given by the Malaysian Federal Government to the SIRCs.

TAX

Awqaf established and operating under common law or civil law jurisdictions are often organized in such a way as to take advantage of tax benefits accruing to other non-profit or charitable institutions. These include tax exemptions on certain categories of income. Moreover, donations to the institutions are tax-deductible or given as a tax credit.

In Turkey, new tax incentives were introduced after 2008, whereby donations to all *awqaf*, with or without public benefit status, are exempted from gift and inheritance taxes. All donations made for maintenance, reparation, restoration and landscaping of cultural properties belonging to *awqaf* are now fully deductible from income or corporate taxes.

Awqaf in state-controlled regulatory models may or may not receive special tax treatment. In Malaysia, they are considered government assets and therefore any income is not taxable. However, *waqf* assets are still subject to property tax and municipal assessment. In Saudi Arabia, *awqaf* are not exempt from *zakah*.

THE WAY FORWARD

Waqf has never just been a vehicle for piety. Instead, it has fulfilled many socio-economic roles that meet the needs and demands of the community. As an organic economic institution, capable of generating income and growth, equipping it with the necessary tools to meet the challenges of the 21st century is vital to development of the community. Prospective donors or founders of a *waqf* should be given the option of incorporating the *waqf* and having it governed by an independent board of trustees. Civil society works differently today. As is happening in Turkey, groups of people should be allowed to organize and found a community *waqf*, adopting the concept of crowd-funding and leveraging technology.

The benefits of *waqf* might be expanded to address the needs of the 21st century society, including promoting public safety and security, the family, women's and girls' issues, culture, recreation and sports, and the environment. Today, the conversation surrounding *waqf* should include governance (including transparency), investment choices, income generating activities, checks and balances, and professionalism. There ought to be support for *awqaf* that provide public benefit in the form of tax privileges.

In conclusion, from a legal perspective, work on the law of fiduciaries, governance frameworks, a code of ethics for trustees, compensation for professional *waqf* personnel and managers must commence in order for the *waqf* to modernize.

FOOTNOTES:

1 Johor was recognized as a sovereign state by the British through the Anglo-Johor Treaty of 1885, and Johor courts applies sovereign (i.e. Islamic) law pursuant to Courts Enactments (1911, 1914, 1920 and 1935).

2 Labuan Foundations Act 2010. A *waqf* is to be formally established as a Labuan foundation. As Labuan is an offshore tax haven, only non-Malaysian property may be the subject of the endowment of a Labuan foundation.

3 Vakiflar Kanunu or Foundations Law 2008 (Law 5737).

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LEGAL AND REGULATORY ASPECTS OF *ZAKAH*

Dr. Mohammed Obaidullah

Traditionally, most Muslim societies have viewed *zakah* as a purely religious matter. In such countries, *zakah* is managed entirely by the state apparatus dealing with religious affairs. In other countries where secularism is the official policy, the state sees no role for itself in religious matters and leaves *zakah* management to individuals and non-state actors. In yet another set of countries, the state takes a proactive role in *zakah* management, even while the task of *zakah* collection and distribution remains in the private domain. These countries have sought to create an enabling environment for *zakah* management and its integration with the financial system. This article presents the global diversity of *zakah* regulations and laws for *zakah* collection, distribution, management, governance, transparency and accountability.

ZAKAH COLLECTION AND DISTRIBUTION

Zakah is levied by the state in a few countries, such as Saudi Arabia, Malaysia, Sudan and Pakistan. It is voluntary in most other countries, including ones with elaborated *zakah* management infrastructure, such as Indonesia. Nigeria is an interesting case. Of the nine provinces that have opted for Shari'ah as the basis of legislation, four states have made *zakah* payment compulsory, while the remaining five have left *zakah* payment to individuals. When *zakah* payment is compulsory, the way the states ensure compliance is much stricter using both "carrots" and "sticks," compared to a "carrots only" policy in a voluntary regime.

Considering "sticks" first, such laws may prescribe physical and/or financial penalty against non-payment (e.g. in Malaysia and Nigeria). It must be noted here that such provisions in law are seldom enforced for a variety of reasons. Primary among them is perhaps the reluctance to enforce Shari'ah law in a population marked by great religious and cultural diversity. Law may also provide for the forced recovery of due and unpaid *zakah* (e.g. in Sudan).

Incentivizing *zakah* payment may also involve "carrots" (e.g. in the form of tax benefits). Tax incentives for *zakah* payment usually take two forms. Some states permit the deduction of *zakah* paid from taxable earnings (e.g. Indonesia, Pakistan and most other countries). Others permit deduction of *zakah* paid from tax payable, as in case of Saudi Arabia and Malaysia. Tax rebates make sense in the latter countries, where law does not permit non-state actors to collect *zakah*.

Sudanese law includes the only piece of legislation that comprehensively provides all such rules pertaining to the collection of *zakah*. It explicitly provides the general conditions relating to the *zakah* liability, various admissible methods for the estimation of the *zakah* base and applicable rates of levy, and the assets, output, and earnings that are exempt from *zakah*. Indonesian law does not go beyond identifying various eligible assets for *zakah*, and refrains from providing the applicable rates and method of calculating *zakah* liability. It merely asserts that the terms and method of *zakah* calculation should be in accordance with Islamic law.

Sudan is also the only jurisdiction that provides a detailed explanation of how to define the *asnaf* (beneficiaries) deemed eligible in the eyes of the Shari'ah. It clearly articulates a priority scheme

> *A unique feature of zakah laws in a few Nigerian states like Zamfara is the provision for self-distribution by the zakah payer.*

for distribution, giving a clear preference to the poor and the needy, as well as local distribution. On the contrary, most laws simply contain a general requirement that the collection and distribution of *zakah* must be in conformity with Shari'ah. For example, Indonesian law prescribes *zakah* to be distributed to a *mustahik* (an eligible recipient) in accordance with Islamic law and based on priority after considering the principles of equity, justice and territorial proximity. It clearly stipulates that *zakah* can be used for productive activities to address poverty and to improve the quality of life, but only after fulfilling the basic needs of the *mustahik*. In no other country do laws deal with the issue of the prioritization of *zakah* distribution.

A unique feature of *zakah* laws in a few Nigerian states like Zamfara is the provision for self-distribution by the *muzakki* (*zakah* payer). These laws also provide for the investment of undistributed *zakah* surplus.

MANAGEMENT AND GOVERNANCE OF *ZAKAH* INSTITUTIONS

In states where *zakah* is compulsory, the management of *zakah* is invariably entrusted to state-created institutions. In Saudi Arabia, the Department of *Zakah* and Income Taxes (DZIT) ensures a fully integrated *zakah* and tax system. In Malaysia, with its federal structure of government, all matters pertaining to Islam including *zakah* fall directly under the Sultan of the province or state. Under him, the State Islamic Religious Council (SIRC) is the sole entity empowered to collect and distribute *zakah*.

In Sudan, the Diwan *Zakah* is the apex body, established as an independent corporate body. Sudan provides an excellent example of *zakah* law in which the Diwan is empowered to set regulations, enforce *zakah* collection, seek any information from any individual or entity for determination of its *zakah* liability, demand any kind of assistance from other state agencies that is deemed necessary for effective *zakah* collection, and enforce *zakah* distribution. A specific feature of Sudanese *zakah* law makes a range of commercial and financial transactions contingent upon the presentation of a *zakah* compliance certificate, and it thus ensures better *zakah* compliance.[1] Malaysian law is less comprehensive and uniquely empowers the SIRCs to punish unauthorized collection and payment.

Several countries where *zakah* payment is voluntary also have *zakah* laws under which a dedicated apex body for *zakah* management has been created. Examples include: the National Zakat Board or Badan Amil Zakat Nasional (BAZNAS) in Indonesia, the Majlis Ugama Islam Singapura (MUIS) in Singapore, Departments of *Zakah* in Pakistan and Bangladesh and the like. Such bodies have been empowered to set regulations pertaining to *zakah* management.

Zakah laws also contain provisions relating to the governance of *zakah* infrastructure. For example, Sudanese and Indonesian law provides for detailed rules and criteria for membership and executive positions in the apex agencies, the constitution of a Shari'ah body for advising the agency in matters that require formulation of new regulations and rules and that have Shari'ah implications, and financial provision for agencies to cover their expenditures.

The use of *zakah* proceeds for covering operational expenditures incurred on the management of *zakah* is a critical governance issue. Here, alternative provisions are possible. The state may provide finance to cover operational expenditure of the apex *zakah* body (as in Brunei Darussalam). Alternately, the *zakah* body may be permitted to use part of *zakah* collected (subject to a cap) to absorb operational expenditure (as in Sudan and Indonesia).

A key requirement of Shari'ah governance in *zakah* management is the separation of *zakah* funds from other forms of charity funds collected. However, only Indonesian law clearly provides for this, stipulating that all non-*zakah* charity funds must be recorded in a separate book.

TRANSPARENCY AND ACCOUNTABILITY

Laws in Sudan and Indonesia put strong emphasis on the transparency in books of accounts and accountability of *zakah* officials to the public. As a principle of good governance, laws should provide for strong deterrents in the form of financial penalty and/or physical punishments for dereliction of duty, fraud, and dishonesty on the part of *zakah* officials. Dereliction of duty by *zakah* officials may take several forms, such as the violation of confidentiality of information provided by *zakah* payers. In Sudan, the Diwan is held fully accountable for ensuring the confidentiality of information provided by individuals and businesses. *Zakah* laws in Indonesia provide for strict deterrents in the form of financial penalty and/or physical punishments against fraud, dishonesty and misappropriation of *zakah* funds. There are also strict deterrents in the form of financial penalty and/or physical punishments against Shari'ah non-compliance.

CONCLUSION

This review of the legal and regulatory environment for *zakah* in various countries underlined the need for proactive reforms in response to changing times and in the light of new social realities. Indonesia and Sudan present two good examples of enabling legal and regulatory environments applicable, respectively, for voluntary and compulsory *zakah* regimes.

FOOTNOTES:

1 However, the sweeping coverage of the provision itself raises questions regarding its practicality, as its enforcement by the Diwan requires a high degree of cooperation by and coordination with other government agencies.

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The Islamic Center of Washington, D.C., USA, opened in 1957.

LEGAL AND REGULATORY ASPECTS OF TRUSTS

Dr. Hurriyah El Islamy

'Finders keepers' is an established principle under common law from its origin in Roman law. This means that if someone finds something of value and he keeps it, the possessor of that property is considered its rightful owner, unless it is proved to the contrary. The position of Islamic law, however, differs. The Mejelle (the Ottoman Code of Islamic law), for example, specifically stipulates that if one finds something that belongs to others and takes it, it is considered either theft, if the intent is to keep it, or trust, if the intent is to return it to the owner. This is an important element of the Shari'ah's protection of one's rights beyond title or possession. It also forms the basis for the law of trust as we know it in modern times. This article examines the notion of trust in both common law and Islamic law and the applicable legal framework in select countries, namely England, Bahrain and Malaysia.

ABOUT TRUST

People invest their wealth to preserve it. Trust is a way to achieve that and more. Trust allows a settlor to have his assets managed in the manner and for the benefit of the people he chooses.

There are usually three parties to a trust: the settlor, who parts with the asset(s) to create a trust, the trustee, who receives and manages the trust asset(s), and the beneficiaries, who should benefit from the trust.

A trust instrument defines the trust. However, trust can be created when the settlor has identified the asset and passes it to the trustee for the benefit of the beneficiaries. The line is harder to draw when the settlor declares himself as the trustee.

In common law jurisdictions, trust is deployed to achieve the specific goal of the settlor to ensure his wealth is invested and managed for the benefit of selected people, usually after his death. Often, the settlor creates a trust to avoid the application of other laws that may result in the distribution or administration of his estate in a manner he does not prefer. The purpose can be charitable or for private distribution of wealth, and it can also work to deny the rights of some people who otherwise would have benefitted from the estate had the settlor died intestate.

This is one of the areas where Islamic law differs from common law. While one has the freedom to dispose of his property as he wishes during his lifetime, he cannot deprive the right of the heirs by way of will, even for a charitable purpose, without the consent of the heirs. Shari'ah places some parameters to inheritance to ensure justice is served. For example, no one can will away all his property to his horse because he was upset with his family before his death.

TRUST AND ISLAMIC LAW

Many believe that the English trust law has its root in the rules of equity. This includes the notions that the law should give recognition to the rightful owner as opposed to the registered one and should not deprive the rights of the beneficiary. Moreover, it helps those whose interests cannot be registered by law be recognized anyway so justice will prevail.

What many fail to appreciate is that the English trusts owe their origins from the *waqf* (Islamic endowment) system. The notion that the trustee should fulfill its duties according to applicable terms are well stipulated in the Qur'an (among others, 2:83; 4:58; 8:27). Many have written on the historical traces of the two; coincidently the evidence of similarity can also be seen in the recent Shari'ah rulings on *waqf* in the AAOIFI Shari'ah Standard No. 33. In fact, *waqf* is just one instrument under the Islamic law where the principle of trust is deployed. The notion of trust is deployed in other forms of Islamic transactions such as will, agency, gift and custody.

Trust can be applied through *wasiyyah* (will), however, a Muslim settlor's power is subject to *fara'id* (Islamic law of inheritance). Therefore, a trust made through a will or incomplete trust will be effective only if the beneficiary is not an heir eligible for inheritance and the gift does not exceed one-third of the settlor's wealth. The trust with respect to any beneficiary who is also an heir under *faraid* is only effective when all eligible heirs did not express any objection. In the event there is an objection, then the rules of *fara'id* shall prevail.

Trust is also found in other Shari'ah principles, such as *wakalah* (agency) and *wadiah* (custody). In terms of living trust, it is treated as *hibah* (gift *inter vivos*). Generally, *hibah* cannot be revoked after delivery without mutual consent of parties or the court order. Nonetheless, fathers can revoke *hibah* in favour of children if the gift is not in line with the laws or spirit of Shari'ah. There are other conditions applicable to *hibah* that do not limit trust, for example: future *hibah* is not valid (while future *waqf* is valid), death of a donor or beneficiary before delivery makes the gift void, and the thing bestowed as gift must be in existence at the time the gift is made. There are also limits to the beneficiary and the size of the gift one may wish to make during a mortal sickness.

As legal systems developed, however, different jurisdictions adopted different approaches in terms of legal framework. Society imposed certain rules that drew the principles apart from Shari'ah. In England, for example, the Court of Chancery and then legislation introduced restrictions against giving benefits in perpetuity in the case of non-charitable trusts. In common law, people opt to use trust in wills for their tax implications and the non-revocability of certain trusts.

THE REGULATORY FRAMEWORK

Trust in England

The legal framework that establishes parameters for trust law differs from one jurisdiction to another. In England, the Trustee Act 2000 replaced the previous law issued in 1925. The new law has, among other things, broadened the investment power of trustees. However, a settlor generally has the freedom either to follow the law or to dictate his terms through the trust instrument. There are some exceptions with specific trusts, where the statutes dictate certain rules as mandatory, such as in the Pension Act 1995, the Charities Act 2011 and the Financial Services Markets Act 2000. Other statutes in the UK that govern trust include the UK Trusts of Land and Appointment of Trustees Act 1996.

The English legal system does not recognize *waqf*. Thus, any person who would like to ensure his wealth invested or managed in a certain manner will have to do it either through trust (charitable or otherwise) or by establishing a foundation (usually charitable). While trusts and foundations can be an alternative to *waqf*, these options may not seem practical when dealing with wealth of not significant value due to the tax

implications as well as management expenses. Be that as it may, trusts and foundations would be the applicable tools for social finance in common law countries that do not recognize *waqf*. To constitute a valid trust, its purpose must be specified and the beneficiaries must be identifiable. That puts some constraints on trusts that do not apply to *waqf*.

Trust in Bahrain

The position of Bahrain is unique. Bahrain is a civil law country. Civil law countries do not usually recognize the notion of trust and the idea of beneficial ownership. Nonetheless, such principles have found their place in Bahrain. They are embedded within the relevant provisions of the Civil Code of Bahrain, which is based on the Mejelle. This is due to the influence of Shari'ah, which the country's constitution declares as the principal source for legislation.

Therefore, *waqf* is legally recognized; in fact, the government has separated Sunni and Ja'fariyyah *waqf* directorates, and the central bank handles the *waqf* fund for the country. Bahrain has a separate law on financial trusts issued in 2016, which replaced a decade-old predecessor financial trust law of 2006. These matters fall within the jurisdiction of the Central Bank. Among interesting features of the new law, the terms of trusts may stipulate that certain aspects of trusts, such as their administration, be subjected to certain chosen laws (even foreign ones) different from the law relating to the trust.

Trust in Malaysia

The laws in Malaysia can be found in several statutes such as the Trustee Act 1949, Trust Companies Act 1949, the Trust (State Legislatures Competency) Act 1949, the Public Trustees Act 1950, the Housing Trust Act 1950, the Trustees (Incorporation) Act 1952, the National Trust Fund Act 1950, and some provisions in the Income Tax Act 1967 and section 134 of the Local Government Act 1976.

In Malaysia, trust matters are regarded as civil matters. Thus, any dispute is heard by the civil courts, as opposed to the Shari'ah courts. This is in line with the inclusion of 'equity and trusts' in the administration of justice included in List I — Federal List of the Federal Constitution. The courts held that *fara'id* does not apply when the trust has been created and the civil law requirements relating thereto are fulfilled. Hence, it could be said that in Malaysia, trust is treated as such, without looking at the religion of the settlor, when the trust is completely created during the lifetime of the settlor.

CONCLUSION

Despite having its root in *waqf*, the law of trust has developed with certain distinctive features in different jurisdictions. Trust is generally treated as such in England and Malaysia, and not restricted solely or mainly to financial trust, while in Bahrain, the general connotation of trust is financial trust, although this may change following the introduction of the 2016 law. The judiciary will consider the applicable laws irrespective of the origin of trust. Even when Shari'ah is recognized in a given jurisdiction, it has yet to be seen if the courts will consider Shari'ah requirements in determining the validity of trust.

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INTERVIEW WITH DR. AIDA OTHMAN

ZICOLAW

Islamic social finance has until recently suffered from a lack of awareness as a concept in Islamic finance overall.

How can Islamic finance professionals help address this gap, particularly at legal firms that are responsible for drafting legal documents for Islamic financial products?

In order to promote awareness about Islamic finance initiatives that focus on social impact, industry players should organize programmes to explain such instruments and to highlight success stories in the conventional and Islamic spheres. Shari'ah concepts that inherently promote social benefit, such as *waqf*, ought to be creatively explored at such events and other forums. This includes incorporating the subject into the syllabi of Islamic finance coursework at various higher education institutions.

There is no impediment to implement social impact financial initiatives, particularly in Malaysia, where demand and liquidity are abundant, and the legal framework is sound. Islamic financial institutions (IFIs) and other organizations such as religious councils ought to explore how they can emulate initiatives such as Khazanah's socially responsible investment (SRI) sukuk or Majlis Ugama Islam Singapore (MUIS) *waqf* sukuk.

Accordingly, lawyers and others may be drafting terms that they have not encountered before, such as stipulating the waiver of profits by sukuk holders when the schools selected for the sukuk achieves the performance target (as in the Khazanah SRI sukuk). However, with time, more and more experts will become familiar with the drafting skills required.

How has Islamic social finance generally performed compared to socially responsible finance at conventional institutions?

Despite the inherent emphasis in the Shari'ah on activities that promote social good and charitable endeavours, Islamic social finance appears to follow in the steps of the conventional initiatives of "social finance" that began worldwide at the end of last decade. It is a movement based on the belief that financial innovation can be used directly to help society's neediest people.

However, the precursors to such initiatives can also be traced to the vision and efforts of Malaysia's Pilgrimage Fund, which began in the 1960s, and the Mit Ghamr Savings Bank in Egypt. Directly or indirectly, the operations of IFIs and Islamic funds do promote ethical activities and screen for unethical and oppressive practices.

Nevertheless, considering the spirit and objectives of the Shari'ah, specific Islamic finance initiatives in this regard are still lacking overall. They trail behind social finance projects that have already taken off significantly in the West to benefit social, environmental and educational objectives.

What are the main legal and regulatory challenges that are hindering the growth of Islamic social finance?

There are no legal and regulatory obstacles for implementing social finance in Malaysia. Once an institution, organization or public authority resolves to implement a social finance initiative, the structuring and required legal documentation can be achieved with multiple types of expertise. Experts from financial, Shari'ah, tax and legal backgrounds often form the team to structure a transaction and draw up the legal documentation for it.

However, for some *waqf*-based social finance structures, since the management of *awqaf* is regulated and monitored by the State Islamic Religious Councils (SIRCs), the cooperation and approvals of these councils are essential in spearheading those projects.

For some countries, a lack of clarity in their legal and regulatory framework will hinder all types of finance initiatives, social or otherwise.

> *Given the condition that waqf is irrevocable and perpetual, it can be a long-term instrument for economic development.*

***Waqf* and *hibah* are viable tools to donate and give one's wealth for charitable purposes.**

How do you believe demand for establishing *awqaf* and *hibah*-based products such as trusts will develop across Southeast Asia?

Overall, the awareness and demand for *awqaf* and *hibah* vehicles and instruments including trusts and foundations are growing. There is a huge potential for Islamic social finance in the Southeast Asia because of the Muslim-majority population in countries like Indonesia, Malaysia and Brunei.

The gradual integration brought about by the ASEAN Economic Community (AEC) initiatives may increase consideration of these vehicles to unite Muslim communities from various Asian countries. One of the aims of the AEC will be financial integration in ASEAN particularly in the banking industry. As part of the ASEAN Financial Integration Framework (AFIF), central bank governors of ASEAN member states decided to create the ASEAN Banking Integration Framework (ABIF).

It is hoped that Islamic banks will also be able to grow in ASEAN. Thanks to this plan, in which products based on *hibah* and *waqf* may be featured and regulated in multiple jurisdictions. For example, a high net worth individual from Laos, which has no framework for Islamic vehicles, may consider a Labuan international *waqf* foundation to pool funds from inside and outside Laos and to deploy those funds to deserving projects throughout Asia and beyond.

What trends do you see in the clientele seeking *waqf* and *hibah* advice?

The types of clientele seeking *waqf* and *hibah* advice vary from individuals to corporate institutions as well as government and semi-governmental organizations. Their main objective is to get a clear understanding from both Shari'ah and legal perspectives of the nature and regulatory framework governing *waqf* and *hibah*, and to get expert advice on their structuring options to achieve their objectives. They would like to ensure the execution of their instrument or project is compliant with existing regulatory requirements and optimal from various perspectives.

Do you think that *waqf* and *hibah* can be effectively employed to shape the future of Islamic social finance?

Yes, *waqf* and *hibah* are concepts for Islamic philanthropy that can play a significant role in managing some socio-economic problems in society.


REGULATIONS
COMPLIA
POLICIES

They may also benefit non-Muslim society if properly regulated, structured and administered. *Waqf*, for example, is quite similar to voluntary endowment in conventional practice. Given the condition that *waqf* is irrevocable and perpetual, it can be a long-term instrument for economic development.

What are legal and regulatory issues and challenges in executing *waqf* and *hibah* in Muslim countries and in Malaysia?

There is no clear legal and regulatory framework for regulating and implementing *waqf* and *hibah* structures in many countries.

One of the legal and regulatory issues arises from the fact that Islamic societies are typically characterized by different schools of Islamic law, including on the implementation of *waqf* and *hibah*. In some countries, Muslim communities may resist regulation of *waqf* and *hibah*. Regulators need to come up with specific laws that retain enough flexibility to accommodate alternative views in order to further expand the practice of Islamic social finance globally.

Without a proper regulatory framework, there will be a lack of transparency and integrity in the management of *waqf* and *hibah* properties, which will cause a negative perception of Islamic social finance initiatives based on those two concepts. Since the establishment of *waqf* and *hibah* occurs on a voluntary and charitable basis, regulators should ensure good governance practices and efficiency in their implementation to encourage participation in these initiatives and to develop public confidence in them.

What are other potential instruments that can be developed to promote Islamic social finance apart from *zakah*, *waqf* and *hibah*?

Other potential instruments for Islamic social finance are Islamic microfinance, takaful, sukuk issuances, crowdfunding and an Islamic institution which could provide financing through business partnerships and trade, etc. and is not trapped by the restrictions that limit Islamic banks. For example, such organizations could provide takaful through the mutual, non-commercial model or partnership-based financing facilities without the capital cost restrictions faced by Islamic banks.

From a legal perspective, in your opinion, what can be done to further enhance the practice of Islamic social finance as a pillar of Islamic finance?

1. Specific tax incentives for relevant structures and institutions to promote exploration and implementation of Islamic social finance initiatives.

2. Collaboration between religious councils in Malaysia to pool funds and efforts in facilitating Islamic social finance projects.

3. Collaboration between AEC countries to mutually explore regional Islamic social finance initiatives and to assist Muslim communities throughout Asia.

4. Proactive policies that encourage Islamic social finance projects from government, public bodies and semi-governmental organizations, as in Western countries.

5. Development of efficient and good governance practices, including supervision and audit, in executing Islamic social finance initiatives that includes collaboration with private institutions to increase confidence in both, and to encourage participation from the public.

6. Standardization of accounting practices to ensure charity or *zakah* funds are directly channelled into the hands of eligible beneficiaries, instead of being credited to an organization's capital.

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PART 4

Latest Innovations in Islamic Social Finance Product Development and Structuring

Summary

The deepending interest and expertise in social finance at Islamic financial institutions (IFIs), as well as development of technology, has helped widen the appeal of Islamic forms of charity. An important consideration in encouraging the adoption of *waqf* as the basis for long-term charity is both increasing the flexibility of the contribution to and investment of *waqf* assets and the quality of *waqf* administration. The advent of professional *waqf* administration at specialised *waqf* banks is paving the way in this field. Banks are focusing on establishing corporate *waqfs* backed by either cash or real estate. IFIs bring an ideal set of skills and resources to this task, including structuring investment and finance for *waqf* assets in Shari'ah-compliant way, as well as centralized Shari'ah supervisory and audit services.

One significant variant on the *waqf* bank is the *waqf*-share, which allows multiple donors to make proportional donations for a larger project of perpetual charity than they could establish as individuals. This phenomenon is getting support and development with the application of financial technology (fintech). With advanced internet usage, many institutions have begun introducing crowdfunding for *awqaf*. The internet does not only allow the secure submisison of small payments from many donors, but it can provide them with comprehensive information and transparency that gives donors a strong personal connection to the *waqf* projects undertaken. On the mass-recipient side, improved technology and regulation has allowed the spread of microtakaful (Islamic microinsurance), permitting more working class Indonesians to enjoy Shari'ah-compliant protection than ever before.

As *zakah* collection becomes more integrated with Islamic finance principles, practitioners are negotiating the possibility of investing *zakah* to multiply its social effects. Although certain Shari'ah opinions oppose any delay in giving *zakah* to the eligible recipients, others permit the investment of surplus funds in Shari'ah-compliant instruments, or to provide *qard hasan* or subsidized housing to the poor. Another important aspect in improving the collection, administration and use of *zakah* funds is in improving the governance of *zakah* institutions and the transparent reporting of their operations. The Indonesian National Zakat Board or Badan Amil Zakat Nasional (BAZNAS) is taking the lead in this area by preparing to issue an annual report that will measure overall participation by both individual and institutional *zakah* payers, as well as the use of *zakah* funds, across different cities and provinces. It will summarize the findings with an easy-to-understand National Zakat Index (NZI) that will allow the government and public to assess improvements over time.

MICROTAKAFUL IN INDONESIA: PRESENT AND FUTURE

Dr. Mohammad Mahbubi Ali

Indonesia is one of the most attractive Islamic financial markets in Asia, as it is home to the world's largest Muslim population and Southeast Asia's biggest economy. The country has huge potential for growth in Islamic finance, including microtakaful.

Microtakaful is an important yet untapped segment of Islamic finance. This is particularly true considering approximately 115 million Indonesians fall into the lower-income category. The fact that micro, small and medium enterprises (MSMEs) accounted for 99.99% of business enterprises in the country and 97.16% of employment in 2013 further highlights the undisputable potential of this segment (Ministry of Cooperative and Small and Medium Enterprises, 2013). The penetration rate of the takaful industry in Indonesia stood at only 0.08% in 2015, a sign that there is much scope for the sector to grow.

Indonesia's positive economic outlook bodes well for the development of microtakaful. Amid the global economic slump, it recorded an impressive real GDP per capita growth of 5.02% in 2016, one of the world's highest rates of economic growth after China and India. In addition, microtakaful has evolved as an indispensable step in the natural evolution of the Islamic banking and finance industry in Indonesia. The early development of Islamic finance in the country concentrated on Islamic banking, takaful schemes and Shari'ah-compliant stocks. However, the last decade has witnessed considerable attention, particularly from regulators, on various microfinancing initiatives, including microtakaful services. The Financial Services Authority of Indonesia (FSA) listed microtakaful in its financial inclusion agenda as an important segment for broadening financial access to the un-bankable and underserved.

PRESENT CONDITIONS

Microtakaful is a mechanism to provide Shari'ah-based protection to working-class and underprivileged individuals at an affordable cost (Khan, 2016). Its development in Indonesia has unfolded at the same pace as the takaful industry worldwide. At present, Indonesian microtakaful products are offered via two main channels: full-fledged takaful operators and takaful windows, as detailed in Table 1.

Currently, there are 14 microtakaful products available in the market, ranging from credit life, to personal accident, motor, disability, education, hospitalisation and dengue fever policies. These are sold to the market via a number of distribution channels, such as individual agents (including branchless-banking agents), Islamic banks, Islamic micro-institutions (i.e. Baitul Maal wat Tamwil and Shari'ah cooperatives), and affinity businesses (i.e. pawnshops and post offices). For example, BMT Sidogiri, the largest Islamic cooperative in the country with approximately 400,000 members, offers ASyKi (microtakaful broker) services, and has managed to reach more than 14,000 small business entities and 40,000 members via their credit scheme (AFC, 2014).

DEVELOPMENTS IN REGULATION AND PUBLIC AWARENESS

The FSA is the central government body regulating and supervising financial institutions in Indonesia. Currently, microtakaful is governed

Table 1: Microtakaful Providers in Indonesia

Types	Name of Takaful Operator	Products
1. Full-fledged takaful operators	PT. Asuransi Takaful Keluarga (Life)	In partnership with TAKMIN, it introduced credit life, additional lives, motor and personal accident (PA) products to microfinance institutions (MFIs)
	PT. Al-Amin (Life)	Health and PA microtakaful products to students and teachers in schools
	PT. Amanah Githa (Life)	In partnership with ASyKi and Baitul Maal wat Tamwil (BMT) Sidogiri, offers life and PA microtakaful products
2. Takaful windows	PT. Asuransi Allianz Life Indonesia	Microtakaful credit life, in partnership with MFIs
	Adira Insurance	Syariah Dengue Fever Product
	PT. Asuransi Jiwa Bumiputera	Microtakaful credit life, motorcycle protection product and Shari'ah compliant investment-linked product
	BRIngin Life	Group and individual microtakaful products

Source: AFC (2014)

> *“A regulation that requires all takaful companies to allocate a certain percentage of their portfolio for microtakaful products would certainly increase the supply of microtakaful to the market.”*

under the existing 18 PMK (Finance Ministry Rules or Peraturan Menteri Keuangan) and FSA Regulation (POJK) or FSA Circular Letters (SEOJK). For that reason, regulatory reform and enhancement has become an important strategic development focus to create a level playing field and conducive environment for the microtakaful segment to prosper. On 17 October 2013, the FSA launched the Grand Design on the Development of Microinsurance in Indonesia, which serves as a regulatory framework and reference source for insurance/takaful players and other stakeholders in developing microtakaful and microinsurance in Indonesia (Mukhlasin, n.d.). To encourage professional development, the FSA hosted a number of workshops and conferences, including workshops on actuarial aspects, distribution channels and product features.

Another important strategy to promote the microtakaful market in Indonesia is the on-going public awareness campaign. The FSA has visited 34 communities across provinces to study the potential of microtakaful as well as the best approach for public awareness. In 2015, the FSA and industry conducted microinsurance/microtakaful roadshows in 16 provinces. The FSA also launched a dedicated website on microinsurance and microtakaful to instil public understanding and awareness of the importance of such products.

THE WAY FORWARD

Notwithstanding these efforts, the development of microtakaful in Indonesia is hampered by a number of complex issues and challenges owing to internal and external factors. The internal factors include the paucity of skilful professionals with technical experience and actuarial expertise, a shortage of products that meet people’s needs, and a lack of information technology infrastructure. The external factors are the need for dedicated regulations governing the microtakaful business and better public awareness, the lack of which has resulted in a low penetration rate.

Therefore, the FSA will play an instrumental role in developing regulations that can incentivise the development of microtakaful in Indonesia from both the demand and supply sides. A regulation that requires all takaful companies to allocate a certain percentage of their portfolio for micro-takaful products would certainly increase the supply of microtakaful to the market. On the other hand, a regulation that requires the general public to have some sort of coverage for certain assets, such as vehicle, or life, such as permanent disability, would contribute to the growth in demand for microtakaful.

Moreover, as part of financial inclusion programs, microtakaful promotion should be combined with other financial inclusion initiatives, such as digital payment and branchless banking. More importantly, effective and continuous campaigns are necessary to increase public awareness and understanding about the importance and benefits of microtakaful. It will be essential to offer customer-friendly operations and to develop the use of technological tools in order to help people to participate more easily in microtakaful schemes.

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THE EMERGENCE OF THE *WAQF* BANK

Hussain Al Qemzi

The concept of *waqf* is rooted in a spirit of selfless charity. It is an Islamic endowment, or a perpetual charity that can play a significant role in societies by alleviating poverty and promoting human well-being.

This process involves a legally binding pledge, where a donor—a solvent adult of sound mind—surrenders an immovable asset, such as real estate, to meet a specific charitable goal. The donor, known as the founder, gives up his rights to the property. Any income or profits that may arise from that property in the future are distributed to the trustees to manage. They administer the property and channel its proceeds to relevant beneficiaries.

The trustees hold and manage the property—be it land or buildings, in perpetuity. This ensures that the benefits of the endowment are channelled towards the beneficiaries in line with the charitable or religious intentions of the donor. Alternatively, another form of donation is made in *waqf*, which includes movable assets such as giving cash or shares for charitable purposes. This is used to maintain the *waqf* and help it to benefit society.

Previously the *waqf* system was a pillar of the agricultural and industrial sectors, and was managed without any cost to the government. It acted as a powerful and versatile force for good, serving to lift the people out of poverty and bridge the rich-poor gap.

WAQF IN THE 21ST CENTURY

Since the beginning of the 21st century, with the resurgence in the global Islamic finance sector, *waqf* has begun to overcome challenges such as lack of governance, abandonment and unproductivity and has begun to make a comeback.

Accelerating this comeback is a willingness of the Islamic finance sector to modify the various legal restrictions on *waqf*, while preserving its all-important mandate to serve as a welfare channel. One important change has been the legitimization of temporary *waqf*, in accordance with Maliki view, which allows a donor to pledge his property for a limited period, in contrast with the traditional practice that it be held in perpetuity, according to the majority of the Islamic jurists.

Islamic financial institutions (IFIs) and corporate organizations are also taking a greater interest in the financing, refurbishment and management of old *waqf* properties, many of which are in prime locations worldwide. Currently, there are various initiatives underway to issue sukuk backed by *waqf* land for mosques, schools, orphanages and more. The scope is huge, since the value of *waqf* assets globally is estimated to be in the range of hundreds of billions of dollars.

WAQF BANKING

It has thus become vital for *waqf* to be managed more prudently. Several banks have emerged to support this strategic need through their dedicated business units or subsidiaries. In the United Arab Emirates (UAE), Noor Bank and Awqaf & Minors Affairs Foundation have established a joint venture, 'Noor Awqaf', which supports the development of *waqf* properties.

The establishment of such dedicated units or subsidiaries (or *waqf* banks), ensure that *waqf* assets are managed efficiently—under the right conditions and regulations—so that this sustainable financial tool can reach its true potential. They do this by providing financing facilities for

> *It is in a waqf's best interest to be managed by a waqf bank, as the bank's principles are aligned to meet its objectives and the considerations of its members.*

the development of *waqf* properties. Alternatively, they provide cash *waqf* services for the undertaking of socio-economic projects.

Essentially, *waqf* banks would provide similar services as those provided by Islamic commercial banks, such as the collection of deposits, fund transfers, and the provision of financing. However, the key difference is that *waqf* banks adhere to Shari'ah rules and principles as well as the related requirements, regulations and laws of *awqaf* authorities. The income from services and fees is mainly invested to help the banks to develop *waqf* properties and participate in other social welfare projects. However, this does not mean that *waqf* banks operate solely on a non-profit basis as they are entitled to charge certain fees for the services rendered.

This is an important difference, because it provides Muslims and non-Muslims alike the chance to approach a bank that is compassionate and is uniquely dedicated to offering resources for the needy. Ultimately, it is in a *waqf*'s best interest to be managed by a *waqf* bank, as the bank's principles are aligned to meet its objectives and the considerations of its members. It is therefore able to offer better products and services.

THE MODELS OF *WAQF* BANKING

There are currently two main models of 'corporate *waqf*' that a *waqf* bank can manage. These include 'real estate *waqf*' and 'cash *waqf*'.

In a real estate *waqf*, a *waqf* bank may form a strategic partnership with *waqf* authorities and corporate bodies to develop *waqf* properties. The building is then leased out and rental generated from the lease will be channelled to the beneficiaries or partly invested in Shari'ah-compliant business activities.

Cash *waqf* establishes an endowment in cash to be managed and invested in a productive manner. In a *waqf* bank, this model may create cash *waqf* certificates to accumulate a fund from individuals and entities. *Waqf* funds are to be managed by *waqf* banks and are to be utilized for Shari'ah-compliant business activities. Income generated from the investment is then channelled to the beneficiaries or reinvested into the portfolio. There is also the opportunity for established specialist fund managers to partner in this space with *waqf* banks.

Similar models can also be applied to shares. For example, a corporate entity may pledge certain shares of its own company as *waqf* to a *waqf* bank. This means that any income or dividend derived from the shares will be channelled to the beneficiaries, ensuring that the bank is promoting sustainable funding and providing benefits as well. Sukuk proceeds can also be donated to the beneficiaries through *waqf* banks.

Under both models, the *waqf* bank would be appointed as an administrator (*nazir*) or trustee (*mutawalli*). The bank's responsibilities would include developing and managing the *waqf* properties, accumulating and investing funds and distributing proceeds to the beneficiaries, as in the case of healthcare and education *awqaf*. The *waqf* bank would then be entitled to charge a certain fee for the services rendered.

REGULATORY REQUIREMENTS

Cash *waqf* would perform better when managed by *waqf* banks as these banks are better equipped to handle the fund's needs. They would meet high regulatory requirements such as Shari'ah boards or central bank supervision, which would ensure that they do not take any unnecessary risks while investing.

Significantly, *waqf* banks are required to manage and administer *waqf* properties in their capacity as *waqf* trustees in line with Shari'ah rules and requirements and in accordance with the related regulations and laws of *awqaf* authorities.

In the UAE, the government and regulators have set up a 'General Waqf Authority'/'General Authority for Islamic Affairs and Endowments' to coordinate and streamline the functions of *waqf* institutions for proper use of the country's *waqf* properties and funds.

THE WAY FORWARD

The key to managing *waqf* efficiently is by changing people's perceptions about how best to help the underprivileged in society. Currently, there is a lack of awareness about *waqf* around the world, which must be tackled to help it achieve its maximum potential. Educating society and creating awareness about the role of *waqf* in alleviating poverty is critical to its future.

As the nature of *waqf* business is a charity-oriented business, it is also important that *waqf* properties are located in strategic areas, so that they may be developed for the undertaking of socio-economic projects, when desired. It is also important that the collaboration between *waqf* institutions and Islamic banks continue to increase globally. This will boost the overall growth of the Islamic economy, and more importantly, contribute positively to society at large.

Disclaimer: Views expressed in the article are the writer's own and do not reflect those of Noor Bank.

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WAQF-SHARES: A FUNDRAISING SCHEME FOR COMMUNITY DEVELOPMENT PROJECTS AND HUMANITARIAN ACTIVITIES

Assoc. Prof. Dr. Magda Ismail A. Mohsin

The *waqf*-share scheme is a 21st century Islamic social finance tool that has been used successfully in Muslim and Muslim-minority countries (Cizakca, 2000). It is a fundraising scheme organized by a charitable institution that issues "*waqf*-shares" for sale to different contributors for various projects. Since a *waqf*-share is a movable *waqf*, it has to follow the strict conditions of *waqf* in terms of its irrevocability, its inalienability, and its perpetuity. This means that contributors cannot sell or transfer their *waqf* shares; they can only receive and hold a *waqf*-share certificate as evidence of their contributions to the project if the created *waqf* is public *waqf*. Moreover, contributors receive continuous rewards until the Day of Judgment as mentioned in the following *hadith*:

> When a man dies, his acts come to an end, but three, recurring charity, or knowledge (by which people) benefit, or a pious son, who prays for him (for the deceased). (Sahih Muslim, hadith no. 1631)

In the case that the created *waqf*-shares are meant for family *waqf* or for both family and public *waqf* (known as mixed *waqf*), contributors and their family can benefit from their *waqf*. As narrated by Abdullah ibn Umar ibn al-Khattab in the case of his father's *waqf*, Umar ibn al Khattab used to eat from his *waqf* known as *Thamgh Garden* in a reasonable and fair manner, besides feeding the poor and the needy.

Even though *waqf*-shares schemes have been practiced successfully in the last few decades in different countries it has mainly been used for the creation of public *waqf*. There has only been one case, in Sudan, where the founder created *waqf*-shares in the form of a mixed *waqf*. This could be attributed to the current law of *waqf* that abolishes family *waqf* in some Muslim countries today (Abdel Mohsin, 2010).

ISSUANCE OF *WAQF*-SHARES IN DIFFERENT COUNTRIES

Recently many *waqf*-shares schemes have been created in some Muslim-majority and Muslim-minority countries to address crucial needs arising either from economic instability, natural disasters or even to support humanitarian activities.

In Sudan, the practice of *waqf*-shares started in the 1990s with the intention of involving all citizens in economic development by encouraging them to invest in cash *waqf* with the smallest amount of money they could afford to give. This concept is based on the *hadith* of the Prophet (SAW): "Save yourself from Hell-fire even by giving half a date-fruit in charity" (Sahih al-Bukhari, *hadith* no. 1417). As such, many *waqf*-shares were created to feed the poor and the needy. One of the best examples is a *waqf*-share created in the form of a mixed *waqf* whereby some women converted their jewellery into *waqf*-shares both to support their children's education and to provide education and shelter for orphans. It could be a good precedent for motivating new founders to create such a *waqf*.

Malaysia also witnessed the creation of many *waqf*-shares in the 1990s with the support of

> *In Kuwait and the United Kingdom, the creation of waqf-shares targeted global welfare by creating different schemes to provide humanitarian aid to the most populated and affected countries such as Pakistan... Yemen and Syria.*

the State Islamic Religious Councils (SIRCs) in most of the Malaysian states. The SIRCs issued *waqf*-shares in different denominations for various projects including: developing existing *waqf* lands; building mosques, religious schools and Islamic knowledge centres; maintenance of religious infrastructure; and providing physical amenities for the Muslim community. *Waqf* shares first appeared in Indonesia in 1993, when the Indonesia *Waqf* Board issued a *waqf*-share for supporting community development programs such as poverty alleviation, the provision of education and free medical services, and financing for entrepreneur development programs.

In Saudi Arabia and the United Arab Emirates (UAE), the creation of *waqf*-shares has helped to provide shelter for poor residents by converting some old *waqf* properties into residential towers. In Kuwait and the United Kingdom, the creation of *waqf*-shares targeted global welfare by creating different schemes to provide humanitarian aid to the most populated and affected countries such as Pakistan, India, Indonesia, Sudan, Philippines, Yemen and Syria. Recently, in Turkey, the Syrian Scholars Association created *waqf*-shares to shelter the Syrian refugees and to educate their children. The value of each *waqf*-share is US$500 to be created through Kuveyt Türk Participation Bank.

These examples demonstrate that the *waqf*-share scheme is one of the most significant innovation fundraising schemes, which has succeeded not only in meeting community development needs but humanitarian supports on a global level.

WAQF-SHARES: MODUS OPERANDI AND STRUCTURE

The following is the process flow and structure for the issuance of *waqf*-shares:

A charitable institution appoints itself to be the trustee for a selected community project or humanitarian activity

↓

In its role as the trustee, this charitable institution issues *waqf*-shares equivalent to the estimated budget for the specified project or activity at various denominations and sells these *waqf*-shares to contributors

↓

Contributors can be individuals, corporations, Islamic financial institutions or even governments

↓

In return, contributors receive *waqf*-share certificates as evidence of their contribution to the selected project

↓

To ensure the perpetuity of the *waqf*-shares the accumulated funds may be managed in two ways, directly or indirectly, depending on the selected project

Direct *Waqf* Projects

In case the selected project will be developed on *waqf* land, then *istibdal* (substitution) can be used to change the cash *waqf* into an asset. For example:

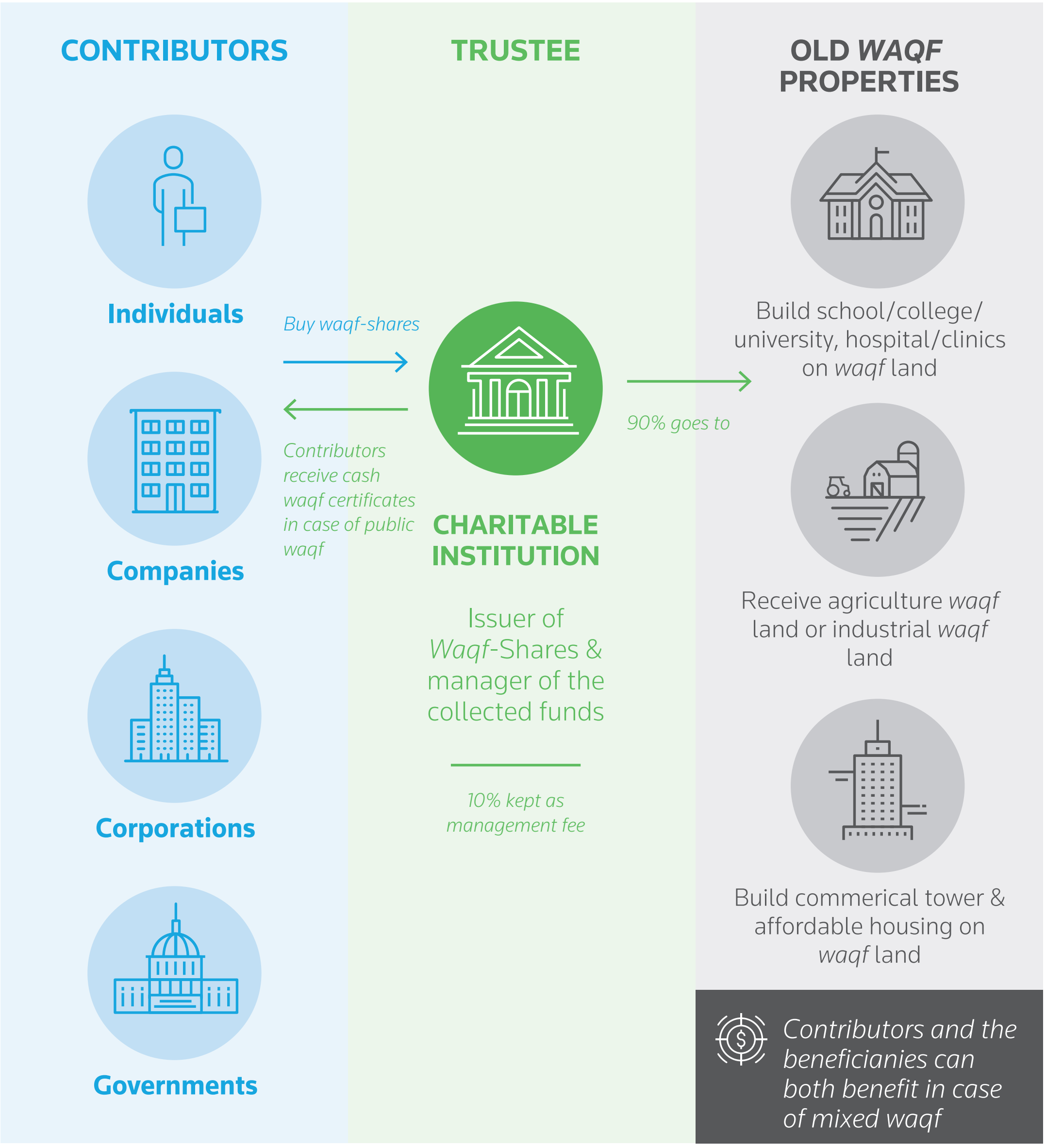
1. a) 90% of the accumulated funds can be channelled directly to the specified project through using *istibdal* and exchanging the liquid money into assets such as buildings, schools, hospitals, commercial and residential towers on *waqf* land.

   b) If the contributors buy the *waqf*-shares in the form of mixed *waqf*, then both children and beneficiaries can benefit from the services provided in a reasonable and fair manner.

2. 10% to be channelled to the trustee as their management fee.

Figure 1 depicts the process flow of managing direct *waqf* projects.

Figure 1: *Waqf*-Shares Scheme: Direct *Waqf* Projects

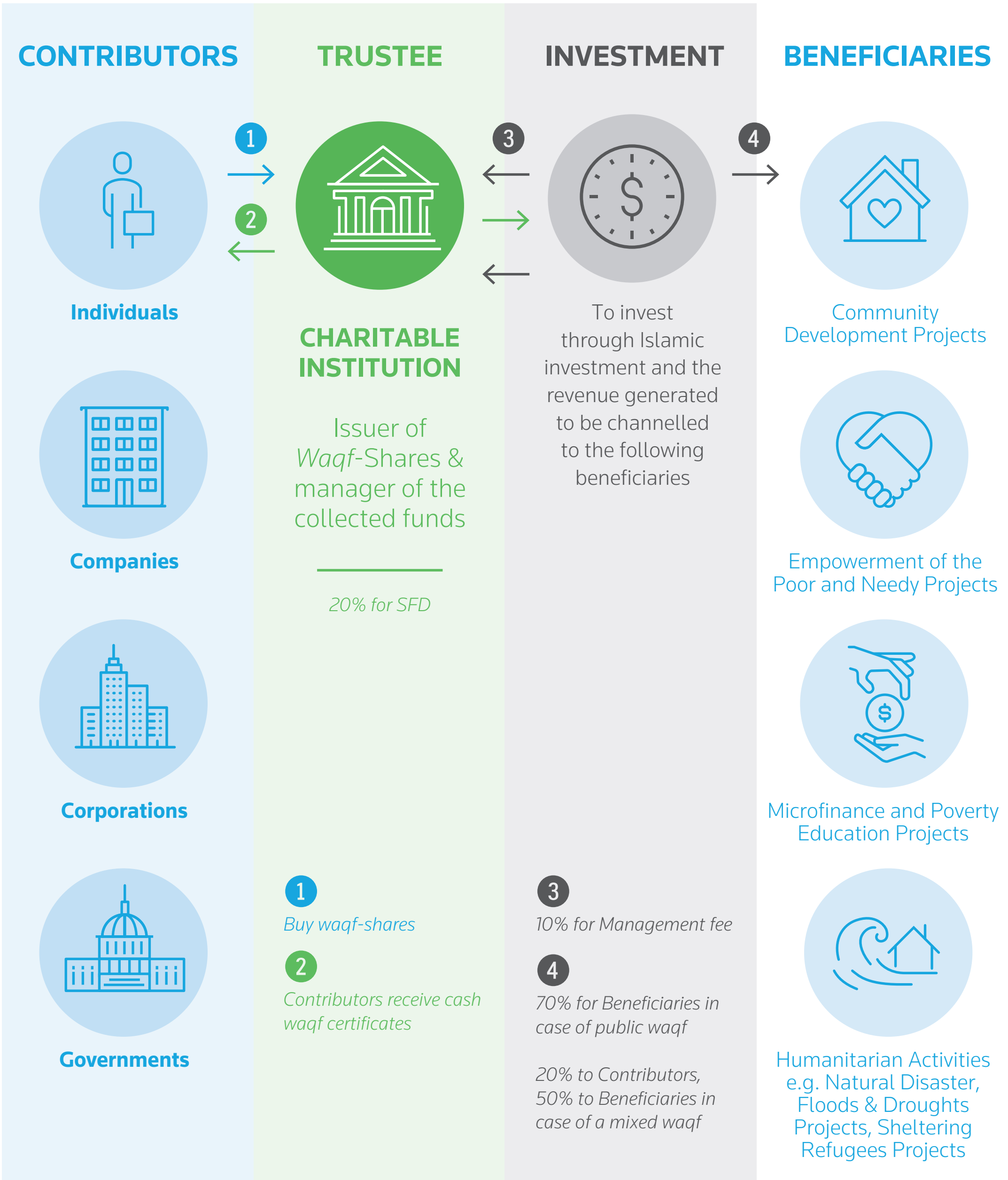


Indirect *Waqf* Projects

In case the project will be developed on privately owned land (see Figure 2), then the accumulated funds must be invested and only the generated revenue must be distributed as specified by the trustee into the following:

1. 10% to be channelled to the trustee as a management fee.
2. 20% to be added to the collected funds from the different contributors known as Self-Finance Device (SFD) and as risk mitigation.
3. a) 70% to be channelled to the specified beneficiaries, either for community development projects or humanitarian activities aids.

Figure 2: *Waqf*-Shares Scheme: Indirect *Waqf* Projects



* Note that all the above percentages are NOT fixed and can be changed by the trustee

b) in case the contributors buy the *waqf*-shares in the form of mixed *waqf*, then both contributors and beneficiaries can benefit from the provided services in a reasonable and fair manner.

CONCLUSION

The current practice of *waqf*-shares in Muslim and Muslim-minority countries with direct and indirect schemes provide successful cases in raising funds not only to meet the different communities' needs but to empower these communities and support humanitarian activities. Furthermore, reviving the law of family *waqf* and recognizing the creation of the mixed *waqf* have motivated more contributors to create *waqf*, including *waqf*-shares, whereby they can also benefit from their own *waqf* together with the beneficiaries in a reasonable and fair manner. Indeed, *waqf*-share is a new financial inclusion instrument that needs more attention.

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COMBINING FINTECH, CROWDFUNDING AND CASH *WAQF* TO CREATE SUSTAINABLE CHARITY: THE CASE OF WAQF WORLD GROWTH FOUNDATION

Ahmad Sabree, Umar Munshi and Richard AbdarRahman Chignell

New information technology has led to various innovations in the way people contribute to philanthropic activities. Through crowdfunding platforms that integrate financial technology (fintech) in their operations, donors can donate their money more easily and efficiently, particularly in the form of cash *waqf*. In this regard, crowdfunding platforms can function as an intermediary for raising charitable funds from donors and for channeling funds to relevant *waqf* institutions or authorities. This article highlights the initiatives of Waqf World Growth Foundation in facilitating cash *waqf* via Ethis Ventures crowdfunding platform.

CASH *WAQF* MANAGEMENT VIA FINTECH

Shari'ah has allowed *waqf* assets and proceeds to be invested in order to increase the value for the beneficiaries. In the cash *waqf* model, donated funds are collected in a pool and then invested in diversified investment portfolios that are low-risk, to ensure caution is exercised in protecting the asset that beneficiaries' have a right to benefit from. While the initial capital of the cash *waqf* must be protected and preserved, profits derived from the investments can be used for charitable activities, building infrastructure projects, providing grants and scholarships, and establishing research houses and other noble causes that benefit society at large.

To maximize its effectiveness, cash *waqf* requires skillful managers or administrators for investing funds in the most profitable revenues, distributing proceeds to the right beneficiaries and ensuring the sustainability of funds. A fintech company that provides financial and management support can potentially offer viable solutions needed by the *waqf* industry today for managing and administrating *waqf* funds. When combined with the *waqf* model and crowdfunding—a modern and effective mode of raising funds in both small and large amounts—fintech can be a powerful means to collect funds and efficiently channel them to various charitable and social activities that benefit the Muslim *ummah*. To propel this noble objective, Waqf World Growth Foundation has partnered with Ethis Ventures—a company that develops crowdfunding platforms and operates a suite of Islamic social finance crowdfunding platforms.

CROWDFUNDING-BASED CASH *WAQF* BY WAQF WORLD GROWTH FOUNDATION

Waqf World Growth Foundation promotes its online cash *waqf* through its official website (www.waqfworld.org), a platform operated by Ethis Ventures where donors can browse a list of charitable organizations that have established their own personal cash *waqf* funds to benefit continuing social works and activities. The *waqf* funds of these charitable organizations must be registered with the relevant recognized authority in their particular jurisdictions, either as *waqf* institutions or other similar institu-

> *Through the waqf crowdfunding platform, each donor can create their own account and track the total amount of funds raised and monitor the performance of each waqf in terms of investments, distribution or utilization of its funds.*

tions, such as endowments, foundations or trusts. Once a *waqf* fund is properly registered, a money manager is appointed to manage the funds according to its optimal strategy. The money manager is paid a pre-agreed fee—based on assets under management—for undertaking the role of investment manager, while the charitable organization utilizes profits to carry out its voluntary and social welfare and development activities. In this arrangement, the crowdfunding platform acts as the agent (*wakil*) to assist in the fundraising process via cash *waqf*, while the charitable organization and the money manager undertake the role of *muttawali* (trustee) that manages, administers, protects, and invests the *waqf* assets.

The use of crowdfunding and fintech, as exemplified by Waqf World Growth Foundation, allows charitable organizations to gain financial support from generous people across the globe and to increase their sustainability by allowing each dollar donated to have a greater social impact than in the traditional model. The platform should also provide greater transparency in the use of these funds, since every donation is channeled to a registered *waqf* institution with audited financial statements.

In addition, through the *waqf* crowdfunding platform, each donor can create their own account and track the total amount of funds raised and monitor the performance of each *waqf* in terms of investments, distribution or utilization of its funds. These features are included in order to implement transparency, which is central to good *waqf* management. As many donors are concerned about the way *waqf* trustees manage donated funds, Waqf World Growth Foundation aims to address these concerns with a firm commitment to best practices in management. With advanced technology and smart designs, this system puts the donor into a role similar to an auditor who conducts regular inspections, serving as a 'check and balance' on the *waqf* assets to ensure they are being properly maintained. Reviving this role of productivity auditing in *waqf* management adds an additional support system to the overall *waqf* ecosystem, thus minimizing the probability of *waqf* assets becoming idle or unproductive.

In the process of establishing Waqf World Growth Foundation and its platform, the team has faced some formidable challenges; particularly educating the public on the concept of *waqf* itself. Many people in the Muslim world believe that *waqf*

is fundamentally a private institution. It is only after the colonial era that they have become nationalized and taken into central management. As a result, many Muslims do not think of investing charitably into works that will provide services to the general public such as building schools and hospitals. Instead, they believe that these public facilities are the responsibility of the government; hence, their charitable efforts should focus on feeding the poor or donating to disaster stricken communities and other forms of one-off donations.

THE WAY FORWARD

There are plenty of Muslim non-governmental organizations (NGOs) that do great work for their communities by collecting funds and helping to alleviate poverty and provide relief around the world. However, they struggle financially on a regular basis. It is hoped that the revitalization of the institution of *waqf* with the innovative technology of crowdfunding can contribute to the sustainability of Islamic organizations doing positive work for the benefit of humanity and the advancement of the *Ummah*.

Through its dynamic online platform, Waqf World Growth Foundation aims to repopularize the concept of *waqf* and reemphasize its relevance globally. By helping Muslims to realize the significant roles of *waqf*—as it used to be during the Ottoman empire—the Foundation visions to have the majority of public services in Muslim-majority countries being funded by *waqf*.

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Following his conversion to Islam, he focused on ethical finance, committing to promoting social entrepreneurialism and social business models. Upon his discovery of the Islamic institution of *waqf*, he committed his life to leveraging his business and investing experience to spread *sadaqat* and *khayr*.

INTERVIEW WITH DR. IRFAN SYAUQI BEIK

NATIONAL ZAKAT BOARD OF INDONESIA

On 13 December 2016, the National Zakat Board or Badan Amil Zakat Nasional (BAZNAS) launched the National Zakat Index (NZI), the first of its kind in the Islamic social finance industry. What is the rationale behind this index?

The NZI is a composite index prepared by the BAZNAS Center of Strategic Studies for the purpose of measuring the performance of national *zakah* development. It contains components that provide information on the impact of *zakah* towards its beneficiaries, the existing institutional development of *zakah*, and community participation and the role of government in supporting *zakah* institutions. This index will be applied at the national, provincial, and city/regency levels. Implementation of the NZI at provincial as well as city/regency levels will provide information on existing performance of the *zakah* system in each region that can be compared to one another.

There are three basic reasons for launching the NZI:

1. There is an urgent need to measure overall performance of BAZNAS and all legal private *zakah* institutions in Indonesia objectively, accurately and in a timely fashion. To perform the coordination and supervision role effectively and at the same time to meet the objectives of *zakah* management highlighted in the Article 3 of the Zakat Management Act, BAZNAS needed a standard of measurement to assess the overall performance of all legal *zakah* institutions.

2. The NZI will provide transparency and accountability in *zakah* management to increase the trust of the public.

3. There is an urgent need for an analytical tool that can be used as a reference for improving the quality of *zakah* management over time. The NZI will assist the BAZNAS Board of Commissioners to improve the performance of entire *zakah* system.

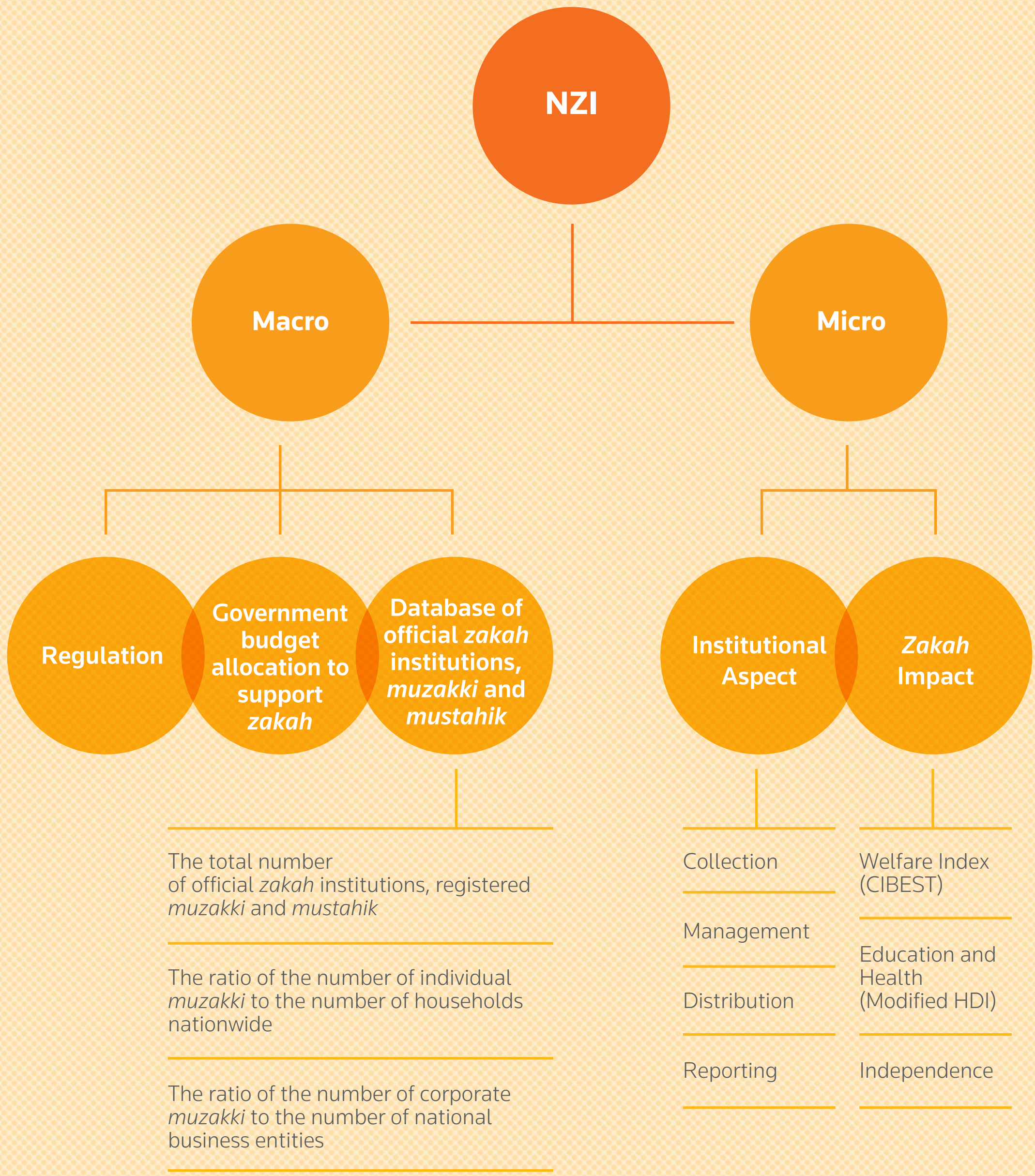
What are your criteria for measuring the development of the NZI? How effective has the NZI been in tracking the development of Islamic social finance within Indonesia?

The NZI is basically a multi-stage composite figure comprising indicators and variables, which are calculated in the form of an index that is multiplied by their respective weight (as illustrated in Figure 1). In general, the NZI is measured based on two dimensions:

1. Macro dimension: It seeks to observe three indicators—regulation, government budget allocation for *zakah* management, and the official database of the number of *zakah* institutions, registered *zakah* payers (*muzakki*) and *zakah* recipients (*mustahik*). The index also measures whether the contribution of the national and regional budget towards *zakah* development is sufficient or not. Lastly, it measures contribution of society towards *zakah* development based on the ratio of the registered individual *muzakki* and corporate *muzakki*. This is part of an attempt to reduce the gap between potential *zakah* of as much as Rp 217 trillion (US$20 billion) per annum and actual *zakah* collection, which is still less than 5% of its potential.

2. Micro dimension: The index will observe two major indicators pertaining to the institutional aspects of the *zakah* system and the impact of *zakah* on the condition of the *mustahik*. Institutional aspects are measured based on the performance of legal *zakah* institutions comprising BAZNAS and LAZ in collecting, managing, distributing, and reporting *zakah* funds including charitable contributions (*infaq* and *sadaqah*) and other socio-religious funds. Meanwhile, the impact of *zakah* on the *mustahik* is measured with three major variables: its welfare impact, health and education impact, and sustainability impact.

Figure 1: NZI Components



> *[The index] seeks to observe three indicators —regulation, government budget allocation for zakah management, and the official database of the number of zakah institutions, registered zakah payers (muzakki) and zakah recipients (mustahik).*

The potential NZI scores range from zero (the lowest) to one (the highest). The NZI will be very effective as a policy tool because it will give clear indications for BAZNAS to improve the quality of *zakah* management in Indonesia. The NZI is an outcome-based index that will objectively assess and evaluate the performance of BAZNAS as the national *zakah* authority.

How have the results of the NZI been aligned to the *zakah* core principles (ZCP), part of the international working groups to govern *zakah*?

The NZI is also geared to the *zakah* core principles document, which has been translated and adjusted to match the Indonesian context. For example, the legal foundation dimension of the ZCP document has inspired the regulation indicator in the macro dimension. Similarly, the distribution variable measured in the institutional indicator of the micro dimension has adopted and modified the criteria from the ZCP document, such as the allocation-to-collection ratio (ACR) and the speed of *zakah* allocation. The distribution index of the NZI will be equal to 1, which is the highest value, if the ACR exceeds 90% and the distribution speed of the social program and economic program is less than three months and six months, respectively. These examples clearly show the adoption of ZCP document in the construction of the NZI.

What are the efforts that BAZNAS is making to create a transparent *zakah* structure in Indonesia? What are the challenges faced in creating a structure aligned to core Shari'ah principles?

To create a transparent structure for *zakah* management in Indonesia, BAZNAS will:

1. Issue the ***BAZNAS Strategic Plan 2016–2020***. This strategic plan comprehensively highlights the mandate given by the Zakat Management Act No 23/2011, Government Regulation No 14/2014 about Implementation of the Zakat Management Act No 23/2011, Presidential Order No 3/2014 on the Collection of Zakat and other relevant regulation, and attempts to realize it in the concrete policy and program.

2. Adjust the BAZNAS organizational structure to meet the objectives of *zakah* management and to improve the operational efficiency and effectiveness. BAZNAS has also received ISO 9001:2015 certificate as part of its attempt to improve the management quality.

3. Improve the credibility and competency of *'amil* officers from both managerial and Shari'ah perspectives through Amil certification program.

4. Introduce SIMBA (BAZNAS Information System) as BAZNAS endeavour to continuously enhance its information system through proper and effective IT system.

5. Publish BAZNAS programs and financial statements to the public regularly through various media, both mainstream (electronic and printed) and social media, to maintain transparency and accountability.

There are several challenges faced by BAZNAS in creating a structure aligned with core Shari'ah principles:

1. **The lack of a Shari'ah standard for *zakah* management and accounting.** BAZNAS has complied with existing Shari'ah standards for *zakah* management and accounting. However, those standards seem to be insufficient to support further *zakah* management in the country. Therefore, coordination with Fatwa Commission of the Indonesian Council of Ulama (MUI) and the Indonesian Accountant Association (IAI) should be strengthened.

2. **The lack of a Shari'ah audit.** The Zakat Management Act requires the presence of both a Shari'ah audit and financial audit. This Shari'ah audit is conducted by Ministry of Religious Affairs (MORA). However, until the report is made, this Shari'ah audit is still in the process of development and has not been implemented yet.

3. **Limited qualified human resources.** This is a general issue in the Islamic fiance world, including for *zakah* services. To solve this problem, BAZNAS has launched a certification program for amil in order to standardize the quality of human resources by establishing regular training and capacity building programs. In the long run, the involvement of formal education institutions such as universities should be sought, especially in formulating curriculum standards that meet the needs of *zakah* development in Indonesia.

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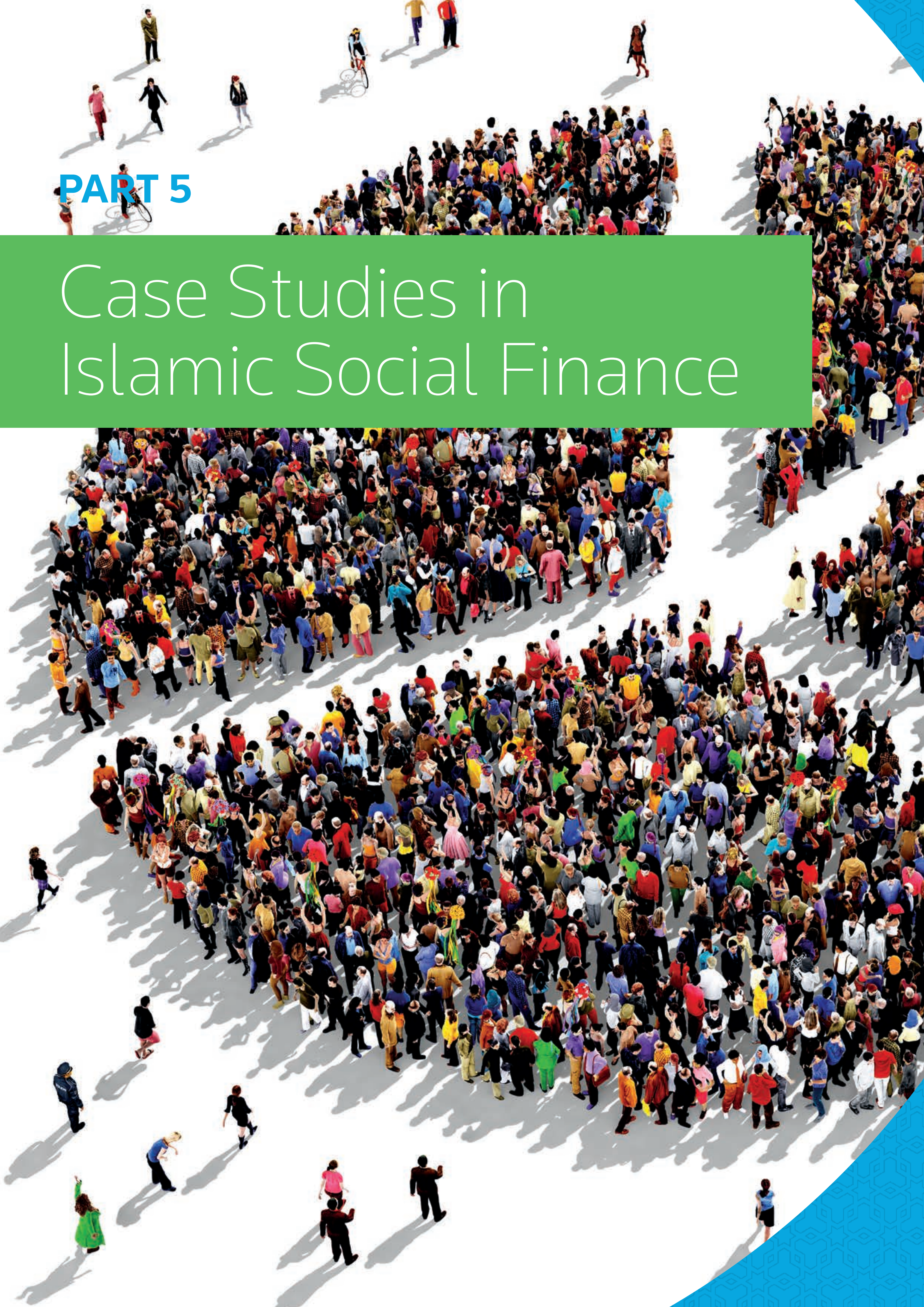
PART 5

Case Studies in Islamic Social Finance



Summary

One of the historical strengths of Islam and Shari'ah is their flexibility and sensitivity to the social needs of every locality. One of the most common forms of socially responsible intitiatives found in Islamic finance is microfinance. Using various incentives, institutions can offer needy borrowers *qard hasan* (interest-free loan) or low-cost financing via Shari'ah-compliant structures, which help these borrowers establish thriving enterprises and contribute to their local economies. Because of the socially embedded nature of these institutions, they tend to have remarkably high recovery rates of financing principal, as well as extraordinary reach among small borrowers.

In Pakistan, Akhuwat has innovated a model for microfinance that provides interest-free microcredit backed by the charitable contributions of successful former borrowers. Borrowers provide two guarantors from their community and Akhuwat offers loans for the purpose of small enterprise, education, health care, housing, marriage or family emergencies. In Indonesia, the parallel model of Baitul Maal wat Tamwil (BMT) has gained ground in recent years. The charitable function of the Baitul Maal (charitable house) in collecting *zakah* (almsgiving), *sadaqah* (voluntary charity) and cash *waqf* (Islamic endowment) is used in part to finance the operations of the Baitut Tamwil (finance house), which offers *qard hasan*. Meanwhile, Kenyan IFIs are pushing to expand their operations into microfinance by calling on the government to accept amendments to Islamic financial regulations and laws permitting *qard hasan* and pension reform that will allow the public to invest pension assets in a Shari'ah-compliant manner.

Malaysia remains at the forefront of Islamic social finance innovation. Amanah Ikhtiar Malaysia has established a wide network of 'microbank' lending and saving institutions using the novel concept of community-based group repayment liability. Five or six borrowers make joint pledges to back each others' loans in the case of a single member's default, while social meetings encourage the habit of saving alongside loan repayment.

Kuwait has been a pioneer in centralized *zakah* administration with the Kuwait Zakat House, established in 1982. While dedicating all domestic *zakah* funds to domestic needs such as educational stipends, social security and healthcare, it also manages a range of *sadaqah* and other individual donations to create cash *waqf*, as well as to fund a range of international charitable initiatives such as sponsoring international students and Al-Azhar seminarians, disaster relief in the Muslim world, construction for residential and social purposes, as well as support for orphanages. In fact, the potential global *zakah* reciepts far exceed the current capability of private organizations and states to collect and to use most effectively. As compared to such philanthropy heavyweights as the Bill and Melinda Gates Foundation, the long-term impact of *zakah* remains relatively small. International coordination in both governance, administration and even charitable projects between jurisdictions will cause a huge increase in the effectiveness of *zakah* worldwide.

AKHUWAT: THE STORY OF INTEREST-FREE LOANS IN PAKISTAN

Dr. Farrukh Habib

In 2001, Dr. Amjad Saqib, along with a group of friends, extended a small interest-free loan (about US$100) to a poor Muslim widow at her request. Owing to her high self-esteem and dignity, she neither wanted charity from others nor a loan with interest, as paying and receiving interest is not permissible under Islamic law. So, she acquired the interest-free loan, bought two sewing machines with it and started stitching clothes for others. Within six months, she was not only able to independently manage sustenance for her family, and marry off one of her daughters; she was able to return the principal amount of the loan. Neither the woman nor Dr Amjad knew at that time that this incident would be a stepping stone toward setting up an institution with the noble goal of empowering marginalised families with interest-free loans. It inspired Dr Amjad to embark on the remarkable journey of founding and developing Akhuwat.

ACHIEVEMENTS

Starting from a small loan of US$100 in 2001, Akhuwat has disbursed more than US$361 million to 1.85 million benefiting families as of March 2017. Of the amount disbursed, around US$258 million has been successfully recovered at an astounding rate of 99.91%; loans of US$103 million are currently outstanding. In terms of geographical coverage, Akhuwat is now operating 672 branches all over Pakistan. However, it is yet to become an international organization.

PHILOSOPHY

The Arabic word '*ukhuwwah*' means brotherhood, fraternity and solidarity. 'Akhuwat' is the Urdu version of the same word, carrying the same meaning. The name of the organization precisely reflects this philosophy, which Akhuwat draws from the Islamic tradition of brotherhood that Prophet Muhammad (SAW) established among the Muslims of Makkah (Muhajirun) and Madinah (Ansar) when the former migrated to Madinah. The Muslims of Madinah shared everything they had equally with the Muhajirun and accepted them as their brothers. This tradition of Islamic brotherhood was not based on mere charity, but rather on the ideology of equity and responsibility. It is this memorable expression of brotherhood that forms the philosophical basis of the organization, and it intends to revive this very tradition through its operations and services.

VISION AND MISSION

Akhuwat envisions "a poverty-free society built on the principles of compassion and equity." To fulfill this vision, Akhuwat believes in "empowering socially and economically marginalized families through interest-free microfinance and by harnessing entrepreneurial potential, capacity building and social guidance." The guiding principles that underlie the organization are provided in Figure 1.

METHODOLOGY AND STRATEGY

Akhuwat adopts the methodology of *qard hasan*, an interest-free loan that the lender willing-

Figure 1: Guiding Principles of Akhuwat

Interest-Free Microcredit
- Loans do not charge interest
- Education boosts the entrepreneurial ability of borrowers

Linkages with Religious Institutions
- Use of mosque and church infrastructure is cost effective in offering products and services
- Activities seek community participation, transparency and accountability

Spirit of Volunteerism
- A combination of volunteers and paid staff promote commitment and determination
- All senior management works voluntarily; paid staff also performs many activities voluntarily

Transforming Borrowers into Donors
- Program encourages borrowers to donate without any obligation or bearing on their credit profile
- Borrowers also contribute by training new clients to establish and run their businesses successfully

> *Social capital is the idea that the communal position and societal status of a borrower can be considered a guarantee for loan repayment.*

ly extends to the borrower only to seek Allah's pleasure. Akhuwat successfully managed to incorporate and institutionalize the methodology of *qard hasan* into modern principles of microfinance.

Another interesting feature of Akhuwat's strategy is its reliance on social capital for loans. Social capital is the idea that the communal position and societal status of a borrower can be considered a guarantee for loan repayment. If the borrower intentionally defaults, he or she is at risk of tarnishing his or her reputation in the community and losing social capital. That is why, instead of a single individual or a group of some community members, loans are extended to a family, while two guarantors from the same community are used as social capital. The benefits of this feature are manifold. Lack of mortgage collateral or a pledge as security is not a hurdle for the poor to acquire loans from the institution. Moreover, Akhuwat's success proves that maintaining social status in the community and avoiding moral failure are significant factors for people. It helps prevent them from avoiding repaying their debts if they have the financial ability to repay or deliberately defaulting on their debts, increasing Akhuwat's recovery rate to the highest level.

Due to its unique methodology and strategy, Akhuwat does not compete with other microfinance institutions. It also differs in its commercial considerations, because its benchmarks or performance indicators consist of how widely its model is replicated and how effectively and efficiently poor people are served.

LENDING AND RECOVERY PROCESS

Akhuwat's lending and recovery process is quite simple, yet it includes capacity building and guidance for borrowers to assist them in carrying out their business activities to achieve success. This is delineated in Figure 2.

PRODUCTS

Akhuwat offers various products, illustrated in Figure 3, which suit the needs of its borrowers.

Although the value of loans that Akhuwat offers under each of its products may seem to be small, the borrowers have been able to use those loans effectively for personal causes or in various businesses. These include dressmaking, industrial electrician, artificial insemination, plumbing, cooking and kitchen management, auto mechanic garages, beautician salons, embroidery, welding and computer hardware and software companies.

Figure 2: Lending and Recovery Process Adopted by Akhuwat

Individual Selection
- Submission of a load application by an individual
- Evaluation by the load officer of financial need, reliable social capital, entrepreneurial skills, etc.

Preparation of Business Plans
- Evaluation of the business ideas of the borrower and its commercial viability
- Interview with the borrower and his/her family

Credit Appraisal
- Appraisal of the technical section by the branch manager
- Referal to the loan approval committee
- Disbursement of the loan, if successful

Guarantee of Loans
- Borrower furnishes two individual guarantors
- The guarantors vouch for the borrower's credentials, monitor him/her, and persuade him/her for the timely repayment of the loan

Credit Distribution/Capacity Building
- The loan is disbursed at a public gathering at a mosque or church
- Social guidance events are organized to build the capacity of borrowers to carry out their work more efficiently and effectively

Recovery/Follow Up
- After disbursement of the loan, the loan officer monitors the borrower on a regular basis
- The loan officer reminds the borrower if his/her payment is not made on time
- If there is further delay, the loan officer contacts the guarantors and asks them to make the payment

Figure 3: Product Range Offered by Akhuwat

Family Enterprise Loan

US$150-300

- To establish a new business or expand an existing one

Health Loan

US$100-200

- To support the costs for necessary health care

Marriage Loan

Up to US$200

- To facilitate the marriage of a female borrower or borrower's dependents

Liberation Loan

Up to US$500

- To repay loans taken from money-lenders on exorbitantly high interest rates
- To counter the effect of loan sharks

Emergency Loan

US$50-100

- To aid the borrower in the case of major contingencies or crisis situations
- To cater for losses in a business, health care expenses, machinery repairs, motor vechicle repairs, veterinary expenses and admission fees

Education Loan

Up to US$250

- To help poor students or a borrower's dependent who is seeking education
- To pay regular, registration or examination fee, clear dues, purchase books and stationary

Housing Loan

US$300-700

- To do necessary renovations on houses, including the construction of rooms, roofs and walls
- Not for luxury renovation

FUNDING

Akhuwat mainly receives its funding through *zakah* (almsgiving), *sadaqah* (voluntary charity) and monetary gifts. It does not accept donations from people or organizations expecting to receive interest on loans or high returns on their investments, because this notion conflicts with its objectives and fundamental principles. Interestingly, the Punjab (local provincial) government also initially contributed US$10 million in 2011, which it later increased to US$700 million thanks to the sincere efforts and performance of the organization.

As highlighted in the guiding principles, Akhuwat encourages its borrowers to become donors themselves. Although, this is not a compulsory requirement, 70% of its borrowers ultimately become donors to the organization after their own success.

CHALLENGES AND DIFFICULTIES

Like any charity organization, the biggest challenge for Akhuwat is the availability of sufficient resources and funds. Although it has a strong appeal at the national level, it faces difficulty in attracting international institutions and governments at the global level. Part of this struggle is due to the ideological and operational uniqueness of the organization. Nevertheless, an affiliated organization, Akhuwat USA, has started its operation in the United States, which can be considered as an important step towards the concept's globalization.

Akhuwat's model inherently entails, on the one hand, a large pool of donors who are willing to give charity in the form of interest-free loans, and on the other, borrowers who must have commercially viable business plans. In other words, Akhuwat may not be able to adequately serve all the categories of the needy population, such as old people requiring health care or young people looking for financial assistance for education. However, to tackle these challenges, Akhuwat has initiated its own educational and health services on purely charitable basis.

THE WAY FORWARD

Akhuwat recognizes that it cannot fight the issue of poverty, a multifaceted and pro-cyclical problem, with only the simple instrument of microfinance. Therefore, it has planned to extend its product range based on other Islamic instruments including *waqf*, *musharakah*, *mudarabah*, etc. Subsequently, it aims to evolve into a full-fledged financial institution, while preserving its spirit and maintaining the same vision, mission and philosophy. In particular, Akhuwat expects to start its own university and business incubators. It also intends to extend its outreach nationally and internationally.

In short, the case of Akhuwat reveals a strikingly different successful story for microfinance with a zero interest rate and 99.91% repayment rate. It has efficiently institutionalized the Islamic mode of lending, *qard hasan*, with the modern principles of microfinance. It affords a great case study not only for microfinance institutions, but also for other institutions interested in any aspect of Islamic social finance.

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BAITUL MAAL WAT TAMWIL (BMT): AN INTEGRATED ISLAMIC SOCIAL AND COMMERCIAL FINANCIAL INSTITUTION IN INDONESIA

Dr. Ascarya

In Indonesia, while Islamic commercial finance is commonly offered by Islamic banks and Islamic rural banks, Islamic social finance is served separately by *zakah* (almsgiving) institutions and *baitul mal* (house of wealth). The Baitul Maal wat Tamwil (House of Wealth and Finance), or BMT, as studied by Seibel (2005), Obaidullah (2008) and Ascarya (2014, 2016 and 2017), is an Islamic microfinance institution (IMFI), registered as an Islamic cooperative, combining Islamic social finance in its Baitul Maal division and Islamic commercial finance in its Baitut Tamwil division.

The Baitul Maal division manages social funds including *zakah*, *infaq* (spending in the way of Allah), *sadaqah* (voluntary charity), cash *waqf* (Islamic endowment) and other social funds. The Baitut Tamwil division acts as a cooperative IMFI, collecting deposits from its members for initial capital (principal and compulsory deposits), saving deposits and time deposits. When funding is short, Baitut Tamwil can source deficit funds from external institutions, such as an Apex institution (a secondary financial institution which provides liquidity for microfinance institutions), Islamic banks or foreign sources. Subsequently, Baitut Tamwil can extend financing to its members mainly for productive purposes using various equity-based and debt-based Islamic contracts.

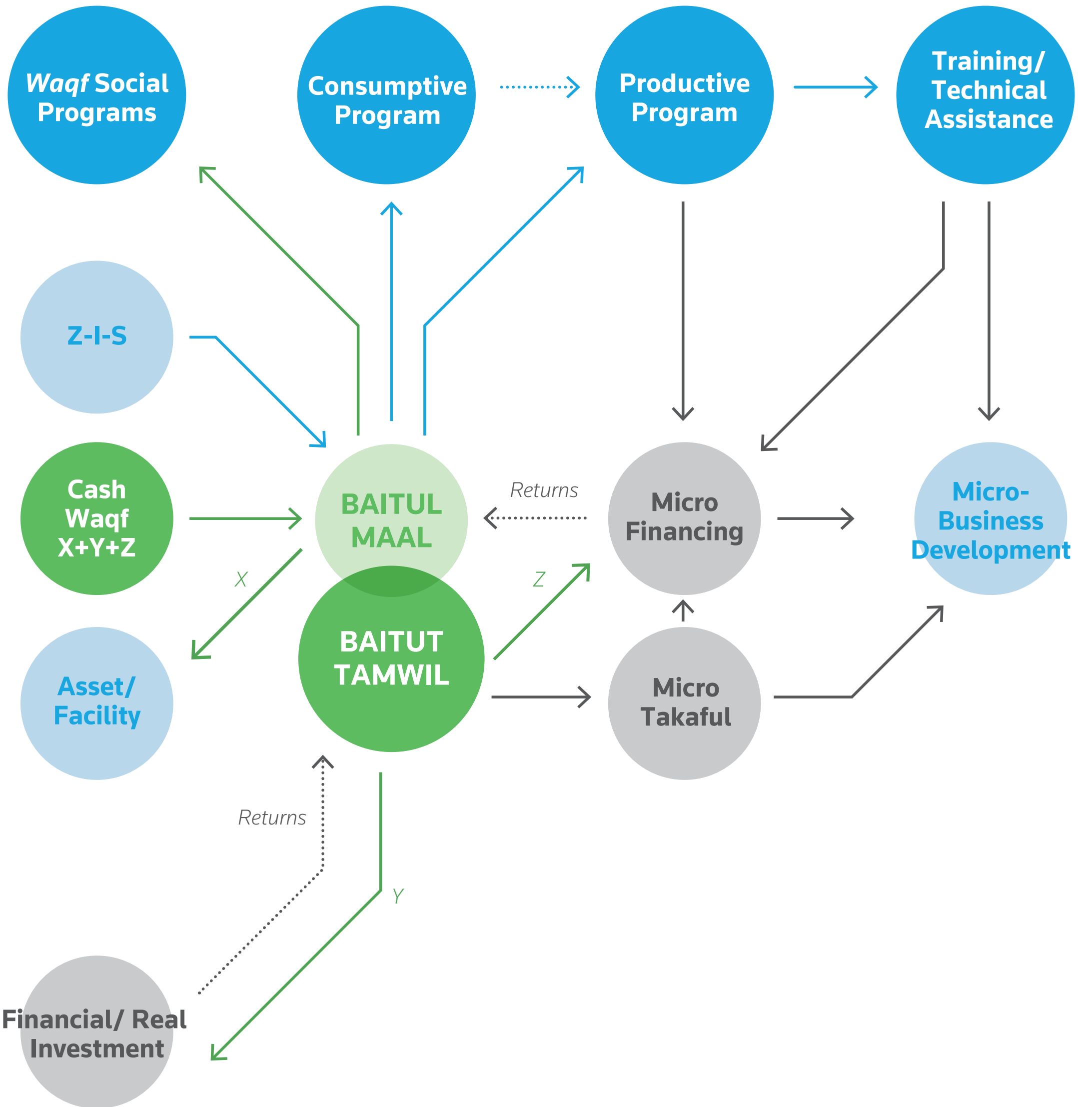
Moreover, Baitut Tamwil provides non-commercial financing, such as *qard* (loan) for emergency purposes or to those in need. In addition, Baitut Tamwil offers various Islamic microfinance services, such as microtakaful (Islamic micro-insurance), fund transfers, bill payments, ATM services, mobile banking and internet banking. The integration of Islamic commercial and social finance under one roof brings distinct benefits to stakeholders and solves some common problems of Islamic financial institutions.

MODELS AND STRUCTURES OF BMT

The model of integrating Islamic social finance and Islamic commercial finance in BMT varies in terms of the management of social funds by the Baitul Maal. The simplest one has a person in charge (PIC) only, such as BMT NU in Sumenep, Madura, East Java. Commonly, the Baitul Maal division operates in parallel to the Baitut Tamwil division, such as BMT Barrah in Bandung, West Java. Larger institutions, however, have separate *zakah* and *waqf* branches, such as BMT UGT in Pasuruan, East Java.

The integration of Islamic social and commercial finance in BMT is illustrated in Figure 1. Baitul Maal, as the certified *zakah* personnel (*amil*), collects and manages *zakah*, *infaq* and *sadaqah* (ZIS) funds from members, employees and the surrounding community, and subsequently uses the funds for their designated purposes through various consumptive and productive programs, including training, technical assistance and *qard* financing to develop the recipients, especially the poor and needy, into self-sufficient micro-entrepreneurs.

Figure 1: The integration of Islamic social and commercial finance in BMT



Baitul Maal, as the certified administrator (*nazir*), in turn collects direct and indirect cash *waqf* and deposits the funds in the Baitut Tamwil. Direct cash *waqf* (X+Y in Figure 1) is used according to its intended purposes for non-profit generating assets (X) such as building an Islamic school, hospital or mosque, or for profit generating assets (Y) such as investnment in certain type of financial/real assets. Indirect cash *waqf* (Z) is used to extend commercial microfinancing to members for developing their micro enterprises or other purposes. To mitigate risks, *waqf* investments are insured by microtakaful. Profits from cash *waqf* investments are used partly to fund social programs, while the other part of the profits is reinvested as cash *waqf*.

CHALLENGES FACED BY BMT

Generally, IMFIs including BMTs face a structural problem of funding, where the customers/members of IMFIs are poor or near poor and their savings are insufficient to meet the demand of microfinancing. Accordingly, the IMFI has to rely on financing from Islamic banks (see Table 1). In addition, the mismatch and liquidity problems (especially at certain times such as the beginning of the school year, the month of Ramadan and festive seasons such as Eid) are also an ongoing problem with no real solutions.

Nonetheless, after some time managing Islamic social funds, especially cash *waqf*, IMFIs will

Table 1: Balance Sheet of BMT before Managing Islamic Social Funds

Assets	Liabilities
Cash	*Wadiah* Saving Deposits
Islamic Bank Deposits	*Mudarabah* Investment Deposits
Receivables (*Murabahah, Qard,* etc.)	**Islamic Bank Financing**
Financing (*Mudarabah, Musharakah,* etc.)	
Fixed Assets	Capital

Table 2: Balance Sheet of BMT after Managing Islamic Social Funds

Assets	Liabilities
Cash	*Wadiah* Saving Deposits
Islamic Bank Deposits	**ZIS Saving Deposits**
Receivables (*Murabahah, Qard,* etc.)	*Mudarabah* Investment Deposits
Financing (*Mudarabah, Musharakah,* etc.)	***Waqf* Long Term Investment Deposits**
Long-term Investments	***Waqf* Equity**
Fixed Assets	Capital

slowly but surely accumulate funds from cash *waqf* (as *waqf* long-term investment deposits) which will help replace its dependency on Islamic bank financing (see Table 2). The nature of *waqf*, which is ever increasing and very long-term (perpetual), should eventually resolve the mismatch and liquidity problems of IMFIs. Moreover, cash *waqf* can also be placed as equity capital (*waqf* equity), which could lower the cost of funds as well as improve the balance sheet structure of IMFIs, especially in terms of having stronger capital.

CONCLUSION

In conclusion, the integration of Islamic social and commercial finance is beneficial not only to recipients of *zakah* and charities and the final recipients of *waqf* benefits (*mawquf 'alayh*), but also beneficial to intermediate *mawquf 'alayh*, namely IMFIs with stronger financial standing. As a result, these IMFIs would be able to provide members with cheaper financing and would be more resilient to financial crises.

This integration of Islamic social and commercial finance can be implemented not only at the micro level as discussed above, but it can also be implemented at the community level by Islamic rural banks (e.g. Bank Pembiayaan Rakyat Syariah – BPRS) and Islamic banks (e.g. Bank Umum Syariah – BUS) in Indonesia. Indonesian Islamic Bank Act No. 21 of 2008 allows Islamic banks to manage Islamic social funds (including *zakah*, *infaq*, *sadaqah* and other Islamic social funds) by establishing Baitul Maal. Some Islamic banks in Indonesia have already established Baitul Maal, such as Bank Muamalat Indonesia, Bank Syariah Mandiri and Bank BNI Syariah. In addition, Islamic banks are able to collect cash *waqf* and channel it to *waqf* institutions.

At the macro level, sound and strong Islamic financial institutions (including Islamic banks, Islamic rural banks and IMFIs) resulting from this development will contribute to a country's improved financial system stability overall.

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BOOSTING THE KENYAN ISLAMIC MICROFINANCE INDUSTRY BY AMENDING THE COOPERATIVE AND SACCO ACTS

Rahma Hersi

Islamic finance in Kenya began in 2005 with the opening of the first Islamic window, "LaRiba," at Barclays Bank. In 2008, the first two full-fledged Shari'ah-compliant institutions, First Community Bank and Gulf African Bank, were established. This is a clear sign that a significant segment of the Kenyan populations acknowledge that the conventional system of finance is not in line with their faith and is abhorrent to their values. Takaful (Islamic insurance) firms have also entered the market to tap this growing niche of clientele. In this process, the Islamic finance industry has grown to encompass Islamic cooperatives and savings and credit cooperative organizations (SACCOs). Islamic finance in Kenya has continued to develop over the past decade with Islamic banking assets growing at a compound annual growth rate (CAGR) of 14% between 2013 and 2015, according to the 2017 IMF Multi-Country Report on "*Ensuring Financial Stability in Countries with Islamic Banking—Case Studies.*"

This growth and development of the industry was made possible in the current Banking Act, CAP 488, by providing exemptions to the law in clauses 12a and 12c allowing for Islamic banks to trade and own property that meet Shari'ah requirements. However, impediments remain, and Islamic financial institutions are required to renew their licenses every five years that fulfil the earlier conditions.

These exemptions have been the only legal concessions the authorities have permitted until this year, when the Cabinet Secretary Mr. Henry Rotich of the National Treasury of Kenya on 30 March 2017, during the reading of the budget, stated:

> Islamic financing arrangement is becoming a major source of funding for development expenditures worldwide. This financial arrangement is getting integrated with the global financial system and has the potential to boost prosperity and raise the standard of living of our people. Kenya intends to maximize its comparative advantage and position itself as a regional hub for Islamic finance products to attract foreign direct investment. I will therefore propose legislative amendments to the Capital Markets Act, the Cooperative Societies Act and the SAACO Societies Act to facilitate Shari'ah-compliant products.
>
> In addition, I intend to amend the Public Finance Management Act to provide for the issuance of sukuk bonds as an alternative source of financing on development projects. I also intend to amend tax statutes to provide for equivalent tax treatment with conventional products.

Mr. Rotich's strong policy statement could have far reaching effects that would greatly develop the industry. This article examines how the proposed legislative amendments to the relevant

> *The growth of the [Islamic banking] industry was made possible in the current Banking Act, CAP 488, by providing exemptions to the law in clauses 12a and 12c allowing for Islamic banks to trade and own property that meet Shari'ah requirements.*

acts will impact the growth and development of Islamic finance, particularly Islamic microfinance, in Kenya.

These amendments have now been passed into law and include the following details:

SACCO SOCIETIES CAP 490 B

- Inserting the word "return" right after the word "interest."
- The term "deposit-taking business" has been removed and replaced with "funding or in compliance with Islamic law."
- The term "finance" has been inserted right after the word "loan."
- A new subsection has been introduced which allows the Cabinet Secretary, in consultation with the authority/regulator, to provide regulations for the licensing and supervision of the Cooperative Societies carrying out deposit-taking business in compliance with Islamic law.

COOPERATIVE SOCIETIES ACT-CAP 490

- The Cooperative Societies Act 1997 has been amended by inserting the words "or adherence to the principles of Islamic law" immediately after the word "members." The implication of this change will provide the justifications for licensing and supervision of SACCOs.

There are currently two SACCOs operating in Kenya:

- Crescent SACCO: the first Shari'ah-compliant SACCO registered by the Commissioner of Cooperative Development. This SACCO at present seeks a deposit-taking license authority from SACCO Society Regulatory

Authority (SASRA) to operate a front office financial services commodity known as FOSA.

- Taqwa SACCO: the Kenya Union of Savings and Cooperative Limited (KUSCCO) stated that this Shari'ah-compliant SACCO has been licensed to take deposits and offer banking services.

- It is apparent from these changes that the licensing and setting up of Islamic microfinance institutions has previously been carried out in an adhoc manner. However, with the amended law, the industry can now better expand with a more structured system.

THE WAY FORWARD

The steps taken by the National Treasury towards developing the Islamic finance industry has shown slow progress in the past decade or so, but as the country and the world at large seeks for alternative sources of finance, the recent strides taken by the Treasury show a deep interest in developing the industry and tapping into the foreign investment funds available around the world.

Mr. Rotich has not only mentioned the Cooperative Act and the SACCO Act but has also discussed other complementary legislations that have been amended to further support the Islamic finance industry in Kenya.

Kenya looks to position itself as the financial hub for East and Central Africa, and Islamic finance is a key component to making this a reality.

Kenya is also a signatory to the 17 UNDP Sustainable Development Goals (SDGs), for which poverty allevation and women's economic empowerment are key areas of focus. Microfinance is one important tool that has been proposed to help fight poverty in a developing country such as Kenya, and these amendments allowing for Islamic microfinance and Islamic finance in general will go along way to solve economic issues facing women and youth.

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Central Business District of Nairobi, Kenya.

AMANAH IKHTIAR MALAYSIA: ITS ROLE AND IMPACT AS AN ISLAMIC SOCIAL FINANCE ORGANIZATION

Prof. Datuk Dr. Syed Othman Alhabshi

Amanah Ikhtiar Malaysia (AIM) has grown in the past 30 years to become a successful non-governmental organization (NGO) that effectively demonstrates its ability to reduce poverty by providing microfinance to households once considered unbankable. Notable milestones since its founding are highlighted in Table 1.

From the beginning, its founders intended AIM to work closely with the government and operate in line with the principles of Shari'ah. Though AIM follows Shari'ah, it is still able to attract non-Muslim participants by adopting poverty as the sole eligibility criteria.

Its philosophy is based on the *hadith* in which the Prophet (SAW) counselled a man to earn for himself and his family instead of begging (Sunan Abi Daud, *hadith* no. 1641). Although the *hadith* is not formally included in the statement of philosophy of AIM, the essence of the *hadith* is reflected in AIM's mission and operations.

FOUNDATION OF AIM

In 1986, economists David Gibbons and Sukor Kasim, at Universiti Sains Malaysia (USM), proposed an action-based research program to replicate Grameen Bank of Bangladesh for two years. A write up in the newspaper attracted a few parties to collaborate on the project, including Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM), Asia Pacific Development Centre (APDC) and the Selangor State Government. The two-year project discovered the learning curve for various challenges in implementation, and more importantly, produced many success stories that justified its permanent establishment as a new institution.

In 1987, the project evolved into a registered Trust Body under Act 258, Trustees (Incorporation) Act 1952 (Revised 1981). AIM was officially launched as a Trustee Body on 17 September 1987.

MODUS OPERANDI OF AIM

AIM has developed and implemented a number of processes to ensure the success of its finance programs for the poor, namely:

1. **Identifying the area of operation:** The high-poverty populations and high-density areas are targeted based on the poverty distribution data from the Economic Planning Unit (EPU) of the Prime Minister's Department.

2. **Recruitment of participants (*sahabat*):** Once the area has been carefully selected, a survey of potential *sahabat* based on a "House Index" is conducted. The House Index judges the condition of a *sahabat*'s house. Most of the households selected for loans either have holes in the roof or walls or sometimes have no windows or doors on their houses. The list is confirmed through a series of interviews and a rigorous identification process.

3. **Formation of groups and centres:** Potential *sahabat* are invited to meet AIM officers and to be briefed on the microcredit scheme. If they agree to be *sahabat*, they have to attend one week of training that teaches them

Table 1: Major Milestones of AIM

Activity	Achievement
Families served by June 2015	366,631
Individuals served by June 2015	1,833,155
Total financing disbursed to June 2015	RM13 billion (US$3.02 billion)
Employees, June 2015	2,200
Average age of participants	70% between 20 and 50 years old
Repayment rate	Above 99%

the procedures and their requirements as *sahabat*. They are instructed in the social obligation to pay their loan as well as for the loan of any member that defaults. After the training, *sahabat* are assigned to a group of five or six. Every five or six groups constitute a centre. The group members do not have to be relatives. However, they are socially connected with each other.

4. **Weekly meetings:** The elected centre leader holds the authority to conduct weekly meetings. *Sahabat* meet and discuss various issues arising from the weekly activities, consider proposals for loans of members and pay loan instalments and compulsory savings of RM1.00 per week, which are different from loan instalments. These savings are imposed to cultivate saving habit among *sahabat*. Loans range from RM1,000 to RM50,000 with an average of RM6,000 per loan.

5. **Monitoring the utilization of funds (loans):** The *sahabat* is given two weeks to implement an approved proposal, and the Trust Officer will be responsible to see that the money has been used as proposed. Since the *sahabat* knows that they will be monitored, it is uncommon that there are abuses, and the repayment rate stands at more than 99%. This process is absent at most formal financial institutions, which instead collateralize the loans.

6. **Effective collection of repayment:** The collection of instalment payments is made at the weekly meetings. The AIM Trust Assistants are responsible for collecting all instalment payments to pay back the loan. There are compulsory weekly savings as well which the AIM Trust Assistants bank them within two days. The savings are for the individuals themselves. In case of non-payment, the group will have to pay on the part

> *AIM consciously encourages the participants to be honest, prudent, disciplined and focused in their efforts so that they can... generate enough income for the sustenance of their families, repay the financing amount, and save a little for the future..*

of the *sahabat* who fails to pay for that week. Successful repayment of the financing immediately entitles the participants to receive financing of normally double the previous amount.

7. Training and motivation of *sahabat*: Apart from providing information on loan requirements, AIM provides regular training to *sahabat* on marketing, leadership, motivational and other business skills.

NURTURING AN ISLAMIC SOCIAL ORGANIZATION

Values and Discipline

Based on its philosophy, AIM consciously encourages the participants to be honest, prudent, disciplined and focused in their efforts so that they can fully utilize the financing amount to generate enough income for the sustenance of their families, repay the financing amount, and save a little for the future.

One of the most important mechanisms in AIM is its disciplinary process, which the staff of AIM conducts if any member breaches moral and corporate values of AIM. A good number of AIM staff has been terminated from service when they did not follow the standard operating procedures, particularly if discrepancies are found in financial records.

Elements of Care and Sympathy

Given the wherewithal of the poor, AIM embraces the spirit of caring and sympathy (*ihsan*) in determining the conditions for financing. Participants need not have collateral and a guarantor, and there is no legal action taken against them in case of default, even if the entire group of five to six people defaults.

It is also based on the principle of *ihsan* that none of the members of the Board of Trustees or Management Committee of AIM take any payment of any kind for their work, time and efforts.

Usage of Technology

To improve efficiency, AIM has also introduced technology into its operation, such as an e-payment system that releases some of the staff from manually collecting and banking the cash. It allows them to do the more relevant and important tasks of training, development and monitoring of participants. These tasks need more attention as their scope keeps expanding.

CONCLUSION

What AIM has achieved could not have been so remarkable if it did not also change the mindset of the participants. They have evolved from seeking a simple income-generating activity to founding an enterprise that requires higher level of skill, innovation and self-confidence. Such a change inspires participants to establish entrepreneurial networks that deal with bigger issues of quality, productivity, marketing and financing, which is a major step towards much bigger achievements.

In the process of alleviating poverty, AIM has quadrupled the average income of its participants in extreme absolute poverty after they joined AIM. Moreover, about 10% of former participants are now considered high-income individuals. A study in 2015 showed that AIM's participants have not only raised their standard of living, but more importantly, they are also more satisfied with their physical, social and spiritual well-being.

From its start from old government quarters in the Lake Garden area at no cost, AIM now owns a multi-million-dollar building with more than 2,200 staff and branches across Malaysia. Such results make AIM a successful Islamic social organization. In recognition of AIM's success, it has been awarded the Best Islamic Microfinance Institution by Global Islamic Finance Awards (GIFA) for four consecutive years, since 2013.

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INSTITUTIONAL *ZAKAH* ADMINISTRATION: A CASE STUDY OF KUWAIT ZAKAT HOUSE

Prof. Dr. Abdul Razzaq al-Tabtabae and Dr. Mahadi Ahmad

A centralized *zakah* (almsgiving) administrative system was first created under the leadership of the Prophet (SAW) at the very time *zakah* was legislated. In today's Muslim world, the Kuwait Zakat House (KZH), established by Kuwait's Zakah Law of 1982 (amended in 2014), has been a pioneer of contemporary *zakah* administration. The recent amendment provided for the constitution of a board of *zakah* administration, chaired by the Minister of Awqaf and Islamic Affairs, and the appointment of a director general and deputies to manage and run the affairs of KZH. The establishment of a board has ushered in a higher level of efficiency in KZH, a development that has positioned the organization as an international point of reference for *zakah* administration in the Muslim world.

Furthermore, as early as 1983, KZH extended its charitable activities to the international arena, proving its growing strength as an institutional *zakah* administrator. This article aims to analyze the administrative system of KZH as a model for other *zakah* institutions worldwide.

THE ADMINISTRATIVE SYSTEM OF KZH

The administrative system of KZH follows a two-tier framework:

1. The first tier: The board of *zakah* administration which enforces the mandate of KZH in and outside Kuwait. The board implements the proposals of its committees, which contain both board members and outside experts. The committees design the technical frameworks and long-range operational plans for KZH, and therefore represent the powerhouse of KZH's success. They include the committee for the development of *zakah* proceeds' yields and publicity, which is also mandated to monitor the full implementation of the *zakah* law; the committee for local and international disbursement; the committee for the investment of KZH resources; the committee on corporate governance and risk management for *zakah* investment; the Shari'ah advisory committee; and the committee for investigation and auditing. One advantage of the board and its sub-committees is that they are outside the influence and above the control of the top management of KZH.

2. The second tier: The top management of KZH, including the Director General of KZH and his deputies. This level runs the daily affairs of KZH based on the law and the policies designed and sanctioned by the Minister and his board members. The top management strives towards achieving the mandate of KZH; a high level of supervision from the board helps it succeed.

BUDGETARY RESOURCES OF KZH

The budgetary resources of KZH are as follows:

1. The annual government budget is about KWD13 million (US$43 million). However, KZH is not allowed to invest the government

allocation unless there are no *zakah* recipients who are eligible to receive the funds (Al-Sabah, 2017).

2. *Zakah* collections from corporate bodies listed on the Kuwait Stock Exchange.

3. *Zakah* from individuals.

4. *Sadaqat* (voluntary charities), such as donations and gifts from individuals, government, corporate bodies and other members of the public.

5. *Wasiyyah* (bequests) made to KZH for the benefit of the legatee.

Some of the mechanisms employed by KZH to ensure its sustainability are:

1. Investment of its resources after proper feasibility studies. As at April 2017, the total value of invested assets at KZH stands at KWD 46 million (US$152 million) (Al-Sabah, 2017).

2. Transfer of non-*zakah* funds (i.e. *sadaqat*) to a special fund called *sadaqat jariyyah* (continuous charities) in form of cash *waqf*, with charitable spending from its profit. The fund invests in Shari'ah-compliant activities approved by the Shari'ah advisory committee.

3. Corporate governance of KZH and risk management of these investments coupled with the auditing of KZH.

4. Open government support and surveillance of KZH by National Assembly, external auditor.

5. Government efforts to safeguard *zakah* funds by providing a special annual subsidy of KWD 1.5 million for administrative costs, so that *zakah* payers' money will be distributed solely to the eligible beneficiaries (*asnaf*).

FUNDS OF KZH AND THEIR UTILIZATION

Zakah and *sadaqat* funds of KZH are divided into two categories, namely, funds for local projects and funds for international projects which are subdivided into several categories. Figure 1 summarizes those various funds.

KZH Funds for Local Projects

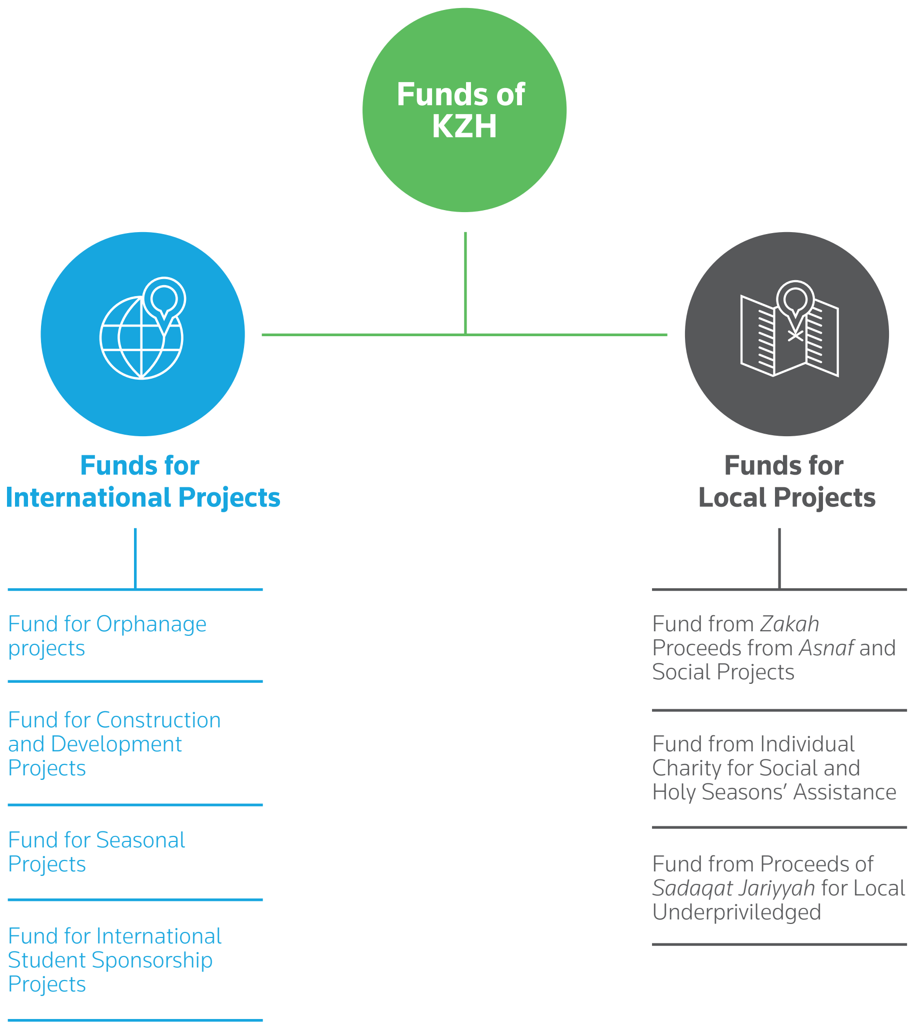
Funds from *Zakah* Proceeds

One distinct feature of KZH policy with regards to *zakah* proceeds is the statutory 70% of *zakah* and *sadaqat* that is exclusively utilized to help *asnaf* in Kuwait, with a special focus on the following areas:

a. **Educational sponsorship for local beneficiaries:** This includes students at the high school level and university students from poor and low-income families in Kuwait. The programme aims to provide this segment of the population with the required human capital development to take their family out of poverty. Each participant receives a monthly allowance of KWD50 at the high school level and of KWD120 at the college level.

b. **Social security services:** KZH uses *zakah* proceeds to alleviate poverty in Kuwait so that the poor can become self-reliant and capable of shouldering financial responsi-

Figure 1: KZH Funding for Local and International Projects



bilities. KZH considers this aspect of *zakah* utilization as a measure for preventing crimes engendered by unavoidable human needs. It will transform Kuwait into a secure society, free of social vices.

c. **Healthcare services for local beneficiaries:** KZH funds go toward the treatment of diseases abroad for illnesses that have no experts in Kuwait, assistance in discharging medical bills for the needy, purchasing medical equipment recommended for persons with terminal diseases, and the treatment of those with low incomes. Furthermore, under this scheme, KZH provides monthly food allowances for low-income earners, families of prisoners, orphans, widows, divorcees, the elderly, and people suffering from terminal illnesses.

Funds from Proceeds of *Sadaqat Jariyyah*

In 1985, KZH established this *waqf*-like fund, which aims to ensure the sustainability of KZH and to act as a financial buffer and risk reduction mechanism for KZH. The fund is managed and invested, and KZH uses its returns on investment to discharge philanthropic works alongside *zakah* spending inside Kuwait, particularly as cash *waqf*. The beneficiaries of this fund include widows, divorcees, the elderly, fam-

> *To provide food aid, KZH slaughters and processes around 2,200 eid al-adha animals annually, which are distributed to the poor...*

ilies of prisoners, low-income earners, orphans, students and other less-privileged families. The fund is also used to manage *wassiyah* on behalf of beneficiaries whose legator has appointed KHZ as the administrator.

Funds from Individual Charities

The third source of KZH's funds specified for local beneficiaries caters to the following key activities:

- **i.** Education of children from poor families, a payment of KWD7,500 per student from primary to higher education.
- **ii.** Management of animals slaughtered for *eid al-adha* by the well-off in Kuwait, who seek to distribute most of the meat to the poor.
- **iii.** Management of *zakat al-fitr* (the *zakah* that must be paid by every Muslim on the eve of eid al-fitr) by collecting it from payers and redistributing it to appropriate beneficiaries inside Kuwait.

KZH Funds for International Projects

KZH is mandated to extend its charitable activities outside Kuwait. Basically, only 30% of *zakah* and *sadaqat* is allowed by law to go to charity outside Kuwait. A sign of KZH's global influence is that a majority of the donors ask KZH directly to find opportunities for them to fund social projects outside Kuwait. Funds for international beneficiaries include:

1. **Fund for international students' sponsorship project:** This project extends financial assistance to international students studying outside Kuwait in Africa, Asia, South America and Europe. It also regularly funds international students studying at Al-Azhar University in Egypt.
2. **Fund for seasonal projects:** The tragedies of natural disasters and internal disorders in Muslim countries have caused KZH to establish a special fund for seasonal projects to allow quick response and humanitarian interventions. To provide food aid, KZH slaughters and processes around 2,200 *eid al-adha* animals annually, which are distributed to the poor in those countries, in addition to *iftar* meals every Ramadan.
3. **Fund for construction and development projects:** In this project, a donor is expect-

ed to pay at least KWD650 per project. KZH uses donations to build residential houses, schools, mosques in various countries in Asia, Africa, Europe and South America. KZH also builds clinics, skills acquisition centres and provides residences with adequate water supply and other infrastructural facilities.

4. **Fund for orphanage projects:** In 1983, just one year after its establishment, KZH established a special fund to aid orphans around the world. In 2016 for example, KZH spent KWD5 million for sponsorship of education and care of 28, 352 orphans in 38 countries.

Each fund is managed separately without its commingling with other funds. This allows KZH to assess the performance of each and identify any weaknesses so that appropriate and timely solutions can address any arising issues.

THE WAY FORWARD

KZH has had long-lasting success since its establishment in 1982. During its existence, it has adopted innovative techniques of *zakah* management and investment. Its significant impact on local and international charitable projects is unrivalled.

KZH envisions spreading knowledge of *zakah* management and other charitable givings to other parts of the world, among both Muslim-majority and Muslim-minority communities. KZH intends to design a curriculum to teach the social importance and rules of *zakah* and *sadaqat* to primary, high school and university students. This will encourage the spirit of paying *zakah* in coming generations and provoke research on ways of developing a *zakah* administrative system that can function more effectively than modern taxation systems.

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THE MODERN *ZAKAH* SYSTEM AND THE BILL AND MELINDA GATES FOUNDATION

Abdulaziz Goni

Zakah, the third pillar of Islam, places the obligation of charitable contribution upon Muslims whose wealth has reached the minimum threshold (*nisab*) and has been in their ownership for a complete lunar year (*hawl*). The purpose of *zakah* is to 'cleanse' one's money and possessions from excessive desire or greed as stated in the Qur'an: "Take, [O, Muhammad], from their wealth a charity by which you purify them and cause them increase, and invoke [Allah's blessings] upon them. Indeed, your invocations are reassurance for them. And Allah is Hearing and Knowing." (Qur'an, 9:103). *Zakah* also aims to teach people not to place too much importance on material wealth and instead to help improve the Muslim community.

The Bill and Melinda Gates Foundation, guided by the belief that every life has equal value, is a philanthropic institution founded by the billionaire founder of Microsoft, Bill Gates and his wife, Melinda Gates. The Bill and Melinda Gates Foundation has made significant strides in social development by tackling diseases such as malaria and polio in poverty stricken countries across the world.

These charitable systems have overlapping philosophies. However, with an estimated 1.6 billion Muslims worldwide, the challenge remains that the *zakah* system has not been able to make a lasting impact on social development for the less fortunate, even though this is an age-old tradition amongst Muslims. Poverty still remains very high in many Muslim-majority countries around the world, which is a sign that *zakah* distribution is not reaching those in need of aid. The Gates Foundation, however, has been able to make a lasting impact on the livelihoods of the less fortunate. This article will investigate ways *zakah* institutions can emulate the successes of the Gates Foundation.

THE MODERN *ZAKAH* SYSTEM

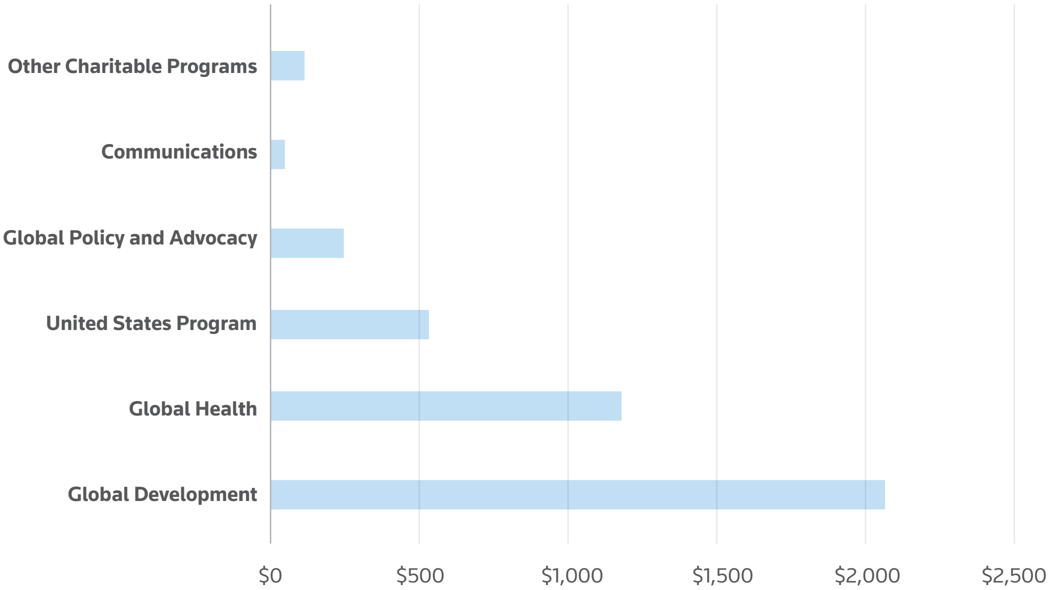
The Prophet (SAW) said, "O People! Give in charity as a time will come upon you when a person will wander about with his object of charity and will not find anybody to accept it, and one who will be requested to take it will say, 'If you had brought it yesterday, I would have taken it, but today I am not in need of it.'" (Sahih al-Bukhari, *hadith* no. 1411).

Based on this *hadith*, poverty could be alleviated in many majority-Muslim countries if there was a more transparent *zakah* system in place, as a number of Middle Eastern countries are among the world's wealthiest nations.

The major challenge for the modern *zakah* system is the lack of a global standard for tracking the collection and distribution of *zakah* in the Muslim world. In developed Islamic economies, governmental *zakah* collection boards typically conduct *zakah* collection. There are a few *zakah* collection boards that diligently track *zakah* collection within their jurisdictions. These include the Kuwait Zakat House (KZH). In May 2017, it launched a campaign titled "Let them spend Ramadan with us," which raised US$4 million to alleviate the debts of incarcerated Kuwaitis who were unable to settle their debts. Since its inception, the KZH has been able to distribute *zakah* worth US$1.05 billion to 102,900 families in the country (Hasan, 2015).

Another recent initiative by a Muslim country to track the collection and distribution of *zakah* is

Figure 1: Bill and Melinda Gates Foundation's Funding Areas in 2015 (US$ Million)



by the Indonesian National Zakat Board or Badan Amil Zakat Nasional (BAZNAS). BAZNAS created a *zakah* index to track the management and performance of *zakah* institutions in Indonesia, which is a step forward in the road to transparency for *zakah* collection and distribution. BAZNAS recorded approximately US$47.6 million (BAZNAS, 2017) in *zakah* donations in 2015.

THE GLOBAL IMPACT OF THE BILL AND MELINDA GATES FOUNDATION

Since the Gates Foundation's creation in 2000, it has donated over US$35 billion worldwide to help battle diseases such as polio and malaria, hunger and poverty. The foundation has also put a focus on fostering agricultural development as well as developing education in poor countries.

In a targeted approach to aid in the socio-economic wellbeing of Muslim countries, the Gates Foundation partnered with the Islamic Development Bank and other regional social development funds in the Gulf Cooperation Council (GCC) to launch the Lives and Livelihoods Fund in 2015. The US$2.5 billion fund aims to develop healthcare, agriculture and infrastructure with grants and concessional loans in Muslim-majority countries. The first project launched by this fund was a US$32 million financing agreement to eradicate malaria in Senegal. In 2015, the Bill and Melinda Gates Foundation donated US$4.1 billion towards all its global development projects. Figure 1 depicts the various programme areas to which the funds were directed.

THE IMPACT OF *ZAKAH* IN MUSLIM-MAJORITY COUNTRIES

Here we will examine the potential for *zakah* collection in Malaysia and Indonesia, two Muslim-majority countries, to make a better impact on social development.

Malaysia

Zakah administration in Malaysia is a state matter, for which respective heads of state manage *zakah* collection under the respective State Islamic Religious Councils (SIRCs). Hence, this article will only look into the *zakah* collection figures within the Federal Territories of Malaysia—comprising Kuala Lumpur, Putrajaya and Labuan—whose *zakah* affairs are managed by Majlis Agama Islam Wilayah Persekutuan

(MAIWP), which established Pusat Pungutan Zakat (PPZ) to collect *zakah*. Table 1 shows that there has been an increase in *zakah* collections between 2014 and 2015 within the Federal Territories of the country. However, the way the funds are distributed remains unclear. MAIWP has a *zakah* fund that mobilizes funds for the development of education and healthcare services for the less fortunate and *zakah* shares, which redirect contributions into investable assets, which we can assume are used for charitable activities. Unfortunately, this cannot be verified, since there is no clear statement on how these *zakah* funds are utilized.

Table 1: *Zakah* Collection in the Federal Territories of Malaysia

2014	2015
US$123.3 Million	US$129 Million

Source: PPZ-MAIWP

Indonesia

Zakah collection in Indonesia is handled by the BAZNAS. There has been a steady increase in *zakah* contributions as well in Indonesia, as depicted in Table 2.

Table 2: *Zakah* Collection in Indonesia

2014	2015
US$248.1 Million	US$274.4 Million

Source: Baznas

Compared to the Federal Territories of Malaysia, *zakah* contributions in Indonesia are mobilized into clearly stated sectors with a focus on social development for the poor in the country. The areas where funds are mobilized include:

1. Education
2. Humanitarian aid
3. Healthcare for the less privileged
4. Community development

OTHER MUSLIM MAJORITY COUNTRIES

Figure 2 shows the gross domestic product (GDP) per capita of a selection of 14 Muslim-majority countries whose data are analysed to give us an idea of how *zakah*, if managed efficiently would be able to alleviate poverty in the Muslim world. The sum total of the GDP per capita of these countries is US$231 trillion. When multiplied by 2.5% it gives a total potential of US$577 billion to be collected as *zakah* in these countries. An annual collection of even a small portion of this amount would be more than enough to cater to the basic needs of the hardcore poor in these countries.

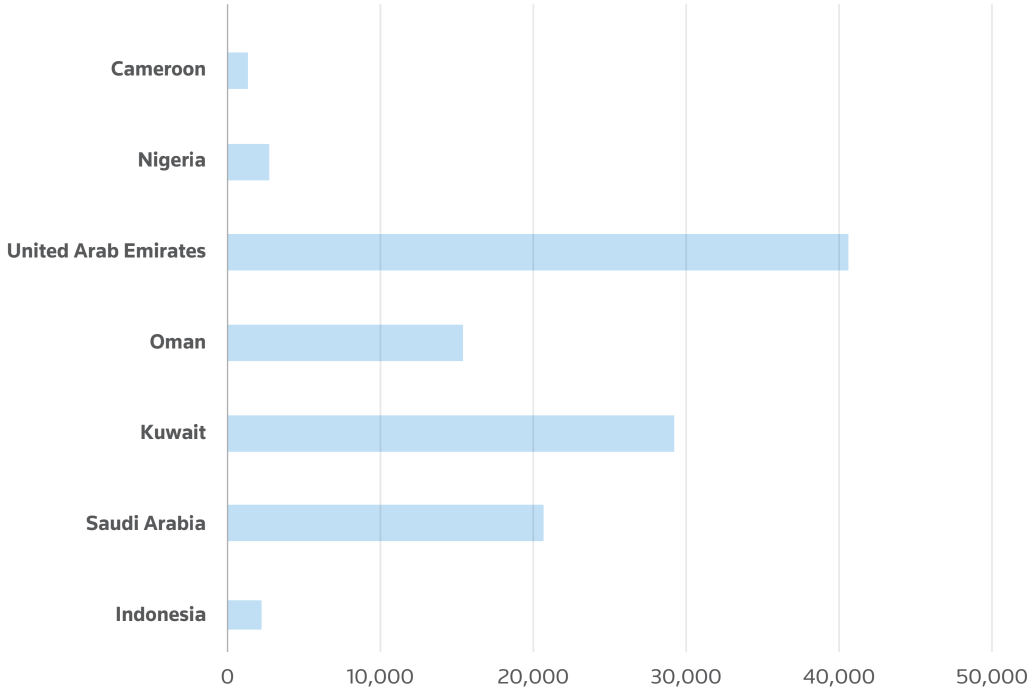
THE WAY FORWARD

As Muslims, we need to take a more active role in keeping track of our *zakah* contributions. Once poverty is alleviated, we can focus on using it to become higher-income and knowledge-based economies. Charity is non-taxable globally, which should encourage full utilization of resources for proper distribution to those in need.

Malaysia, Indonesia and some countries in the Middle East have established efficient *zakah* collection systems, however, there still does not exist any proper *zakah* administration or legislative structure to monitor the distribution of funds received. This is very important to establish in order to make sure that any funds contributed are not mismanaged.

One solution could be to keep track of *zakah* payments with a global *zakah* tracking system created by an independent body. *Zakah* payments could be collected by each member country's collection board, after which these funds would be deposited into a centralized global fund managed by the independent body and distributed accordingly based on the global

Figure 2: GDP Per Capita in Muslim-Majority Countries (US$ Million)



Source: World Bank

needs of the member countries' poor. This system would help properly allocate *zakah* aid to those in need and improve global social development.

Efforts have been made by the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB) in collaboration with governments of Jordan and Kuwait to create a central *zakah* organization that will track *zakah* collections globally. The headquarters of this organization is based in Kuala Lumpur, Malaysia and annual meetings are held to discuss methods to better mobilize the collection of *zakah*. However, as this organization is in its early stages, its impact cannot be currently assessed.

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PART 6

The Way Forward

Reuters/ Muhammad Hamed

Summary

The rapid spread of Islamic finance around the world in the past 40 years has raised many questions about the best way for governments to regulate and encourage this business such that it fosters public trust in its authenticity and social and economic contribution. With the growing interest in both socially and environmentally aware investing, and the spread of corporate social responsibility programs, Islamic financial institutions (IFIs) bring forward sophisticated Shari'ah-compliant services that are totally in line with current global trends towards ethical finance and attractive to Muslim clients.

To spread the use of Islamic social finance, professionals and Shari'ah scholars are recommending efforts to harmonize Shari'ah regulations across jurisdictions to increase public confidence and seek economies of scale. Indonesian-based IFIs have held comprehensive workshops to establish core principles for *zakah* and *waqf* management. These conferences recommend minimum global standards for *zakah* and *waqf* authorities encompassing best practices in supervisory and prudential regulations. They have also addressed issues such as *waqf* credit risk, governance and transparency.

Meanwhile, Malaysian IFIs are incorporating Islamic social institutions into their corporate social responsibility programs that engage bank clients with *sadaqah* and *waqf* programs to which they may voluntarily and efficiently contribute. These institutions manage the funds, returning the surplus to the community in the form of *qard hasan* and takaful coverage. Prominent individual philanthropic groups are also encouraging the public to donate more generously, such as the Abdulla Al Ghurair Foundation for Education in the United Arab Emirates (UAE), by stressing a more active form of charity based on developing the economy through improving the skill set of the younger generation.

International organizations such as the International Monetary Fund (IMF), World Bank, Islamic Development Bank (IDB) have taken interest in increasing awareness about the opportunities Islamic social finance can provide worldwide. This year, the World Bank and IDB published "*Islamic Finance: A Catalyst for Shared Prosperity*". IMF Senior Financial Sector Expert Abdullah Haron believes such collaborations, including between international organizations, national states, and Islamic finance industry stakeholders, are essential for improving the regulatory environment that will lead to improved public awareness of Islamic social finance and financial inclusion.

TOWARDS A UNIFIED REGULATORY FRAMEWORK FOR ISLAMIC SOCIAL FINANCE: LESSONS FROM THE DEVELOPMENT OF CORE PRINCIPLES

Prof. Dr. Dato' M. Azmi Omar and Dr. Hylmun Izhar

Institutional development in the Islamic financial services industry has taken place at different levels. Composed of four primary sectors, namely Islamic banking, Islamic capital markets, takaful and retakaful, and Islamic social finance, the industry has achieved its current level of development mainly by the efforts of profit-geared institutions. In particular, the Islamic banking sector still continues to predominate in shaping the goals and methods of the industry. One sector that is often overlooked but carries immense potential, is Islamic social finance. It has been proven more resilient than the first three sectors aforementioned and, in fact, it can help in achieving greater financial inclusion. This is due to the fact that the institutions in Islamic social finance require no 'regulatory capital' formation as such. Therefore, they operate under fewer constraints than profit seeking institutions, such as Islamic banks.

The Islamic social finance sector, which broadly comprises traditional Islamic institutions based on philanthropy such as *zakah* (almsgiving), *sadaqah* (voluntary charity) and *waqf* (Islamic endowment) as well as contemporary Islamic not-for-profit microfinance institutions,[1] has huge potential to serve clients that are not 'bankable.' Since these institutions use forms inherited from Islamic tradition, the way they operate is also subject to a set of Shari'ah principles that must be adhered to at all times. Management should maintain their financial sustainability and outreach,[2] in order to ensure that their benefits and impact will endure for the next generation.

In light of these goals, the harmonization of business practices and the regulatory framework for Islamic social finance is a necessary condition for further nurturing the sector, owing to the differences of regulation and regulatory frameworks across jurisdictions. Such variations reflect the unique circumstances and priorities of each jurisdiction resulting from the history and customs of their societies. Harmonization, however, is an important objective. The harmonization of regulations across jurisdictions allows for expanded activities that will unleash the potential of the Islamic social finance sector, resulting in a greater impact on society.

PERTINENT ISSUES IN ISLAMIC SOCIAL FINANCE

Although Islamic social finance has grown and attracted a range of new key stakeholders, it remains faced with a number of challenges at the macro-, meso- and micro-levels of organization. These include:

1. How much regulation is right for the Islamic social finance sector?

2. Do stringent laws and overregulation stifle the sector?

3. How should the key stakeholders harmonize different regulatory frameworks governing

> *The Islamic social finance sector has huge potential to serve clients that are not 'bankable.'*

institutions that include religious and secular philanthropy, co-operation, and not-for-profit and for-profit finance?

4. How should they develop a unified and integrated framework for the Islamic social finance sector?

More specifically, as articulated in the IRTI Islamic Social Finance Report 2015, questions relevant to *zakah* that may have major policy implications are:

1. How do we ensure standardization in defining assets subject to *zakah* and estimating *zakah* liability in the presence of diversity in legal opinions?
2. Is *zakah* a dependable source of funds for institutions?
3. Does the state perform better than private institutions in the domain of *zakah* management?
4. Should *zakah* payment to state authorities be made compulsory?
5. Should a *zakah* payer (*muzakki*) be allowed to choose between public and private *zakah* collectors?
6. Should *zakah* payments be allowed as a deduction to income tax payable or to taxable income?
7. Is corporatization good for *zakah* management?
8. Should *zakah* be allocated for other types of beneficiaries only after the needs of the ultra-poor are addressed?
9. Does the requirement of ownership (*tamlik*[3]) in *zakah* imply unconditional cash transfer?
10. Should *zakah* be used for giving loans (*qard*)? Will the answer be different if *zakah* funds are used to create a revolving fund (credit pool) to leverage the relatively scarce *zakah* funds for meeting the needs of a much larger number of the poor? Will the answer be different if the revolving fund is owned by the poor?

Moreover, the IRTI Islamic Social Finance Report 2015 identified the following issues related to *waqf* that have become the source of continued debate:

1. What should be the coverage of an ideal legal framework for *awqaf*?
2. How should the regulator strike a balance between concerns of preservation and development?
3. Must an endower (*waqif*) always be a Muslim?
4. Should *waqf* be restricted only to immovable properties like land and buildings?

5. How should family *waqf* be dealt with in legal frameworks?

6. Should the state have absolute power to terminate a trustee (*mutawalli*) nominated by the *waqif* and to take *waqf* assets under its own management?

7. How should existing *awqaf* be preserved and protected?

8. How effective are the penalties imposed by law against erring and dishonest private *mutawalli*?

9. How should the corpus of a *waqf* be invested?

STRATEGIC INITIATIVES TO ADDRESS THE ISSUES

Answers to the above questions surely require careful analysis and careful observation, backed up by robust data and sensitivity to the uniqueness of each jurisdiction. In an attempt to establish a unified framework, a memorandum of understanding (MoU) between the IDB Group and Bank Indonesia was signed in November 2014. Its main objective was to provide a general framework for facilitating collaboration and cooperation between the IDB Group and Bank Indonesia in promoting both institutions' mutual interests towards the development of Islamic social finance.

As a result of the MoU, the institutions held four workshops on *zakah* management core principles, followed by a public hearing. The first workshop on Core Principles of Zakat Management was organized jointly by Bank Indonesia, National Zakat Board or Badan Amil Zakat Nasional (BAZNAS), Islamic Research and Training Institute (IRTI) and Islamic Development Bank (IDB) during August 28-29, 2014 in Jakarta, Indonesia. This workshop was held as part of the 3rd International Conference on Inclusive Islamic Financial Sector Development and International Working Group on Zakat Core Principles.

The purpose of the conference was to strengthen cooperation among Muslim countries to better implement *zakah* and *waqf* as a means of increasing Islamic financial inclusion. The workshop focused on fine-tuning a first draft for core principles of *zakah* management. It sought the opinion of representatives of different jurisdictions to make it acceptable to pass laws and regulation pertaining to *zakah* in their respective countries. The core principles of *zakah* management will help existing regulatory bodies in different jurisdictions to improve governance. For the countries that do not have a *zakah* system in operation, it will provide the basis for making *zakah* laws and regulations.

In essence, the main objective of the *zakah* and *waqf* core principles is to strengthen a sound supervisory *zakah* and *waqf* management by establishing a set of minimum standards and principles to be adopted by relevant *zakah* or *waqf* authorities. While *zakah* core principles comprise eighteen principles, which are divided into two main categories: i) essential criteria and ii) additional criteria. *Waqf* core principles, on the other hand, consist of twenty eight core principles, further classified into two main components: i) supervisory powers, responsibilities and functions, and ii) prudential regulations and requirements.

What is meant by essential criteria set out in *zakah* core principles is any element that should be in place in *zakah* management in order to function both efficiently and effectively, such as the presence of legal foundations and robust governance. Whereas the additional criteria refers to 'add-on' elements, such as risk management, that may be much relevant to those who are more advance in managing their *zakah*.

Furthermore, key issues that are deliberated upon in *waqf* core principles are risk factors confronting *waqf*. It goes without saying that a *waqf* has many distinct features making it different from lending-type financial institutions. For example, credit risk with cash *waqf* is highlighted in the document as a major risk factor, particularly in the context of a non-traditional "temporary" cash *waqf* where the corpus must be returned to the *waqif*. Another prominent issue being dealth with is about *waqf*-corpus depletion. Other issues set out in the standards include *waqf* governance, disclosure and transparency, and revenue and profit loss sharing risk.

The Zakat Core Principles were ultimately launched at the United Nation's inaugural World Humanitarian Summit on 23-24 May 2016 in Istanbul. A day before the launch, the daily Star of Malaysia published an interview titled "Taking Islamic Social Finance to the World" with His Royal Highness Sultan Nazrin Muizuddin Shah, who led a special session on Islamic social finance at the summit.

WHAT'S NEXT?

To foster the development of the *zakah* and *waqf* sectors in a more systematic manner, there is also a plan to establish a new standard-setting body, namely, the Islamic Inclusive Financial Services Board (IIFSB). IIFSB aims at producing a sound regulatory framework for *zakah* and *waqf* systems, as well as increasing the quality of *zakah* and *waqf* management. IIFSB would develop principles for effective and efficient *zakah* and *waqf* supervision and regulation that could be the main reference for the OIC member countries. Furthermore, the regulatory standards issued may be used in the international financial sector assessment process (FSAP), as the *zakah* and *waqf* sectors are embedded features of the Islamic financial system.

With such immense potential for uplifting the economic status of un-bankable beneficiaries, the Islamic social finance sector cannot simply be overlooked. It does not only have the ability to tap a market that mainstream finance has difficulty serving. More importantly, it possesses huge potential to provide additional and alternative financial services that have possibly even greater economic benefits than conventional finance. The key in achieving such potential, however, may depend on the degree and quality of social finance institutions' governance and management. These core principles, therefore, must be developed to establish foundations and principles on which Islamic social finance institutions can be built.

FOOTNOTES:

1 The definition of Islamic Social Finance is adopted from IRTI Islamic Social Finance Report 2014 and 2015.

2 Nazir for *Waqf*, Amil for *Zakah*.

3 The term *tamlik* implies a process of imparting ownership. In the context of *zakah*, *tamlik* is seen as a requirement that essentially implies making the mustahiq (*zakah* recipient) the owner of donated funds.

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COMMUNITY EMPOWERMENT INITIATIVES BY ISLAMIC BANKING INSTITUTIONS VIA *SADAQAH* AND *WAQF*

Dr. Hamim Syahrum Ahmad Mokhtar

Islamic social finance instruments such as *zakah* (almsgiving), *waqf* (Islamic endowment), *qard hasan* (interest-free loan) and *sadaqah* (voluntary charity) are significant mechanisms to empower social justice and to eradicate poverty. This article explores how these alternative sources of income to Islamic banking institutions (IBIs), particularly *sadaqah* and *waqf*, can be harnessed to enable Islamic banks to link with social finance and thus to have a positive impact on society. This can be done by giving the option to clients to donate some portions of their money in the form of *sadaqah* or *waqf* via direct transfer or by drawing from the *hibah* (gift) earned on deposits and investment account profits.

THE RISE OF ISLAMIC SOCIAL FINANCE

IBIs are increasingly involved in corporate social responsibility (CSR) initiatives as part of their efforts to give back to society. Heavily funded by Islamic banks, a majority of these CSR initiatives focus on community, poverty, education and the environment to promote socioeconomic justice and the equitable distribution of wealth.

Seeing the significant impact that CSR initiatives have had, a number of Islamic banks have tapped into alternative sources of funds, namely *sadaqah* and *waqf*, to offer various social finance products. Box 1 delineates the latest social finance initiatives by IBIs in Malaysia. With these

> *Islamic banks may also use the pooled funds to offer qard hasan or other suitable Islamic financing contracts, particularly to micro-entrepreneurs.*

Box 1: Innovative social finance products by IBIs in Malaysia

Wakaf Selangor-Muamalat

A joint collaboration between Perbadanan *Waqf* Selangor (PWS) and Bank Muamalat. The collection of the *waqf* funds is carried out on behalf of PWS and credited into PWS' collection account. The *waqf* fund is managed by a Joint Management Committee (JMC) of Bank Muamalat and PWS. *Waqf* funds collected will be channeled to providing education and improving health, while Bank Muamalat also makes prospective investment recommendations for JMC's consideration. Investment returns will then be fully transferred to the *waqf* fund for use.

Wakaf Perak Ar-Ridzuan

Maybank Islamic is collaborating with Majlis Agama Islam Perak (MAIP) in the collection of cash *waqf* from the public. Maybank Islamic will assume three roles under the *waqf* arrangement: collection agent via the online platform (Maybank2u), endower (*waqif*) and fund manager. The arrangement is expected to improve cash *waqf* collection and management by capitalising on Maybank Islamic's vast distribution network and expertise in cash and fund management. Maybank Islamic, as waqif, contributes RM5 million to *waqf* khas (for the construction of a hostel project in Perak) and RM5 million to general cash *waqf* which is pledged on one-to-one basis of every contribution made via Maybank2u. As the fund manager, Maybank Islamic will invest the general cash *waqf* fund via investment portfolio consisting of fixed income, equities and balanced fund. Dividends from the investment shall be partly recapitalized to the general cash *waqf* for further investment and partly be utilized for various projects such as education, healthcare and economic empowerment.

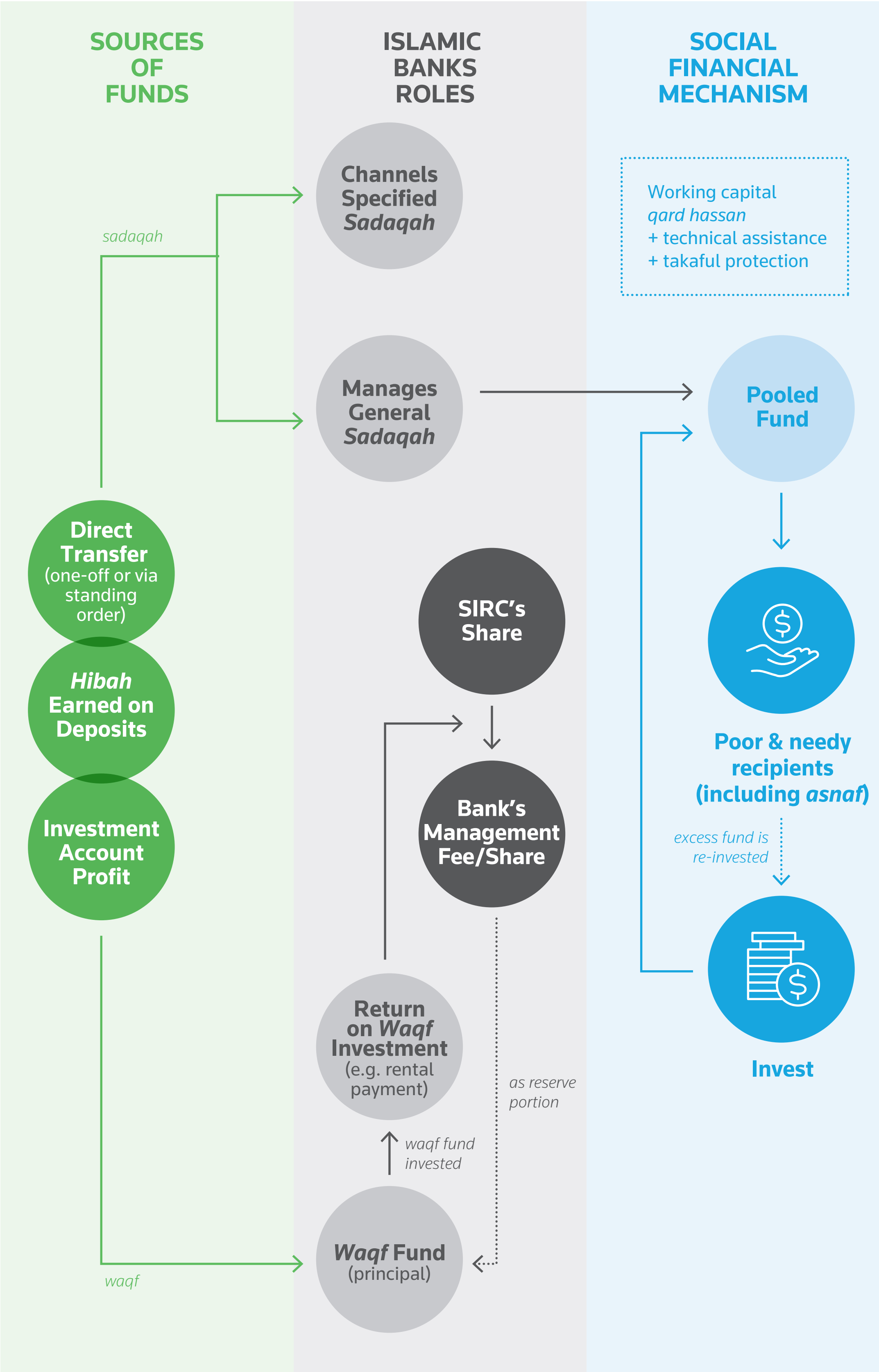
Cashless donation via Visa Paywave

In the move towards a cashless society, Bank Islam has introduced a contactless donation service via e-donation terminals in mosques. The e-donation terminals (using Visa payWave) make donations easier as there is no need for donors to bring cash to the mosque. This has also improved the cash management process of mosques by minimizing the risk of theft and robbery.

Debit card with *waqf* feature

Bank Muamalat introduced debit card 'Aisya', whereby 20% of the interchange fee income paid by the merchants will be directed to *waqf* with no extra fees and charges to the customers. This initiative is part of Bank Muamalat's community empowerment programme to contribute to society.

Figure 1: Community Empowerment Initiative (Phase 1)



additional sources of funds, IBIs are able to link Islamic finance with social finance, greatly expanding the scope of social initiatives beyond current CSR practices.

INTEGRATING *SADAQAH* AND *WAQF* UNDER COMMUNITY EMPOWERMENT INITIATIVES

The community empowerment initiative is a concept that Islamic banks may wish to explore to offer *sadaqah* and *waqf* as part of their services. As shown in Figure 1, the public has the option to give away some portions of their money in the form of *sadaqah* or *waqf* via direct transfer or drawing from the *hibah* (gift) earned on deposits and investment account profits.

THE ROLE OF ISLAMIC BANKS IN MANAGING *WAQF* AND *SADAQAH* FUNDS

Given the different nature of *waqf* and *sadaqah*, Islamic banks are expected to play distinct roles in managing these funds, as follows:

- Administering specific as well as general *sadaqah*. *Sadaqah* received from the public is either for specific or general purposes. For specific *sadaqah*, Islamic banks will channel contributions directly to specific charitable organizations that are recognized and eligible to receive charitable funds. For general *sadaqah*, contributions will be channelled to the pooled fund.

- Managing and distributing the return from cash *waqf* investments based on the Shari'ah contract of *mudarabah* (profit sharing) or *wakalah bil istithmar* (investment agency). As *waqf* falls under the jurisdiction of respective states in Malaysia, Islamic banks need to closely work with State Islamic Religious Councils (SIRCs) to become collection agents and to jointly manage the funds. In accordance with the nature of *waqf*, the principal of a cash *waqf* fund must remain intact. Therefore, only the returns on *waqf* investment will be distributed between SIRC (as a sole trustee of *waqf*) and the Islamic bank based on a pre-agreed ratio.

CREATING SIGNIFICANT BENEFITS TO SOCIETY

With large pooled funds, Islamic banks will have a greater ability to manage and finance various programmes, including:

- **Technical assistance:** Providing various skills enhancement programmes such as sewing, electrical wiring and entrepreneurship skills. This will elevate the employability of various target groups including *asnaf* (*zakah* beneficiaries), and the marketability of their products. To identify eligible *asnaf*, Islamic banks may wish to collaborate with SIRC.

- ***Qard hasan:*** As the poor also need a variety of services catering to their financial needs, Islamic banks may also use the pooled funds to offer *qard hasan* or *others suitable Islamic financing contracts*, particularly to micro-entrepreneurs who have limited access to finance. The administrative cost of disbursing the qard is absorbed using the pooled funds, and so the poor are able to repay at an affordable principal cost. In cases that larger scale financing is required by the micro-entrepreneurs, the pooled funds can be combined with the deposit funds, allowing a lower cost of financing to be offered.

- **Takaful coverage:** To grant the poor greater access to takaful protection, the pooled funds can also be used to pay for protection covers. Takaful operators may become part of the community empowerment initiative by establishing a special takaful fund based on mutual arrangement, in addition to the risk fund and investment fund, dedicated for microtakaful coverage such as personal accident and charity. Using this model, payment of benefits upon the occurrence of unfortunate events will be made subject to the availability of funds, thus minimising the cost of providing the coverage.

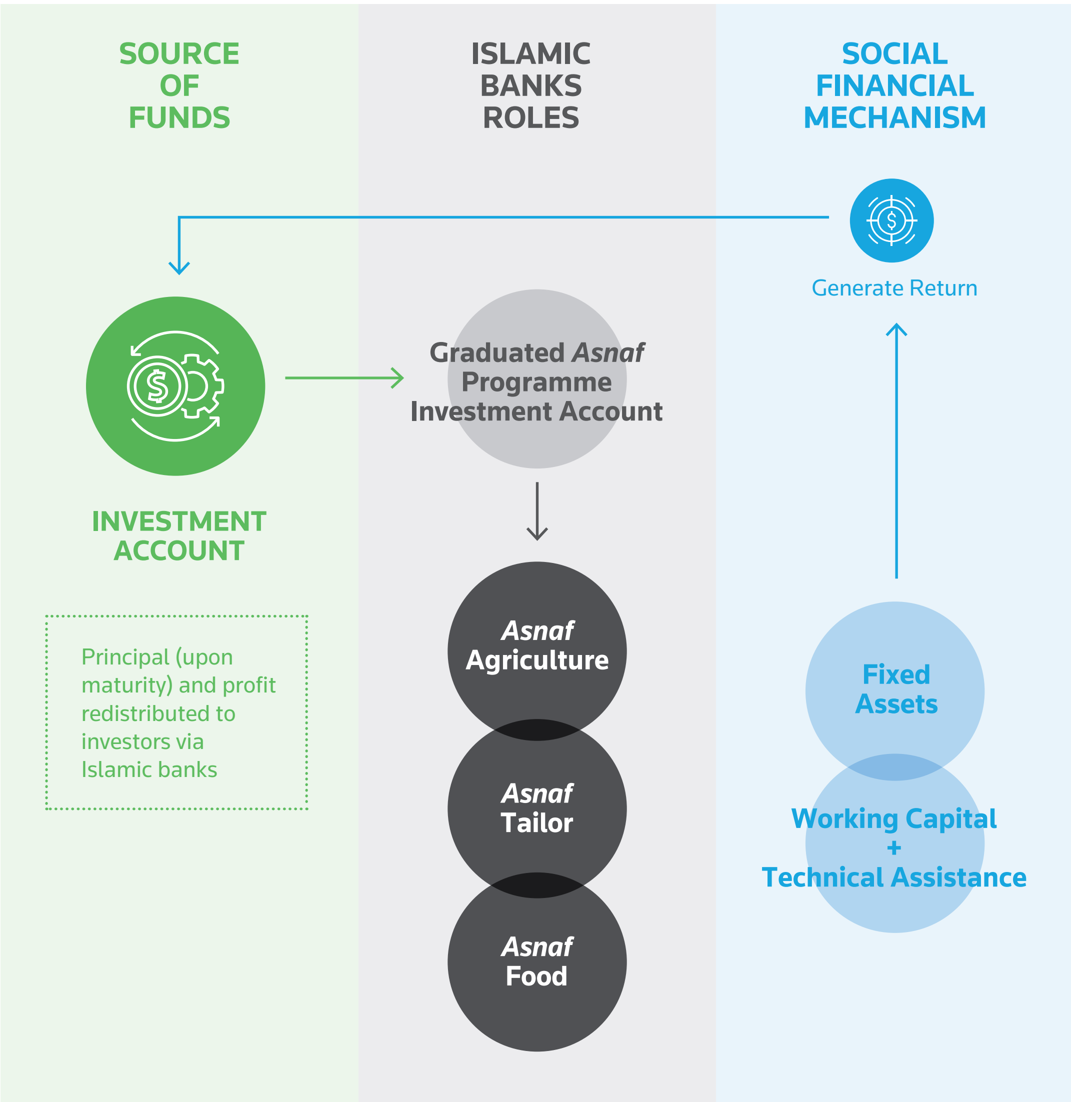
To ensure continuous and sustainable initiatives, the surplus from the pooled funds shall be invested in various portfolios to create a self-funding mechanism.

FINANCING THROUGH AN INVESTMENT ACCOUNT

Once a poor individual or family has the ability to generate their own income and meet basic needs, they would no longer be eligible for the pooled funds. Therefore, Islamic banks may consider using investment accounts as an alternative source of funds that can be channelled to finance such customers' business needs (Figure 2).

Investment accounts provide an opportunity for the public to extend a helping hand from the funds provided to graduated *asnaf* who are slowly transitioning out of poverty, but who may not be fully prepared to undertake normal financing terms offered by Islamic banks. This will enhance their well-being and prevent them from falling back into poverty. Unlike Phase 1 of the community empowerment initiative, where the risk is fully borne by the pooled funds, investment accounts promote risk-sharing, whereby the

Figure 2: Community Empowerment Initiative (Phase 2)



level of return depends on the performance of the business and the form of return is governed by the type of Shari'ah contract adopted. Depending on a business' needs, Islamic banks may provide working capital, technical assistance or fixed assets to help graduated *asnaf* to enhance their skills and knowledge to run businesses as shown in Figure 2. Profits generated from the businesses shall then be distributed to investors.

THE WAY FORWARD

The integration of *waqf* and *sadaqah* in the community empowerment initiative is in line with Islamic values. It is envisaged that Islamic banks will be able to explore the potential of the several suggestions above to promote social justice and the equitable distribution of wealth. By effectively channelling the public's contribution to and investment in the poor and needy, it will reduce the income inequality gap in Malaysia.

In the future, Islamic banks may wish to expand CSR initiatives beyond helping the poor. This includes empowering the community with the development, funding and implementation of effective financial solutions for other challenges it faces. Availability of sophisticated Islamic social finance products would further have a positive impact on the community and foster new business opportunities for IBIs, which are expected to balance commercial and social considerations in navigating their strategic decisions. They may thus naturally give back to society in their business practices and offerings, beyond corporate social responsibility activities. This may be measured in the number of IBIs involved in community-based projects. Islamic banks should also consider providing financial assistance to various humanitarian projects, such as rebuilding houses in areas affected by natural calamities. Such initiatives would enhance the image and reputation of Islamic banks as well as heighten customers' confidence in these institutions.

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SHIFTING FROM TRADITIONAL CHARITY TO AN ISLAMIC ECONOMIC SYSTEM FOR HIGH-IMPACT PHILANTHROPY

H.E. Abdul Aziz Al Ghurair

The act of charitable giving is a foundation of Islam. Driven by their faith and the call of duty, Muslims around the world donate generously every year to alleviate human suffering, and their donations are estimated between US$250 billion to US$1 trillion annually (Alam, 2010). However, most of this giving is unorganized and is given by individuals to recipients directly. All Muslims are bound by a shared duty to give those in need, but they also have a duty to ensure that their contributions are making the best possible impact.

The Muslim world makes up less than a quarter of the global population, but houses nearly half of the world's poverty. In many Muslim countries, infant mortality and infectious diseases are at unacceptable levels. The Middle East and North Africa regions have the worst youth unemployment rates in the world, a fact made worse by a chronic skills gap and low rates of access to quality education.

Many governments, private donors and traditional charities have invested in solving these challenges, but none of them has been able to solve them from within their silos. The truth is that no one sector acting alone can harness sufficient innovation to effectively address the huge scale of the issues those governments face. Shifting away from individual, fragmented giving and joining efforts is the only way to realize a greater impact.

ISLAMIC SOCIAL FINANCE IN THE MUSLIM WORLD

Given that the majority of people in need of aid are in Muslim countries, the role of Islamic social finance is particularly important. The Islamic social finance is an essential source of financing that can be better leveraged to reduce vulnerability. Combining resources and expertise will allow the creation of innovative solutions to the Muslim world's most pressing problems, and scaling them up to remarkable levels. Not only will innovative investments lead to long-term social improvements, but they will also build long-term resilience and develop adaptive capacity building for communities. These investments will empower communities in need to develop more strongly, and will facilitate social and economic inclusion within their populations.

The Muslim world has so much to be optimistic about: it has some of the fastest growing economies, a growing population of dynamic and motivated young people, and some of the world's most charitable donors. Yet Muslim communities have significant obstacles to overcome before it can reach its full economic and social potential. With the resources, technology and networks that the 21st century made available, Muslim philanthropists, along with other players, have a duty to solve these problems, and their success depends on collective collaboration.

The Arab region has a proud history of philanthropy to build on. Many of the notable philanthropists are also outstanding business leaders who have been visionary in seizing the opportunities of today's interconnected world to build multinational companies. But while they have revolutionized their businesses, they have failed to bring these same bold approaches to the immense challenges of poverty, ill health and social inequity. Arab philanthropists must harness the rich and abundant tradition of char-

> *The Islamic ecosystem is built on three principles: first, having a tangible impact; second, being transparent and accountable; and third, being innovative in finding the best solutions...*

ity in Islam to ensure that charity is achieving its full potential to improve lives.

PARADIGM SHIFT IN PHILANTHROPY

Muslim philanthropists must shift from traditional charity to a new economic system of high-impact philanthropy. Businessmen and professional leaders engaging in philanthropy quickly see the advantages of institutionalizing their contribution. The Islamic ecosystem promotes allocation of resources for the welfare of the entire society, and requires individuals to be considerate about the need of their fellow brothers and sisters as they are for themselves. Ideally, the Islamic ecosystem is built on three principles: first, having tangible impact; second, being transparent and accountable; and third, being innovative in finding the best solutions that will maximize the impact.

These principles are the driving force of the work of the Abdulla Al Ghurair Foundation for Education, launched in Ramadan (June/July) 2015. Education is often a root cause of the challenges that Arabs are facing in the region. Therefore, the Foundation is using all available resources to help as many talented young Arabs who lack the opportunity to access the best education the world can offer. The Foundation also recognizes that, in order to be truly successful, the impact of its philanthropy work must extend well beyond the scholarships it provides. The ultimate goal of Abdulla Al Ghurair Foundation for Education is to be a catalyst for innovation to achieve sustainable development in Arab societies. As such, the Foundation is using the potential of technology to spread access to education in the region. The joint way of giving, where donors, governments, employers, foundations and educational institutions combine their efforts, is the only real path forward to achieve high-impact philanthropy.

This collaborative approach to giving funnels billions annually towards improving and extending access throughout the entire lifecycle of education. Through their programs to educate and upskill, these donors are generating long-term sustainable impact in the form of curbing unemployment and underemployment, increasing lifetime earnings, and contributing towards a more productive workforce that attracts investment and revitalizes local economies.

Prophet Muhammad (SAW) said: "Believers, to each other, are like a building where each part supports the other" (Sahih al-Bukhari, *hadith* no. 467, Sahih Muslim, *hadith* no. 2585). The practice of pooling the *zakah* is not a new one but is needed now more than ever. Implementing new approaches and more collective and strategic pooling of resources will lead to significant progress toward the solution of some of the pressing issues in the Arab World.

An example of this type of approach is the Lives and Livelihoods Fund, which was set up by the Islamic Development Bank (IDB) with the Bill and Melinda Gates Foundation as the largest multilateral development initiative in the Middle East and North Africa for poverty alleviation. The fund aims to address issues of health care, agriculture and rural infrastructure in the IDB member countries by following a unique approach. While each partner contributed US$100 million, the fund is seeking to leverage this into US$2.5 billion on projects that help people in 30 of the poorest Muslim countries to lead healthy and productive lives. This example and many others show that the impact of organized and collaborative work is much greater of the sum of individual parts.

MODERN LANDSCAPE OF HIGH-IMPACT PHILANTHROPY

Giving is as essential to the spiritual lives of Muslims as their daily prayers. Everyone realizes, however, that profound change cannot be achieved by individuals' fragmented efforts, no matter how noble the intentions may be. As such, it is very promising to see the private giving in the Arab world channeled into new institutional forms, where resources are utilized effectively to address the fundamental causes of social problems and resolve them, eventually. By getting governments, donors, philanthropists, foundations and every other relevant player collaborate, charitable contributions will be most effective as vehicles of future social change, and will map the modern landscape of philanthropy in the Arab world.

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Communal charity iftar organised on a street by a local mosque, Dubai, UAE. Kertu / Shutterstock.com

INTERVIEW WITH ABDULLAH HARON

INTERNATIONAL MONETARY FUND (IMF)

How would you describe the role of international multilateral organizations such as the World Bank, Islamic Development Bank (IDB) and International Monetary Fund (IMF) with regard to developing Islamic social finance? What are some significant initiatives that they have embarked on toward developing these activities?

- **Multilateral organizations collectively have been and continue to address social finance issues, regardless of religion.** In 2000, United Nations (UN) member states unanimously agreed on achieving eight development goals, commonly known as the Millennium Development Goals (MDGs). By 2015, several international and multilateral development organizations, including the World Bank, IDB and IMF, have pledged to help achieve these goals. Progress has been made in achieving several MDGs, such as reducing extreme poverty, narrowing disparities of primary school participation between girls and boys, and decreasing tuberculosis and malaria.

  Subsequently, the Financing for Development Conference in July 2015 in Addis Ababa, the Sustainable Development Goals (SDGs) summit in New York in September 2015, and the UN Conference on Climate Change in Paris in December 2015 together provided a framework for ending poverty, transforming all lives and protecting the environment for the next 15 years and beyond. The IMF, in particular, has expanded access to all of its concessional facilities by 50 percent, provided zero interest rate financing to low-income countries struggling with natural disasters and conflict, and scaled-up support for raising domestic revenue potential and for equity and inclusion. In addition, it enhanced financial support and intensified its policy advice, technical assistance and capacity building in strategic areas to better assist developing countries in their pursuit of the post-2015 SDGs.

- **The IDB and the World Bank jointly produced a report this year, *"Islamic Finance: A Catalyst for Shared Prosperity"*, which outlines the potential for Islamic finance in curbing income inequality and ending poverty worldwide.** I think this is a significant first initiative specific to Islamic social finance, which highlights trends in Islamic finance, identifies the major challenges hindering the industry's growth, and recommends policy interventions to leverage Islamic finance for fostering shared prosperity and ending poverty.

Do you think the Islamic finance industry has aligned itself with the UN Millennium Development Goals (MDGs)? What Islamic instruments are critical to this development?

- **Islamic finance, through its core principles, advocates for the just, fair, and equitable distribution of income and wealth during the production cycle. It also provides mechanisms for redistribution to address any imbalances that may occur. These actions would already be in line with the MDGs, in a broader sense.** Financial intermediation through risk sharing contracts has been contributing to shared prosperity. In fact, Islamic financial institutions are increasingly pursuing risk-sharing intermediation and encouraging the allocation of credit to the micro, small, and medium enterprise (MSME) sector. Islamic banking is a mode of financial intermediation offering banking and asset management services. However, current practices are restraining its full potential because of attempts to replicate conventional banking and asymmetry issues.

We've witnessed new initiatives on how to track *zakah* from a few Muslim majority countries. What is your opinion on this move? Will the initiatives be able to address

There is a need for a single task force responsible for moving this program on financial inclusion forward, and this task force needs to report to some sort of a council comprising senior persons from all relevant stakeholders and experts.

financial inclusion in many undeveloped Muslim countries?

- ***Zakah* is not the only instrument to address financial inclusion. As I understand, other initiatives such as *awqaf* instruments also have an impact on financial inclusion and poverty reduction.** In some countries, these instruments provide intervention support programs in the areas of business empowerment, delivery services, capacity-building/skills acquisition programs and building of mosques, hospitals and schools, to name a few. I believe that this move can potentially address the basic needs of the extremely poor and the destitute, and can create a social safety net.

- Reforming *zakah* along the lines pioneered in Southeast Asia, notably involving a shift from traditional charity to incorporate greater support for sustainable poverty alleviation, would potentially mobilize greater *zakah* donation, raise transparency and accountability, and expand the scope for collaboration with community-based civil society groups and corporations.

- The instrument of *awqaf* is ideal for the creation and preservat-ion of assets that can ensure a flow of resources to support education, health care, and other social goods. These measures would greatly boost shared prosperity, improving the welfare of the least well-off.

- **From my understanding of the experience of some countries, attempts to enhance financial inclusion through *zakah* and *awqaf* are not without challenges.** These include donors' attitudes about making the prompt payment of *zakah* when it is due, funding mobilization through education and awareness campaigns, and a lack of expertise in the management and administration of Islamic welfare funds. In addition, in some countries, including Malaysia, *zakah* institutions are often criticized for their slowness in releasing funds as the public is unaware of necessary due diligence the state must make prior to releasing the funds.

Innovation is crucial for the development of Islamic social finance. What are the current trends you have witnessed in innovative Islamic social finance products? What are pertinent challenges in promoting such innovative products?

- **I still believe that contracts of exchange and risk-sharing instruments remain important instruments** for the economically able segment of society or institutions to share the risks faced by the less able segment of the population. The problem is linking the risks arising from information asymmetries and the high transaction costs of processing, monitoring and enforcing small loans.

- **Crowdfunding and peer-to-peer (P2P) financing can potentially provide a platform for risk-sharing instruments in the financial sector,** which have not been very successful in the traditional financial environment. Investors are also entitled to higher potential returns by investing directly into the business ventures that they finance via the online financing marketplace. The World Bank reported that financial technology (fintech) is able to provide access to financial solutions for the roughly two billion adults who are currently unbanked.

There has been a lack of public awareness about Islamic social finance, which is impacting its development. What strategies should be taken, in your opinion, to create awareness of the need for financial inclusion within the Islamic finance industry?

- **I do not think a lack of awareness alone has impacted the sector's development but the perception of financial inclusion overall with respect to corporate governance, transparency, as well as lacking suitable instruments collectively contributed to the slow progress.** The key to improving all these factors is coordinated efforts across multiple regulators and government in the industry. There is a need for a single task force responsible for moving this program on financial inclusion forward, and this task force needs to report to some sort of a council comprising senior persons from all relevant stakeholders and experts. This would ensure progress in implementation. Adequate funding is another important aspect to ensure the project's successful execution.

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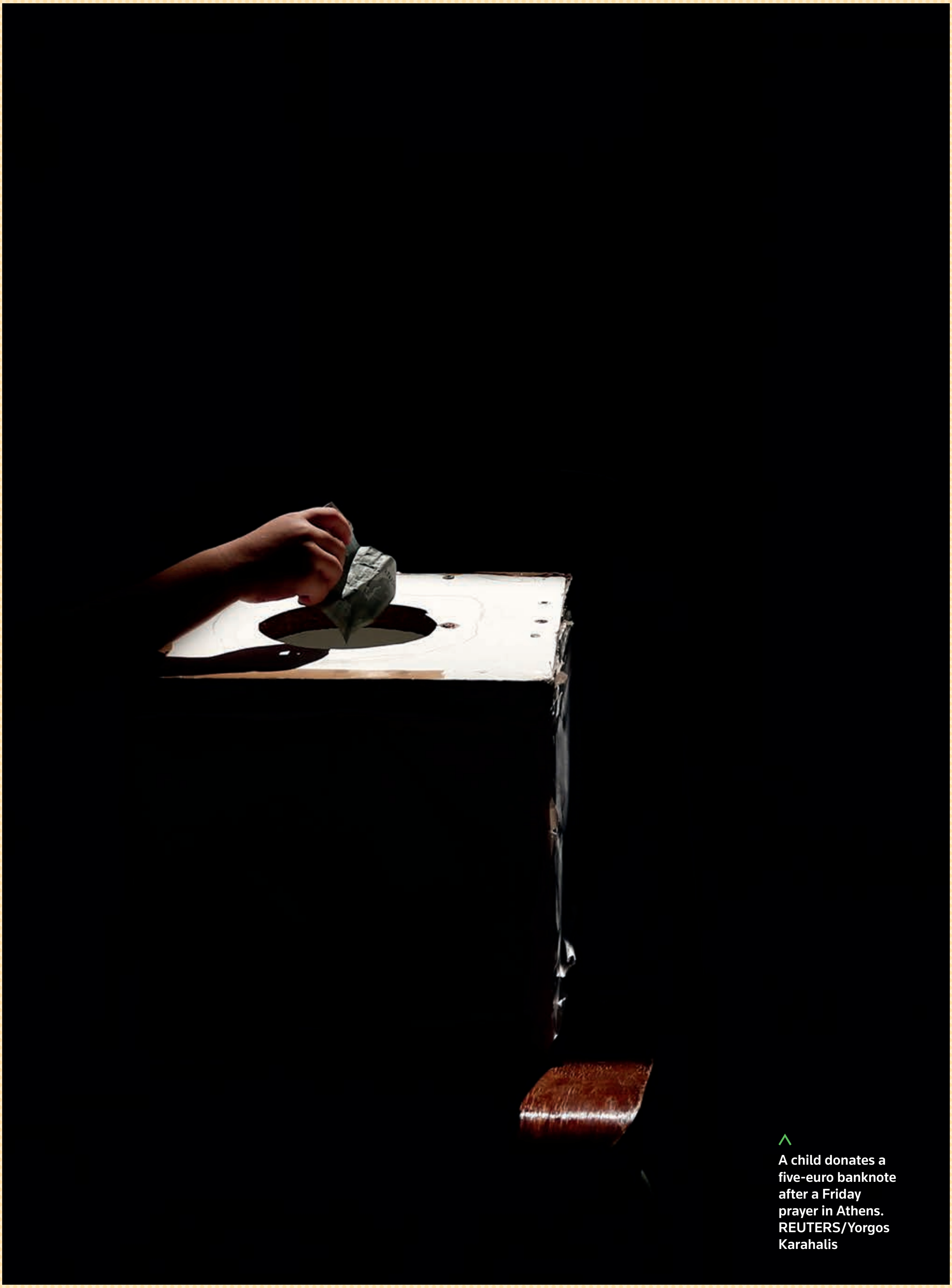

A child donates a five-euro banknote after a Friday prayer in Athens. REUTERS/Yorgos Karahalis

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