CELEBRATING 3 YEARS OF CIWM

Feature Article:
- Which creates more value for investors in equity funds: Being Socially Responsible or Shariah Compliant?

Also in this edition:
- Issues in the Malaysian Waqf System
- Sukuk & its Wealth Effects
Introduction

Welcome to the first, special edition, bulletin of the BNP Paribas Centre of Islamic Wealth Management (CIWM) that captures the foremost activities of the Centre since its inception in January 2013.

The objective of this bulletin is to provide readers with a broad appreciation of the intellectual contribution through research conducted by PhD students and academic staff in various fields of Islamic Wealth Management. The highlights of various events organized by the Centre to share ideas and knowledge with the industry are also presented.

The bulletin provides a summary of six research papers sponsored by the Centre that will be featured in an academic publication on Islamic Wealth Management to be released by Edward Elgar Publishers, UK, next year. A feature article in this issue is on identifying what creates more value for equity investors: socially responsible funds or Shari’ah-compliant funds.

The bulletin also includes discussion on the issues of wealth in Malaysia and what is offered through Labuan RPO (Waqf) foundation, extending beyond the waqf paradigm is an overview of zakat and how it affects wealth for individuals and societies in the short and long term. Purifying wealth is relevant for any Islamic portfolio and a brief discussion is presented with the arguments surrounding contaminated wealth and impermissible gains.

The issuance of sukuk and its overall announcement effect on corporate share value is analysed and issues of resemblance of bonds and sukuk are considered.

Future editions of the CIWM Bulletin will cover contemporary issues in Islamic Wealth Management together with global trends in the sector and market perspectives from industry leaders. We hope that you enjoy this and future editions as the Centre strives to drive Islamic Wealth Management to the forefront of a highly-competitive sector.

What is CIWM?

The Centre for Islamic Wealth Management (CIWM) is a joint initiative between the BNP Paribas Malaysia and the International Centre for Education in Islamic Finance (INCEIF).

CIWM is the Global University of Islamic Finance. It is dedicated to support the growth of the global Islamic wealth management industry with the key objectives of furthering education, industry innovation and policy development.

To achieve its objectives, CIWM conducts workshops, conferences, and public lectures in the areas of Islamic wealth management that covers aspects of wealth generation, accumulation, protection, purification and distribution. CIWM aims to be a catalyst of innovation in the nascent area of Islamic wealth management by sharing and enhancing knowledge and know-how of practitioners, investors, academics and Shari’ah scholars. The Centre also supports applied research initiatives in specialised areas of Islamic wealth management to address operational and strategic challenges in this fast-growing global industry.

In order to encourage more participation and to develop interest in Islamic Finance among students, CIWM offers three (3) prestigious PhD scholarships annually for bright and excelling recipients from all over the world.

For INCEIF, this significant collaboration with a bank of global repute in the area of wealth management and a strong local presence augurs well for its quest to be the knowledge leader in Islamic finance and subsequently, contribute towards the development of the sector as a whole.

For more information, go to www.inceif.org/ciwm
Message by the Chairman of the Advisory Board

Datuk Prof. Dr. Syed Othman Alhabshi
Chairman, BNP Paribas – INCEIF Centre for Islamic Wealth Management Advisory Board

It is indeed a great pleasure and honour to be writing this message on behalf of the Advisory Board of the BNP Paribas – INCEIF Islamic Wealth Management Centre for its inaugural bulletin, outlining the activities the Centre had undertaken over the last three years. Although Islamic Banking, Islamic Capital Markets and Takaful have propelled into commendable institutions in terms of asset size, profitability, portfolio of product offerings, efficient operations, etc. after being in operation for about four decades, it is the Private Banking or Wealth Management aspect of Banking that has not sufficiently matched the growth of the industry as a whole. Hence the contribution of this Centre is in an element of the Islamic finance space that is still at its infancy, especially when compared to its conventional counterpart. As such, there is considerable amount of work that can be done by this Centre to assist in the development of Islamic Wealth Management.

The decision by BNP Paribas and INCEIF to establish the centre with the blessing of Bank Negara Malaysia was not only apt but very timely indeed because wealth management is an emerging sector within the Islamic finance industry. I still remember the three mandates given by the Governor of BNM when we discussed the proposal to establish the Centre. She insisted that there should be quality research, innovation and policy implications in whatever the Centre does.

Taking such a cue, the Board of Advisors as well as the management of the Centre have over the last three years focused on the mandated areas. The Centre has successfully conducted lectures on various topics related to Islamic Wealth Management delivered by regulators, academics and industry experts not only to create interest among participants, but more so to expose them to the tools and skills that would help them to be involved more ably in Islamic Wealth Management. Apart from the lectures, the Centre has also organised workshops and seminars that managed to attract speakers from various sectors to exchange views and experiences that are relevant to the further development of the field. The Centre has also encouraged research in current topics by providing funding to interested academics and researchers. Scholarships have been awarded to PhD students to help them with their dissertation in topics related to Wealth Management. Such scholarships have helped to produce a more in-depth study of the subject as they are only awarded to students who have successfully completed their courses with excellence, completed the PhD Comprehensive Examination and have had their research proposals approved by the Thesis Committee. The Centre is also at the point of publishing a book on Islamic Wealth Management based on research output by scholars in the field.

All in all, the investment by BNP Paribas and INCEIF in the establishment of the Centre and the support and guidance by BNM have started to produce tangible results. As the Chairman of the Advisory Board I would like to see the Centre continue its good work and bring its activities in the next three years to a higher level, God willing.

Thank you.
Forces behind CIWM


Dr Eskandar has been serving as the Deputy Director of the Centre of Islamic Wealth Management (CIWM) since 2013. He is also Associate Professor and Deputy Dean, School of Graduate Studies of INCEIF. Dr Eskandar has published several articles and references which include Research on Islamic Banking in Malaysia: A Guide for Future Direction, The Impact of Working Capital Management on the Profitability of Shariah-Compliant and Non-Shariah firms: The Case of Malaysia, and Rationalizing the value premium in emerging markets (with M. Shahid Ebrahim, Sourafel Girma and Jonathan Williams). His current research areas include Islamic Capital Markets and Financial Inclusion. He currently serves as the Treasurer for Malaysian Finance Association (MFA).

Message from the Director

Prof. Dr. Shamsher Mohamad Ramadili Mohd
Director,
BNP – Paribas – INCEIF Centre for Islamic Wealth Management
BSc (UPM), MBA (Leuven), PhD (Glasgow)

Assoc. Prof. Dr. Mohamed Eskandar Shah Mohd. Rasid
Deputy Director,
BNP – Paribas – INCEIF Centre for Islamic Wealth Management
BBA (IIUM), MIEF (Queensland), PhD (Nottingham)

A Glimpse at the Global Islamic Wealth Sector

The Governor of Bank Negara Malaysia (BNM), Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz announced at the GIFF Conference in September 2012, her decision to select INCEIF as the institution to house the BNP Paribas Center for Islamic Wealth Management (CIWM) aimed at advancing research and publications on the same. This is a unique partnership, with full sponsorship in the form of an annual grant made by a leading financial institution, BNP Paribas, with its headquarters in France, to focus on creating awareness and more significantly, augmenting a surge in meticulously researched quality publications in Islamic Wealth Management. BNP Paribas has a long history in Wealth Management and their core business stretches over 150 business centers in more than 23 European countries. The bank is now making inroads into Islamic Finance, a global growth industry, and has to-date a full Islamic bank in Mauritania as well its first Private Sukuk (USD650 million - 5 year- for Saad Trading Contracting & Financial Services Company) in Saudi Arabia. Its contribution to finance this Center (CIWM) is part of its strategic plan to contribute to the growth of the Malaysian Islamic Banking Industry in particular and the Islamic Finance sector in general.

Islamic Finance is well established as a rapidly growing industry that has quickly proliferated on the basis of the strong ethical principles that it espouses, surpassing religious boundaries and contributing to economies as a whole. In more than 76 countries, Islamic banks number approximately 1,120 globally, most of which have made substantive progress within a brief period, although some are at their infancy. For an industry that began with a single product in the early 60’s in Egypt, Sudan and Malaysia, the progress made over the last 5 decades has been rather astounding. This consistent development has been facilitated by a combination of factors, the most substantial being the role played by central bankers in both developed (example Bank of England developing this new niche finance officially from 2002) and developing countries (such as Bank Negara Malaysia for Malaysia, and similarly for Bahrain and Saudi Arabia). From the first commercial Islamic bank, the Islamic Development Bank based in Jeddah, to the first retail Islamic Bank (Dubai Islamic Bank), the variety of products spawned have managed to satisfy the contrasting needs from the public to the private sector.
Where are we after five decades? A quick review of aggregate statistics show some interesting insights. For example, the largest portion of assets in this new form of financial transactions is in Shariah-compliant stocks included in some 22 Islamic indices. The total assets of Sukuk securities traded in 11 Islamic bond markets using $6 of 16 possible types of Sukuk certificled is estimated to be US$ 300 billion outstanding by 2015; Malaysia alone accounting for two-thirds of this total.

With an estimated asset base of US$ 2.4 trillion (an informed estimate), enjoying a cumulative annual growth rate (CAGR) of 17.3% post financial crisis, it is difficult to ignore such marked advancement. Islamic banks represent more than US$ 400 billion in share capital, maintaining a CAR (capital adequacy ratio) of about 14 per cent against the conventional banks' ratio of between 11-12 per cent.

The Islamic fund industry has assets under management in Islamic mutual funds reported to be approximately US$400 billion across six major regions. The Shariah-compliant Islamic money market instruments or IMMs, (aggressively promoted by Bank Negara Malaysia, and practiced in several countries) together with the assets of some 45 takafus and re-takafus firms and informal Islamic finance and investment co-operatives, syndications, waqf assets and zakat funds increase the value of assets in the sector in all probability to an excess of 5-6 trillion US$. Although, in perspective, it is still a very small fraction of the assets being held conventionally, Islamic finance CAGR is four times the rate of growth in conventional finance, making it a key contender in the near future.

Islamic Wealth management encompasses aspects of wealth creation, wealth accumulation, wealth purification and wealth distribution, all operated within the guidelines of Islamic principles. In broader strokes, Islamic wealth creation ranges, from venture capital to micro-finance based on a diversity of Islamic contracts. Wealth investment activities are concerned with the Islamic concepts of justice and fair-dealing in achieving the desired objectives. Wealth purification involves cleansing the generated wealth from any form of unintentional non-compliance, to be distributed to charity, taking care of deserving members of the society. Zakat, an obligatory contribution on wealth is another source of revenue to fulfill social responsibility and alleviate poverty. Wealth distribution is related to the role of endowment (waqf) that ensures that portions of the wealth of affluent individuals can be dedicated to the needs of the society on a perpetual basis. Furthermore, as much as wealth generation is lauded, it cannot be achieved through any detriment on society at large.

The role of CIWM

Hence, among other activities, the focus of the wealth management research and publication activities under the BNP CIWM grant is to facilitate research on the various aspects of Islamic Wealth Management, including approved equity securities; sukuk securities; Islamic banking; Islamic mutual funds; Islamic money market instruments; Islamic insurance (Takaful); Wealth purification; Zakat and Waqf. The center also initiates public lectures and symposiums with the industry to share experience and knowledge on the current status, industry expectations, the gaps between expectations and current practices and the potential strategies that can address these gaps. These efforts are expected to facilitate both the industry and academia in charting the future for the Islamic finance and wealth management sector.

Since its inception in January 2013, the Center had organized six symposiums on various aspects of Islamic Wealth Management, sponsored relevant research projects from INCEIF academic staff and PhD students; offered 6 PhD scholarships; completed an industry booklet for fund managers and bankers to market Shariah compliant and Socially Responsible Investments globally, a bulletin to capture all the major activities for the last three years, and is in the process of completing a book publication titled ‘Islamic Wealth Management: Issues in Practice’. All these initiatives would not have materialized without the commitment and support of INCEIF’s management and staff. I take this opportunity to thank them all for their contributions towards making this Centre a success.

This message would not be complete without a special mention of appreciation to the Management of BNP Paribas, Malaysia for their collaboration and partnership, the PCEO of INCEIF, Mr Daud Vicary Abdullah for his commitment in all the activities initiated by the Centre, the Chairman of the Advisory Board, Datuk Syed Othman Alhabshi for his dedication and always spurring us on, the Deputy Director, Dr Eskandar Abdul Rashid and the members of the advisory board that comprise representatives from BNP Paribas and INCEIF. We look forward to your continuous encouragement and support in our endeavours to contribute to the domestic and global Islamic Wealth Management Industry. After creating awareness and collaborating with the Industry, the Centre has planned activities for the next three years that are more global in perspective, supporting the government’s efforts on maintaining Malaysia as the global hub for Islamic Wealth Management.

The role of CIWM
Events

2014

With the year themed “Towards Becoming an Islamic Wealth Management Hub: The Roadmap”, CIWM continued its momentum with another 2 public lectures and a colloquium.

The first public lecture of the year was in the month of April. The featured speaker Mr. Ahmad Hizzad Baharuddin, Director- General, Labuan Financial Services Authority (Labuan FSA) presented his speech with the title ‘The Role of Wealth Distribution in Islamic Wealth Management: The Case of Labuan Islamic Trust and Foundation’. The second lecture was presented by Dato’ Dr. Nik Ramlah Nik Mahmood, Deputy Chief Executive, Securities Commission Malaysia titled “Malaysia: A Centre for Islamic Wealth Management”.

In the month of April, the Centre organised the Islamic Wealth Management Symposium 2014. This event marked the first jointly organised Islamic Wealth Management Symposium aimed at raising awareness of Islamic wealth management in Malaysia. Invited speakers for the inaugural event included Mr. Ahmad Hizzad Baharuddin, Director- General, Labuan Financial Services Authority (Labuan FSA), Dr Mohd Daud Bakar, Founder and Group Chairman Amanie Advisors and Prof. Dr. Shamsher Mohamad, Director, BNP Paribas – INCEIF Centre for Islamic Wealth Management (CIWM).

This was followed by a conference on Private banking with the increasing number of High Net Worth Individuals (HNWI) in Malaysia. This increase saw the opening of numerous opportunities for further growth in the private banking industry in Malaysia. The November colloquium saw a number of respective figures share their knowledge on the theme such as Mr. Justin Ong, Partner, Asia-Pacific Private Banking Leader and Asset Management Leader and Mr. Pathik Gupta, Director Head of Wealth Management, Asia-Pacific Business, McLagan, Singapore.

2015

Islamic Wealth Management Symposium 2015 was held with more than 152 attendees from various backgrounds. The symposium talked about ‘Sovereign Wealth Funds And Shared Prosperity: Should Malaysia Champion It?’, ‘Labuan IBFC’s International Waqf Foundation - The First Islamic Foundation Aimed At The International Market’, ‘Seeking Diversification In Islamic Investment Products’ and ‘How Can Practitioners Best Meet The Demands And Challenges Of The Nascent Islamic Wealth Management Industry?’. Prof. Dr Abbas Mirakhor, the INCEIF Chair of Islamic Finance, Ms Che Jamaliah Abdul Thahir the Head of Islamic Finance Unit, Labuan Financial Services Authority (LFSA) and Dr Aida Othman Partner, Zaid Ibrahim & Co were among the invited speakers of the symposium.
Policy Blindness and People’s Welfare

After 250 years of unbridled pursuit of laissez faire, cross-border free trade via open economy theories and unbridled capitalism over the last four decades, a watershed appears to have been reached at the start of the 21-st century. Mercantilism of the 18-19-th centuries gave way to an open economy model of freer trade in goods and services. The last 45 years saw the dismantling of barriers to financial trade as well. These moves have led to unbridled private pursuit of wealth creation supposedly meant to lead to greater human welfare. Despite the creation of wealth, the dismantling of laws since the Reagan-Thatcher brand of capitalism took root, the wealth inequality has gone to the level existing some 180 years ago: see The Economist (October, 2012). Wealth inequality has started to widen since the 1980s to a level which is reversing a fair degree of prosperity of the middle-class as once shared in all countries that had worked to reduce inequality.

Wealth maximization has become a mantra for managing the resources of the world in favour of the ones who hold power. Naked capitalism now becomes entrenched with no counterbalancing power groups so that wealth holders can demand dismantling of barriers to creating more wealth. For a time, the unbridled borrowing power of governments kept some level of welfare support by more borrowing until the debt burden has now become so great that the working classes are asked to retire later, sacrifice part of their pension, take wage cuts (Greece, Malta, Spain and Portugal) harming the glue that classes are asked to retire later, sacrifice part of their pension, take wage cuts (Greece, Malta, Spain and Portugal) harming the glue that holds societies together, widening the income gap.

Given this background to the current state of affairs, we examine the role of people’s property rights and the proper control of the waqf assets for the intended purposes as trusts.

Zakat and Waqf are two instruments that are people-based such that governments need not blow their fiscal burden through welfare-demanding debt-taking. The obedience of moral man to an apparent ‘society-friendly’ exhortation to give alms creates conditions that take care of common demands for basic welfare without resorting to government. The purpose of the government then becomes law and order, regulating how peace and prosperity could co-exist.

Waqf as a Tool for Capital Management

Waqf, a form of continuous charity (sadaqah jariyah), is created by donating an asset (property or cash) that produces benefits/revenues for a targeted objective on an infinite basis.

Through a deed, the founder (waqif) determines the objectives for which the waqf can be used and the modes of distributing its fruits, services and revenues. The founder determines the waqf management and process of succession of managers allowed to impose any restrictions or qualifications he/she likes on his/her waqf. Most awqaf are perpetual and very often so emphasized in the waqf deeds. While the cash waqf dates back as early as the turn of the first century of Hijrah, i.e. 671 AD) most of awqaf established are real-estate based.

In Malaysia, there are property-based (both movable and immovable) Waqfs and Cash Waqfs though the former has a longer history. Cash waqfs currently exist in Johor and the Federal Territory in the form of cash funds and bank accounts.
1. **Zakat Concepts and Objectives**

1.1 **Defining Zakat**

Zakat is mentioned 58 times in the primary source of law for Muslims – Al Qur’an. It is the third of the five fundamental pillars of Islam, mentioned in the Qur’an 32 times in isolation and 26 times alongside prayer. Legally, Zakat refers to the compulsory transfer of a portion of wealth to one or more of the 8 categories of recipients as directed in the Qur’an.

The deducted meaning of zakat is that of obligatory purification of a Muslim’s wealth that has exceeded the minimum value (nisab) for the payment of zakat which would represent 2.5% of his total zakatable wealth annually (lunar year).

1.2 **Recipients of Zakat**

The categories of recipients are described in the Qur’an as follows (Chapter 9: Verse 60):

> “Zakat is for the poor and the needy and those who are employed to administer and collect it, and for those whose hearts are to be won over, and for the freeing of human beings from bondage, and for those who are overburdened with debt and for every struggle in Allah’s cause, and for the wayfarers; this is a duty enshrined by Allah, and Allah is the Al-Knowing, the Wise.” (9:60)

Not all wealth is zakatable. Clarke et al. [1994] sums up the wealth that zakat is payable on:

- i. genuinely owned wealth,
- ii. productive, and
- iii. surplus assets that have been owned for a full year.

In the case of a business this excludes any fixed assets that are not held for trade. Therefore, buildings, vehicles and furniture would all be exempt from zakat.

The goal of zakat is therefore two-fold:

- a. It purifies the wealth of the payer (Removing the impurities that were accumulated alongside the wealth)
- b. It enables the recipient (generally categorised amongst the poorer members of society) to participate in society, even economically (Suhaib, 2009).

2. **Zakat Wealth Effects**

2.1 **Zakat Contribution and Consumption**

Zakat seeks to improve the economic status of its recipients through the alleviation of poverty. From the economic perspective, zakat is considered to alleviate poverty as it transfers wealth from those that have a lower marginal propensity to consume to those that have a higher marginal propensity to consume. Keynes’s (1936) absolute income hypothesis forms the basis of this argument, further establishing the postulate that as income increases, consumption decreases in terms of overall income even in Islamic economic terms.

Consumption in Islam, according to Qardawi (1999), is framed by Islamic ethics and values. Islam allows only the consumption of permissible goods that will benefit the consumer and have not been prohibited even in small amounts.

The resultant effect of zakat on consumption is expected to increase aggregate demand and zakat effects on investment are also expected to be positive as zakat encourages investment by penalising idle cash (Kahf, 1999). This increase in aggregate demand and consumption expenditure is expected to contribute positively to economic growth (Murinde et al., 1995; Norulazidah PH Omar Ali & Myles [2010].

Zakat distribution also reduces non-performing debts as those burdened with debt are entitled to zakat and zakat collection and distribution also increases employment and has an overall positive effect on labour force participation (Al Suhaibani, 1990). For example, Ibrahim (2007) found that zakat distribution resulted in a significant reduction in the poverty rate for Selangor, Malaysia from 62% to 51%.

Hassan (2010) argued that if zakat funds were collected and managed efficiently, they could have contributed to 21% of the Annual Development Plan (ADP) of Bangladesh in 1983/1984 and as much as 43% of ADP in 2004/2005. In an earlier study by the same author, Hassan and Khan (2007) claimed that foreign aid for Bangladesh could in fact be replaced and the debt burden reduced if zakat was properly managed. The use of zakat in developmental projects could therefore form a key component of economic growth in Bangladesh.

The consequent wealth effects of an effective zakat cycle, i.e. calculation, collection, distribution and investment, have been summarised by Ammann et al. (2014) as follows:

- a. Zakat effectively supports sustainable and consistent economic growth through legitimate investment, employment and consumption
- b. Promotes socio-economic equality in distribution of wealth by reducing poverty and increasing investment
3. Zakat and Financial Well-being

Salleh (2012) reflects on contemporary Islamic management views that consider zakat to be one of the most compelling components of wealth-sharing that ensures a higher standard of living for Muslims.

The nominal negative rate of return on idle wealth by zakat is expected to motivate the rational investor to circulate his wealth in risk-sharing projects commensurate to his risk profile, goading further economic activity. The multiplier effect of consumption and demand of goods through zakat injection results in job creation. As the zakat cycle is achieved, the multiplier effect on wealth becomes more formidable.

A Muslim’s wealth management plan should include the calculation of zakat.

A number of challenges exist that restrict the potential wealth effects of zakat. Zakat on businesses has been applied and calculated differently across regions. The adaptation of zakat rules to encompass what is considered wealth in the 21st century has also been met with contention. Although there is precedent in expanding the net of zakatable assets, Islamic Jurists have been cautious in allowing too much flexibility in changing the zakat rulings in order to protect the sanctity of zakat as a form of worship.

Another obstacle in maximising the effects of zakat on wealth is the effective management of zakat funds from the collection phase to its disbursement. Studies have shown that material portions remain undistributed, either not reaching the intended recipients or not being able to identify sufficient recipients for the specific year.

The positive wealth and societal consequences of zakat can be astounding once a more considered approach is adopted especially given that it is a pillar in the core five pillars of Islam. 

“Another obstacle in maximising the effects of zakat on wealth is the effective management of zakat funds from the collection phase to its disbursement…”

Labuan IBFC’s International Waqf Foundation

Introduction

Waqf is one of the noble vehicles for wealth preservation and management in Islam. Waqf has evolved and developed throughout Islamic history since its inception during the time of Prophet Muhammad s.a.w. The first Islamic waqf is the Masjid of Quba’ in al-Madinah al-Munawwarah, which was built upon the arrival of the Prophet Muhammad s.a.w. to this town in 622. It now stands admirably on the same site with a new and extended structure. This was followed six months later by the establishment of the Masjid of the Prophet s.a.w. in the center of al-Madinah as another significant representation of Islamic waqf. Since the time of the Prophet s.a.w., waqf has thrived during the reign of the Khulafa’ al-Rashidin and subsequent eras of Islamic rule.

Waqf literally means “to hold” or “to preserve”. Technically, waqf means holding or setting aside certain property by the founder (waqif) and preserving it in order that benefits continuously flow to specified beneficiaries for religious, charitable or pious purposes as recognized by the Shariah for the pleasure of Allah SWT.

The virtues of establishing waqf is evident in Al-Qur’an and the Sunnah of Prophet Muhammad s.a.w. In Surah Ali ‘Imran, verse 92, Allah SWT says:

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

One of the renowned evidences of waqf in the Sunnah of Prophet Muhammad s.a.w. was the narration by Ibn ‘Umar that Umar ibn Al-Khattab r.a. obtained a land in Khaibar and he went to the Prophet s.a.w. to consult him about it saying, “Messenger of Allah! I obtained a land in Khaibar. I never got a property more precious to me than this. What do you advise me?”

The Prophet s.a.w. said, “If you want, you can make waqf on it, and give it as sadaqah (charity), provided that it should not be sold, bought, given as a gift or inherited”. Then, Umar r.a. gave it as charity to the needy, kith and kin, for freeing slaves, for Allah’s cause and for the travellers and guests. There is no harm for the person responsible for it to feed himself or a friend from it for free, without profiting.

Author: Puan Che Jamaliah Abdul Thahir (Labuan IBFC)

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Incorporating Waqf under internationally recognized Foundation Laws

In the contemporary environment, waqf can be incorporated under internationally recognized foundations laws. Foundations provide a conduit for dynamic wealth transfer, dynastic planning and inheritance management protected within a tax-efficient legal entity.

A foundation in the Labuan International Business and Financial Centre (Labuan IBFC) is a corporate body with a separate legal entity, established with the objective of managing its own property for any lawful charitable or private wealth management purposes. It is governed by the Labuan Foundations Act 2010 (LFA). A Labuan Islamic foundation is a foundation in which its objectives and activities are in compliance with Shariah principles. This is enshrined in its incorporation charter and governed by the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA).

A Labuan International Waqf Foundation (LIWF) is essentially designed as an Islamic foundation to hold waqf properties (referring to properties that are endowed into the foundation by way of waqf) and manage those properties for identified beneficiaries based on Shariah principles on waqf. The LIWF serves as a conduit and a vehicle for international founders to create foundations based on the Shariah concept and principles of waqf for private Islamic wealth management, philanthropic and financial inclusion purposes.

LIWF can be established under section 107 of LIFSSA while all the provisions of LFA shall also apply to LIWF unless it is specified otherwise. There are distinct advantages of incorporating waqf under foundation laws. Firstly, it gives the founder (waqif) flexibility and exclusive control over how to structure and manage his waqf foundation, distribute its benefits and preserve the assets for a long-term period.

The unique characteristics of LIWF are as follows:

**Endowment**

The endowment of the property into the LIWF by the founder is executed by way of waqf as defined by the Shariah. This can be facilitated by indicating the intention of establishing the waqf in the charter (wasiyyah) of the founder while only the income or usufruct of that property is distributed to the beneficiaries.

**Duration**

The duration of LIWF is perpetual or for a specified period of time. In principle, the waqf should be perpetual. However, temporary waqf is permissible when the founder desires to reclaim his property after a specific period.

**Charter (Wasiyyah)**

The charter describes in detail the waqf that has been made, its purpose as well as the terms and conditions within which the waqf foundation shall be governed and managed. The charter regulates and administers the waqf foundation in accordance with Shariah principles and Shariah principles on waqf.

**Waqf Property (Mawquf)**

The properties endowed into LIWF are Shariah-compliant properties which may include:

- Real estate together with permanent furniture and fittings;
- Movable assets;
- Money or cash;
- In the case of money, the income generated from the utilization of the money are spent on the waqf beneficiaries while the principal amount is retained;
- Shares and sukuk;
- For shares and sukuk, the income earned by the shares or sukuk are spent on the waqf beneficiaries;
- Rights that can generate income (for example intellectual property rights); or
- Other properties accepted by Shariah for waqf.

**Beneficiaries (Mawquf ‘alaih)**

The beneficiaries of LIWF are recipients who are identified by the founder and endorsed by the Shariah advisor of the waqf foundation.

Given the strict Shariah principles on waqf management, there is a need for a strong and effective governance and management framework for LIWF. In this regard, the waqf foundation must ensure that the persons involved, directly or indirectly, in its management or operations are those with sufficient level of competency, integrity and credibility. The respective roles and responsibilities of the founder, supervisory person, council member and officer of LIWF must be clearly defined and understood to ensure accountability, avoid overlaps and ensure efficiency.

**Faraidh application of LIWF**

Upon the demise of the founder, Faraidh (Islamic inheritance law) is not applicable and relevant on the endowed properties into the LIWF provided that the endowment of the waqf property into the LIWF satisfies specific conditions.

Enhancing the potential of waqf in Islamic wealth management. Across decades, waqf has played a pivotal role in supporting noble charitable purposes such as education, social welfare and healthcare in countries such as Turkey and Egypt. In the current environment, it is timely to capitalize on the strong intrinsic virtues of waqf to revive and expand the role of waqf for not only philanthropic objectives but also for private wealth and estate management. It is hoped that the introduction of LIWF in Labuan IBFC would act as a catalyst to spur further the development and growth of the concept of waqf in Islamic wealth preservation and management.

### Figure 1

**Different types of waqf under LIWF**

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
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<tbody>
<tr>
<td>Charitable waqf</td>
<td>Al-waqf al-khai’ri</td>
</tr>
<tr>
<td>Family waqf</td>
<td>Al-waqf al-ahli</td>
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<tr>
<td>Joint waqf</td>
<td>Al-waqf al-mushtarak</td>
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<tr>
<td>Self-dedicated waqf</td>
<td>Al-waqf ala al-nafs</td>
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<tr>
<td>Other waqf</td>
<td>Al-waqf ala al-‘anafi</td>
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**Figure 1**

Types of Waqf under LIWF

<table>
<thead>
<tr>
<th>LIWF can be established for different types of waqf as illustrated in Figure 1:</th>
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<tbody>
<tr>
<td>1. Charitable waqf (al-waqf al-khai’ri) where its income or usufruct is dedicated for a charitable purpose.</td>
</tr>
<tr>
<td>2. Family waqf (al-waqf al-ahli) where the income or usufruct is reserved for the founder for specified family members and relatives. The income or usufruct of this kind of waqf is distributed to a charitable purpose when none of these persons exists.</td>
</tr>
<tr>
<td>3. Joint waqf (al-waqf al-mushtarak) where the income or usufruct is shared accordingly between the family members and the specified beneficiaries for charitable purposes.</td>
</tr>
<tr>
<td>4. Self-dedicated waqf (al-waqf ala al-nafs) where the founder (waqif) retains the income or usufruct of the waqf properties for him as long as he is still alive. After the death of the founder, the income or usufruct of the waqf is given to charitable purposes as specified by the founder.</td>
</tr>
<tr>
<td>5. Any other types of waqf in accordance with Shariah principles.</td>
</tr>
</tbody>
</table>
Introduction
Financial planners are usually well familiar with terms like wealth creation, wealth accumulation, wealth protection and wealth distribution. However, the term wealth purification is something unique to Islamic wealth management and planning and it may look strange to those not familiar with this concept. According to Islamic injunctions, everything that human beings are bestowed with is a gift from Almighty God. Wealth is one such precious gift that can be used for material success in this world as well as eternal salvation in the afterworld. For this purpose, certain obligations are imposed upon the wealth that is accumulated by a person in legal way. The purpose of such obligations is the benefit of individuals and society both. By performing these obligations, one purifies his wealth which may otherwise be polluted and impure due to the mixing of other people’s rights in it.

Wealth can be a means of purification for human heart and soul. Purification of heart and soul from the sins can be obtained by spending wealth willingly for the sake of Allah. This spending can either be either obligatory, like zakat, kaffarat etc, in which case it has to be performed, after certain conditions are met, and there is no option of not doing it. However, purification through wealth may be through optional means of spending in which case the performer will be rewarded bounteously by doing it, but he will not be held answerable if he refrains from doing so. The most important means of purification through obligatory means is zakat. Literally, zakat is used in two meanings: growth and purification. Quran has explicitly used it in the meaning of purification in the following verse:

“Take Sadaqah (alms) from their wealth in order to purify them and sanctify them with it…” (Al-Taubah, 103)

It should be noted here that majority of the commentators of Quran take the word “sadaqah” in this verse in the meaning of zakat. But the question here is that what is it that they are purified from by means of sadaqah? In other words, how does sadaqah purifies and from what? Some commentators of Quran have interpreted it as purification from sins. For instance, according to Ibn Jareer1, purification here means purification “from the grime of human sins” which indicates the purifying impact of zakat.

A few scholars have argued that purification here is actually purification of human heart from negative human desires and emotions like malice, greed, and the obsessive love of wealth and other worldly material. Such emotions may deviate one from attention to God.

Thus, paying zakat and other non-obligatory donations is a means of heart and soul purification for both the payer and the payees. On the part of this payer, paying these is the solution to natural human greed and the desire to accumulate more and more wealth. It is also a means of inducing the spirit of sacrifice for the sake of God. For the other party, the receipt of money in such forms pacifies his negative emotions towards society in general and towards the rich class in particular.

Apart from the meaning of purification as explained thus far, zakat is also literally used in the meaning of increase and growth. The economic benefit of the wealth purification in the form of wealth increase through paying of obligatory and optional means.

Second Meaning of Wealth Purification

Wealth purification may also refer to the process by which impure wealth is made clean and purified. Practically, wealth is usually mixed up of both halal (permissible) and haram (impermissible) or mushtabih (dubious) portion. The non-permissible or dubious portion is not necessarily made a part of the permissible portion willingly, rather the two may be mixed due to circumstances outside one's control. In such case, the non-permissible or dubious portion is distinguished from the permissible portion and then treated accordingly. Wealth which is haram can be in two forms: either the entire amount of wealth is haram, or only part of it is haram while part of it is halal. The Muslim jurists have treated both these differently as elaborated below.

2.2.1 Purification of Wealth that is entirely Haram

Wealth that is solely haram can never be a source of salvation and it is not acceptable to Allah Almighty in any form of sadaqat, as reported in a hadith by Imam Muslim:

“Allah the Almighty is Good and accepts only that which is good/pure [halal]…”

Imam al-Nawawee asserts that this hadith is like a pillar of one of the most important principles in Islam: anything that is spent by a Muslim in the way of Allah must be halal and pure from impermissible mixture.

Muslim scholars argue that if entire wealth is earned from non-permissible sources and no portion of it is halal, zakat will not be paid from it. This is because the purpose of zakat is the purification of one's self as well as the remaining wealth; but if the wealth itself is not clean, how can it be a source of cleanliness and purification for others?

Imam al-Qurtubi’s opinion that the way to repent from the haram wealth in one’s hand, if it is earned through riba, is to return it to the person from whom it is taken. If he cannot be found, he should give this wealth as sadaqah from his side.

Imam al-Nawawee cites al-Ghazali as an evidence for this provision stating that:

“If a person has wealth usurped from people in his possession and its portion is known, but it got mixed up with his own wealth (which is halal) and cannot now be differentiated and the person intends to repent, the solution is that he and the owner of usurped wealth should agree to distribute (this mixed wealth according to their respective portions).”

Conclusion

Islam is a complete code of life. With the advancement in complexity of the financial world, it is often difficult for Muslim investors to keep their wealth 100% halal. For situations outside their control, it places significant strain on owners that have had impermissible funds mixed with pure, to distribute all their tainted wealth to charity.

Hence, the Muslim scholars of the past have stated that it is sufficient to remove the impermissible portion in order to purify the overall wealth. Purification of wealth is the hallmark of Islamic wealth planning and it is the duty of Islamic financial planners to be well equipped in advising clients on this most essential element of a Muslim’s financial plan.

The SRI booklet is a joint effort between CIWM and the Malaysian International Islamic Financial Centre (MIFC) towards a publication that is industry driven. The booklet seeks to raise awareness on the inextricable link between sustainable investments and Shariah-compliant investments. This booklet covers topics including Principles of Investing, SRI Strategies, Attractions of SRI and Emerging Markets & Islamic Investment. A key objective of the publication is to create awareness on shared SRI and Islamic finance value propositions, develop a global interest for SRI sukuk and to support business engagements in securing SRI mandates and ESG-based business (Islamic Fund Managers, Investment banks and investors).

Book Publication

Islamic Wealth Management Issues in Practice is proudly the title of the first book that will be published by the Centre. Consisting of 25 chapters, this book will discuss pertinent issues around Islamic Wealth Management. With a total of 22 contributors from various fields, the Director of the Centre, Prof. Dr. Shamsher Mohamad Ramadli Mohd himself leads the project. This book will cover the following topics: Definition and Concepts of Islamic Wealth Management, Governance Issues in Managing Wealth, Wealth Creation, Wealth Preservation and Purification, Wealth Distribution and Wealth effects.

This book is expected to be completed and published in June 2016.
Introduction and motivation:

The mutual fund industry has seen rapid growth in the last two decades or so as an alternative investment scheme. The growth of the mutual fund industry saw a jump of 12% from the year 2012 to 2013 as assets under management (AuM) increased from $60.9 trillion in 2012 to $68.7 trillion in 2013 (Boston Consultancy Group, 2014). As far as regional growth is concerned, it has slowed down in most of the emerging markets but increased steadily in MENA and Asian countries. Its growth has varied in Australia, Asia, Japan, the Middle East and Africa and North America and varied from 14 percent to 20 percent. As far as Europe and Latin America is concerned, the average growth rate has been 8% and 7%, respectively.1

On the other hand, the industry has also seen the remarkable growth of two distinct types of mutual funds during the same period. These funds are namely, Shariah-compliant funds (SCFs) and Socially responsible funds (SRFs). Both these alternative investment tools came into existence as the traditional tools do not fit the criteria of Islamic and ethical principles. In addition to financial screening (risk and return), these funds also use certain non-financial screening criteria to filter these funds along the ethical and religious lines.2

Although both classes of funds employ certain screening criteria but there exists a distinction between them (Forte and Miglietta, 2007). As far as the definitions are concerned, SRFs can be defined as an investment vehicle that combines the investors' financial objective of monetary gains with certain non-financial objectives related to the social and ethical concerns.3

SRFs can be defined as an investment vehicle that combines the investors' financial objective of monetary gains with certain non-financial objectives related to the social and ethical concerns:...”

Examining the data

To examine, we utilize the survivorship bias free sample of 963 funds with 306 SCFs and 658 SRFs with investment focus in Asia pacific, Emerging markets, Europe, Global (with no focus to any specific country or region), Middle East and North Africa (MENA) and Latin America for the period of 12 years that spans from January 2002 to December 2013. For the purpose, we employ single factor of CAPM as well multi-factor model of Garhant.

Our results suggest significant underperformance of both the funds suggesting that the screening has a negative impact on them. Regionally, except for the case of Global markets, irrespective of whether we use single-factor or a multi-factor model, both the funds underperform the market. However, for the Global markets, we found no performance difference between the conventional benchmark and the combined performance of both the funds. These findings may give an indication that the poor performance is due to reduced investment universe as the Global funds invest in more than one region and hence they have a much larger universe of stocks at their disposal. To sum up, we can say that there is a price that an investor has to pay for being socially responsible or Islamic. Although both of them underperform the market, SRFs manage to do slightly better than the SRFs.

As far as the investment style is concerned, as per the SMB coefficients, SCFs do not seem to follow any specific strategy but SRFs are tilted towards small capitalized stocks. The preference of SRFs towards small stocks is understandable as the negative screening seems to remove the large stocks as they are more diversified and can have operations that are not in line with the screening criteria. However, the results of SRFs are puzzling as the literature suggests that the SRFs should also be investing in small stocks as the large stocks are likely to have high beta, and therefore these stocks would be screened out in the Shariah screening criteria related to leverage. As far as the HML factor is concerned, both of them substantially invest in growth stocks as compared to value stocks. These findings make sense as most of the value stocks such as basic industries and energy would be screened out in the environmental screening. For the SCFs, most of the value stocks would be screened out due to the high leverage. On average, the momentum factor loadings reveal that these funds follow contrarian strategy as opposed to momentum. Finally, in sharp contradiction with the literature our results show that the SCFs' performance took a further dip during the crisis. It dismisses the claim of many SRFs that can provide a safer haven during crisis and are in line with Kraeussl and Hayat (2011). On the other hand, the performance of SRFs do provide weak support to the findings of Nofsinger and Varma (2013a) as they manage to provide at least similar returns as the market.

Conclusion

Before we reach any bold conclusion that the SRFs and SCFs are worse than the conventional benchmarks and the investors have to pay a price if they wish to invest as per their ethical or religious beliefs, we have to acknowledge that the performance of mutual funds rely heavily on managerial skills. If the manager is not skilled enough in terms of picking the stocks and/or timing the markets or even timing the style, then it can lead to poor performance of these funds. We acknowledge that this is one of the limitations of the paper and we leave this for a future research.
Sukuk and its Wealth Effects

Introduction

Classical corporate finance theory considers capital market behavior crucial to understanding how to maximize firm value and shareholder wealth. How this is achieved has been debated extensively over the last century. It stands to reason though, that maximizing firm value requires effective investment decisions which in turn necessitates a valuable source of capital. This capital can be provided either internally or externally, each influencing the risk of the firm and initiating varied wealth effects. The type of financing a firm takes to finance its business activities creates an impression in the market and investors react to such announcements by trading (to buy or sell depending on their understanding of the announcement) in the shares of the firm and consequently creating the wealth effect. The intensity of the wealth effect depends on many factors, among others, the type of bonds issued, the intended use of the proceeds and the level of leverage of the firm.

When firms announce issue of corporate bonds, the market perceives that there is some potential value that the management is not willing to share with new shareholders (by not issuing shares) and the share prices are undervalued, creating a positive wealth effect.

Over the last decade and a half however, with the growth of Islamic finance, firms have an additional financing option available to them through issuing sukuk. Often referred to as ‘Islamic bonds’ or ‘Islamic debt certificates’, sukuk have been avant-garde, especially for companies that are raising capital with Shariah-compliant objectives. Packaged as bonds that comply with Islamic law, sukuk have quickly evolved to offer a variety of classes (debt-based, equity-based, agency-based or hybrid). In theory, the issuance of Sukus should have a lower risk than bonds, as the proceeds of the sukuk issuance is used for real economic activities and there is a risk-sharing attribute that makes it less risky than corporate bonds for investors and issuers. However, in practice, it seems to be perceived as another version of a corporate bond but with Shari’ah compliance. The empirical issue of interest is "Do markets react similarly to Sukuk announcements as they react to corporate bond announcements?" Is there a similar wealth effect?

This article reviews the literature on these issues and deliberates on future research to understand this new financing instrument further. Briefly, the documented studies on sukuk and its wealth effects seem to get caught in the quagmire of underlying structures. As bonds before, sukuk can fall either in the category of debt or equity and the results of grouping all instruments in either one category (either debt or equity) can invalidate the findings.

Table 1: Global Sukuk Issuance, 2014.
Source: Zawya
Non-Muslim sovereigns have also ventured into issuing sukuk to finance mega-projects with Japan, South Africa, the United Kingdom, Germany and Luxembourg raising sukuk for infrastructure projects. The sukuk market has become a formidable growth area within Islamic finance, recording USD116.23 billion in global issuance in 2014 (Zawya), 100 times more than in 2001 (USD1.17bn). With all the potential sukuk issuances in the pipeline and continuous demand for Islamic products, global sukuk issuances are expected to surge to USD150bn in 2015 (Rasameel, 2014). More significantly, a recent Gulf News report shows a CAGR (Compound Annual Growth Rate) of 33% between 2001 and 2014 for the sukuk market.

A review of the findings on bond and sukuk announcements reveals an interesting trend of findings. Out of the 10 studies reviewed from 1999 to 2014 on corporate bond announcements, four conclude a negative response from the market and three studies report positive and no reaction respectively. Out of 9 studies on sukuk, six studies documented positive response, two negative responses and the one with no reaction. The findings in general indicate that for corporate bond announcements, the findings are inconclusive whereas for sukuk announcements, majority document a positive wealth effect.

Data Issues in Previous Research

Ashhari, Chun and Nassir (2009), Ibrahim & Minai (2009) limited their sample to the Malaysian issuances because of lack of debt announcements in Malaysia at that time. Both studies used data for issues between 2001 and 2006.

The number of sukuk issuances used in these studies pale in comparison to issues post 2006, hence expanding the data is expected to further validate factors that might be influencing market reaction to sukuk announcements.

Classes of Securities

Sukuk classification in earlier studies (pre 2014) is generally not evident. In fact, sukuk are referred to as ‘Islamic debt securities’ or ‘Islamic debt certificates’ most probably following the use of the term in the Malaysian Securities Commission Guidelines on Sukuk in 2003. This classification restricts previous research from interpreting the equity components of the sukuk and the asymmetric information to market. This means that whilst sukuk structures might have had an equity component in the samples selected, since sukuk were fairly new and innovative instruments in the early part of the 2000’s, the market might not have been aware of the equity components.

Market reaction on sukuk announcement on the other hand, is evolving as sukuk issuance grows significantly in size and frequency, differing in underlying structures and reflecting attributes of debt, equity, agency and a combination of debt and equity. Therefore, market reaction on sukuk announcement requires further investigation in the light of the following issues that have been identified:

i. The period of the sample selections is limited to either a period of minimal observations (2001 to 2006) or a period during or around the financial crisis (2007 to 2010).

ii. The majority of the data is limited to Malaysian sukuk issuance ignoring corporates in other countries (UAE, Saudi Arabia, Bahrain, and Indonesia) that are major issuers of sukuk (Zawya, 2015).

iii. Underlying structures have not been analyzed in the same way as different bond classes, with results expected to be different for the different sukuk types.

iv. Additional factors influencing market reaction are assumed without considering underlying structure implications.

v. These studies are relevant in understanding the wealth effects of sukuk announcement but do not provide analysis on the risk effects on the issuing firm before and after issuance relative to the market.

Therefore, whilst effort has been made in understanding sukuk and its wealth effects, further research is required in this area to better understand its effects across issuing countries and the risks associated with issuance for corporates. For firms that are considering sukuk issuance, forming an optimal capital structure with the most conservative cost of capital can be achieved only through a more thorough understanding of sukuk and its wealth effects.

Figure 1: Distribution of Global Sukuk Issuance 1st half 2015

Source: Zawya
Moutaz received his early education in Syria and obtained his Bachelor’s degree in Accounting from Damascus University, Faculty of Economy in 2005. He completed his joint Master’s programme in Damascus University and Bordeaux IV, France in Banks and Finance Management. He is currently one of the scholarship recipients for the year 2013 with another year remaining to complete his research titled: The Competitiveness - Stability Relationship Among Islamic Banks.

Obtained his Bachelor in Economics from Damascus University in Syria, before pursuing 2 Masters’ degrees both in Financial Markets and Islamic Finance from The Arab Academy for Banking and Financial Sciences in Jordan and at INCEIF Malaysia respectively. He chose to continue with a PhD at INCEIF and is currently working on his research titled: Determinants of Sukuk Credit Rating and Stock Market Reaction during the Shariah Governance Reform Period.

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