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*MERGING WAQF AND SUKUK:
SHOULD WE OR SHOULDN'T WE ?*

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MERGING WAQF AND SUKUK

INTRODUCTION:

Awqaf New Zealand, an Islamic NGO operating in New Zealand, recently identified sukuk as a tool to finance large awqaf farms to supply livestock and food for the pilgrimage and zakat al-fitr.² Thus, we are witnessing here an attempt to merge waqf and sukuk, two important financial instruments of contemporary Islam. The purpose of this article is to examine this synthesis from both the Shariah and finance perspectives and suggest, instead, a better alternative – a synthesis of *esham* and waqf. But first, a brief explanation of the *modus operandi* of these three financial institutions need to be made.

WAQF (PLURAL AWQAF):

Of the three institutions, waqf is the oldest with its origins traceable to the Prophet of Islam. The classical waqf used to be established by a wealthy person who donated his/her own accumulated wealth, in the form of real estate, for a charitable purpose of his/her choice. When made a waqf, the estate was considered to have become Allah's property and the rent that it generated was used for the purpose of the waqf. In short, a privately owned asset was donated in perpetuity for charity.

Centuries later and after long debates, Ottomans introduced and legitimised cash waqfs during the fifteenth and sixteenth centuries. Thus it became possible to establish a waqf with cash as its corpus, capital. This had momentous consequences as it paved the way for small savers to participate in charity. Indeed, with small savers making modest cash donations to existing waqfs, bulk of the society could now be involved in charity. In the early twentieth century, establishment of waqfs even with shares of joint-stock companies was also

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² Letter sent by the Secretary General of AWQAF New Zealand to the participants of the World Islamic Economic Forum, dated July 25th, 2016

permitted.³ These developments laid the ground work for the emergence of crowd funding in the twenty-first century waqf affairs. It is precisely this method of finance that Awqaf New Zealand aims at. While as a first impression this looks like an excellent idea, the problem with the New Zealand project is that they are planning to raise their initial cash capital with sukuk. Why this would lead to serious problems will become clear only after a proper understanding of sukuk.

SUKUK:

For all practical purposes, sukuk is an instrument for borrowing large amounts of cash from the public. In its most popular form, *sukuk al-ijara*, a triple transaction known as *sale-rent-repurchase* takes place.

A brief look at the way the *First Malaysian Global Sovereign Sukuk* had been designed should clarify this process:

- 1) The government **sold** an asset (hospital) that it owned to a special purpose vehicle (SPV) for USD 600 million. The SPV became the owner of the asset.
- 2) The SPV issued sukuk certificates to the public worth USD 600 million. Investors paid to the SPV USD 600 million and purchased the shares.
- 3) Meanwhile, the government **leased** the asset from the SPV. Thus the government that used to be the owner of the asset now became the tenant of the same asset.
- 4) The government began to **pay rent** for the asset.
- 5) The SPV transferred these rents to investors. Thus investors received regular rent income as a reward for their investment.
- 6) When sukuk certificates matured, the government **repurchased** the asset for USD 600 million from the SPV.
- 7) When this repurchase transaction was completed, the SPV transferred the USD 600 million to investors and **redeemed** the sukuk certificates. The certificates were returned to the SPV.⁴

The crucial steps of the process have been written in bold. In a nut shell, we are observing the sale of an asset, its lease back by the previous owner from the new owner, payment of rent to the investors to reward them for their investment, repurchase of the asset and finally redemption of the sukuk

³ For a detailed explanation of cash waqfs and these developments see; Çizakça, 2000.

⁴ Rosly, 2005, pp. 473-476.

certificates by paying back to investors their initial capital investment. All of this boils down to the issuer borrowing money from the public and then paying it back at a certain date. During the time that the issuer (government) keeps the borrowed moneys, investors are paid a rent to reward them for lending their cash. In short, what we have here is a credit transaction rendered Islamically acceptable by substituting interest with rent.

This was the *modus operandi* of the *First Malaysian Global Sovereign Sukuk*. For the purposes of this article, the crucial question is how exactly can this process be utilized for establishing a waqf – how, indeed, can the institutions of waqf and sukuk be merged?

The basic structure proposed is that the Awqaf NZ shall issue sukuk to raise global capital to acquire farm lands in New Zealand with the purpose of provisioning *kurbani* during the annual Islamic pilgrimage. It is envisaged that the unused parts of the sacrificed animals shall generate waqf revenue. The sukuk will be structured as not for profit and will be paid back to the investors at a certain date. Investors will be able to sell their sukuk to third parties before maturity. Since they forfeit their rights to profit, these will be distributed to beneficiaries globally.

This *modus operandi* of the Awqaf NZ can be summarized as follows:

- a) Awqaf NZ establishes an international “smart waqf” (This is an offensive term and implies that all other waqfs previously established by Muslims throughout history were not so smart!)
- b) The first asset of this waqf will be a NZ farm purchased by sukuk funds
- c) These funds will be raised globally through a not for profit sukuk. Profits will be given to charity.
- d) Guarantors may be available
- e) The sukuk will be redeemed at a certain date and investors shall be paid back their capital.

THE CRITIQUE:

The most crucial and problematic part of the proposal is raising the capital of Awqaf NZ through sukuk which must be paid back at maturity. In a nutshell, the capital of this waqf is to be raised through sukuk from global investors. Although these individuals forfeit their rights to profits, they shall be paid back

their initial investment when the sukuk matures. So, for all practical purposes, investors will be lending their capital to Awqaf NZ. This means that at maturity, when the capital must be paid back, Awqaf NZ will be forced to liquidate itself. It will be forced to pay back its very capital to those who provided it in the first place. This is tantamount to self-abolishment.

Thus, with the self-inflicted abolition, Awqaf NZ assumes the character of a temporary waqf – it is established with capital loaned through a global sukuk and is brought to an end when its borrowed capital must be paid back at the maturity of sukuk.

From this point on, we need to focus on the question of whether it is permissible to establish a waqf, normally considered perpetual, on temporary basis.

But this is not all, an almost equally difficult problem emerges from the very structure of sukuk – the need to ensure investors that their capital shall, indeed, be returned at maturity. This leads to the need to use the capital of the waqf as collateral. So the new question is whether it is permissible to use waqf's capital as such.

The condition of perpetuity (*te'bid*) is the majority opinion among the classical jurists. This view is based upon the *hadith* when Omar bin Khattab asked the Prophet (SAW) about a donation he wished to make. He was told to keep (*habs*) the land itself for as long as the earth and skies existed and give the usufruct for charity. The condition of perpetuity is therefore crystal clear. Majority of the Shafi'is, Hanefis and Hanbelis insist on the condition of perpetuity. These scholars also argue that to establish a waqf is similar to manumission. Manumitting a slave is a gift (*teberru*) and once made, there is no revocation of a *teberru*. All the classical Hanefite scholars, without an exception, agree that a temporary waqf combined with the stipulation of returning the original capital invested (*ruju'u*) is illegal.⁵ There is disagreement among these scholars only about temporary waqfs without this stipulation. Since the model we are discussing here pertains to a temporary waqf with the stipulation of returning the capital (which had been invested through sukuk) there is no need to go into the details of these debates for such waqfs are considered illegal by the majority of classical jurists and all the Hanefite scholars.

⁵ Ahmet Akgündüz, 1988, p. 87.

The only classical school that permits temporary waqfs and the return of the original capital back to the donors is that of Malik and his followers. These scholars consider waqf as a *sadaqa* and argue that *sadaqa* can be temporary or perpetual. They argue further that there is no express text prohibiting a temporary waqf and that not insisting on perpetuity would encourage Muslims to establish more waqfs.

These classical debates about perpetuity vs temporality have surfaced in modern times as well. Perpetuity was still the predominant condition in mid-twentieth century as the 1946 Egyptian law of waqfs (items 17-18) and the Lebanese law (items 8-11) demonstrate.⁶ The latest Turkish waqf law of 2008 does not even mention the term temporary waqf among the various types of waqfs it formally recognizes.⁷ On the other hand, the draft law of waqfs jointly prepared by IDB/IRTI and the Kuwait Public Foundation to be proposed to all Muslim countries has re-introduced family waqfs and allowed them to be temporary. It has also permitted charitable waqfs (*waqf khayri*) to be permanent or temporary.⁸ Indonesian Law of Waqfs has permitted both permanent and temporary waqfs but has prohibited revocability. Malaysian law has also permitted both types. More specifically, it has created two categories with *waqf am* as a dedication in perpetuity and *Waqaf Khas* in perpetuity or for a limited period. Indian Law of Waqfs defines waqfs as a permanent dedication and excludes temporary waqfs. Waqf laws of Pakistan and Bangladesh also define waqf as a permanent dedication.⁹ In view of all this, any waqf that is established on temporary basis is bound to invite objections from many contemporary scholars.

The next problem concerns whether it is permitted to use the waqf capital as collateral. The proposed model considers this necessary in order to ensure sukuk investors that their capital is guaranteed. Once again, the majority of classical jurists prohibit the use of waqf asset as collateral. This has also been confirmed by the AAOIFI clause 5/3/4. These prohibitions are based on the general *fiqhi* rule that what is not allowed to be sold, is not allowed to be used as collateral.

It appears that there is an implicit *gharar* in the proposed *modus operandi*. Indeed, the most difficult part of the model is that sukuk holders will be paid

⁶ Akgündüz, *op.cit.*, p. 92.

⁷ Kanun no. 5737, Vakıflar Kanunu 20.2.2008, www.alomaliye.com/2008/5737_sayili_kanun_vakiflar.htm

⁸ Item 70/3; Appendix Item 64. See; Çizakça, 2014(b).

⁹ Thomson Reuters, 2014, p. 80.

back their principals by the revenue of the farm. The problem is that sukuk will mature at a certain date and it is by no means guaranteed that the farm, with all the uncertainties of agriculture, will be able to generate sufficient revenue to redeem the sukuk by that date. In short, the model envisages the definitive redemption of sukuk at a certain date with uncertain agricultural income. This is tantamount to shifting all the risks upon the waqf and constitutes *gharar*. It should not be permitted.

Finally, the proposed model is highly complicated. If we take into consideration all the parties involved, the number exceeds 20. Nearly all of these parties would clearly be interested in drawing as much profit from the *modus operandi* as possible. This would naturally reduce the revenue available for charity. Put differently, what Awqaf NZ will earn should be considered as a zero sum game, the more parties are involved in the *modus operandi*, the less will be left for charity. So, to maximize what is left for charity the *modus operandi* should be simplified and the number of participants should be drastically reduced. As a rough guide, we can refer to the endowment deed of the well-known Koç Foundation of Turkey where it is stipulated that a maximum of 20 percent of the revenue to be generated shall be allocated to administrative expenses.¹⁰ With more than 20 participants, it is very unlikely that the administrative expenses of Awqaf NZ can be kept within this limit.

RECOMMENDATION (*ESHAM*):

The most crucial weakness of the proposed model boils down to the fact that it is designed as a waqf established with borrowed money through sukuk. Once envisaged like this, a series of very difficult Shari'ah questions such as temporality of a waqf, using its *asl al-mal* (capital) as collateral, revocability, even *gharar* inevitably follow. In short, a waqf should not be established with borrowed money. If it is desired to establish this waqf with global funds, in itself an excellent idea, the need arises to do this with an instrument that does not have to be paid back. As it is well known, such an instrument exists and it is called *esham*.¹¹ In what follows, I will explain how this instrument can be used by Waqf NZ to raise global capital without any Shari'ah objections.

¹⁰ Çizakça, 2000, p. 101.

¹¹ Esham (plural of sehm) means shares. They were utilized probably for the first time in Islamic financial history by the Ottoman government. Defeated by the armies of Imperial Russia in 1774, Ottomans had to pay a huge war indemnity within a year. Moreover, since the borrowing had to be done by the government of the Caliph, it had to be Shari'ah based. The solution found was *esham*. It successfully raised about one third of the

Modus Operandi:¹²

a) The Asset:

The operation starts with the issuer (Awqaf NZ) setting aside an asset yielding a regular annual revenue. The asset is owned and managed by the issuer, who allocates a certain fraction of the annual revenue for *esham*. Since what is of interest here is a waqf that is issuing *esham*, waqf must set aside its own revenue yielding asset for *esham* issuance. This is possible if it is clearly permitted by the founder in the endowment deed.

a) Securitization:

This revenue fraction is then securitized into equal shares and offered for sale to the public. Each share authorizes its purchaser, the investor, to receive his share of the allocated annual revenue fraction *pro rata*. This is a fixed amount, which makes it quite attractive to the investor. Why, notwithstanding this fixed annuity, *esham* does not constitute *riba*, will be discussed below.

b) Duration:

Esham does not have a fixed period. With respect to duration, there are usually two kinds of *esham*: limited for a life time, or perpetual. The investor, who has purchased a *sehm* share, continues to receive his share of the annual revenue fraction earmarked for the project for as long as he/she lives, or even in perpetuity. The latter is called *perpetual bonds* or *perpetual sukuk* in modern parlance. As a matter of fact, *esham* differs from both: it is neither a bond, nor a *sukuk*. It is not a bond because of its specific redemption characteristic. That is to say, whereas conventional bonds guarantee the return of the principal when redeemed at maturity, *esham* provides no such guarantee. Moreover, whereas with conventional bonds interest is determined as a percentage of capital,¹³ with *esham*, annuities are determined as a fraction of the revenue or the profits generated. It is not a *sukuk* either, because unlike most *sukuk*, it neither has an SPV nor a specific date of redemption. Consequently, it is considerably simpler than most *sukuk* and has lower transaction costs.

war indemnity within less than a year and then came to dominate Ottoman public finances for the next century or so. For further details see Çizakça, 2011.

¹² The following *modus operandi* is based upon Genç, 1995.

¹³ Usmani, 2016.

Even more importantly, whereas “virtually all of the *sukuk* issued today guarantee the return of the principal to the *sukuk* holders at maturity in exactly the same way as conventional bonds”,¹⁴ in *esham* there is no such guarantee. A life-time *esham* would be issued to a specific person and therefore be a registered share, whereas the perpetual one would be a bearer’s share.

c) Pricing:

Each *sehm* share is sold at a certain multiple of the annuity it will yield to the investor. Naturally, a *sehm* for a life time would be cheaper than a perpetual one. There is no fixed rule regarding the initial price of a share, which would be determined by the demand for and the expected supply of funds.

When sold in secondary markets by the initial owner, the price of a share fluctuates reflecting supply and demand as well as the reliability of the previously paid annuities. Perpetual *Esham* can be traded in secondary markets and are fully negotiable. Listed on an exchange, they would behave like participating preferred stocks. Historical examples inform us that a *sehm* can be traded at 75 percent or at par depending upon how regular and reliable the payment of annuities has been.

d) Yield:

Esham is a hybrid fixed income and profit/loss sharing instrument. Returns are paid to the investor in the form of fixed annuities. Profit/loss sharing occurs when it is traded in the stock exchange. Because of the redemption specifics to be explained below, which eliminate any doubt of *riba*, the annual yield can be benchmarked to LIBOR or it can be set even higher. A reserve account can also be set up to avoid reflecting the losses on investors.

Income from *esham* proceeds is channeled into two pools: First pool is reserved for paying the fixed annuities. Second pool contains the retained earnings to be invested in the meantime.

¹⁴ Usmani, 2016, p. 4.

It might be added here that although the overall returns generated by the asset will naturally fluctuate, the annuities paid to investors can be fixed. This is because, only a small part of the overall fluctuating returns will be earmarked for *Esham* annuities. To give an actual example from the eighteenth century, the gross annual yield of the Istanbul tobacco tax-farm was one million *grus* and the amount reserved for the payment of fixed annuities was merely 400.000 *grus*. Consequently, although the annual gross yield of one million *grus* fluctuated from year to year, totally unforeseen circumstances such as wars notwithstanding, fixed annuities could be paid regularly. Alternatively, the modern *Esham* can be designed as a pure profit/loss sharing instrument with the annuities reflecting the true revenues generated by the asset.

e) Redemption:

What makes *esham* unique is the fact that redemption is at the discretion not of the lender but of the borrower. Put differently, the borrower pays back the principal when he sees fit. This means that the maturity is decided by the borrower. While this is so, and the borrower may decide to redeem at a certain time in the future, the investor does not have to sell his *esham*. Thus, the issuer may end up redeeming only those *esham* whose owners wish to cash.

In the case of perpetual *esham*, the borrower may not redeem at all. He is, however, obliged to pay the annuity on time every year in perpetuity. Providing the issuer does not fail to pay the annuities on time, there is no obligation for the redemption of *esham* certificates. Thus investors buy *esham* shares entirely for the annuity payments and are fully informed that their investment may not be redeemed by the borrower. They know that they can sell their shares only to third parties at the stock exchange or through banks.

Consequently, *esham* would be considered not as debt but as equity – a highly advantageous situation regarding the Basel III gearing ratios. Put differently, if the issuer is a company, it would be able to shore up its capital base without deteriorating its debt/equity ratio. More to the point, with no obligation to redeem, unlike the *sukuk* financed model discussed above, *esham* financed waqf capital does not deplete.

f) Third Party Guarantee:

Since the issuer is a waqf, a reliable and trust worthy third party may need to be found. In the case of *esham* third party guarantee pertains to the fixed annuities only.

g) Relevance for Central Banks and Open Market Operations:

The above mentioned characteristics render *esham* an ideal instrument for open market operations of central banks in Islamic countries. Indeed, when these banks want to inject money into the economy they can buy *esham* and when they want to withdraw money from the economy they can sell. Islamic banks can also do the same for managing their liquidity. Currently, these banks utilize commodity *murabahas* or *tawarruqs* for liquidity management. These instruments are subject to *Shari`ah* risks, while *esham* is not. This is so, not only thanks to the redemption characteristics but also because, when perpetual *esham* shares are sold in secondary markets whether by the central banks or individuals, the prices would be determined by market forces.

The *Shari`ah* Perspective:

At this point, we need to take into consideration whether *esham* is a usurious instrument. A cash-cash transaction would be considered as *riba*, if all of the following conditions take place:¹⁵

- 1) Excess or surplus over and above the loan capital to be returned to the lender.
- 2) Determination of this surplus in relation to time with a definite date of redemption
- 3) Stipulation of this surplus in the loan agreement.

With regard to the life time *esham*, since we do not know for how many years the investor shall receive annuities, the uncertainty of the lifespan of the investor eliminates the certainty of the surplus and violates, at once, all three conditions. With regard to the perpetual *esham*, the lack of a definitive date of redemption violates the second condition.

¹⁵ Afzal al-Rahman quoted in Abd al-Mun`im Mahmud al-Qusi, 1982, p. 122.

Another criterion that we need to take into consideration is risk transfer vs. risk sharing, with the former disallowed and the latter permitted. When an investor sells perpetual *esham* shares in his/her possession in secondary markets, the price will be determined by supply and demand as well as the past payment performance of the annuities. This will render *Esham* a true profit or loss sharing instrument. Moreover, with the redemption being at the discretion of the borrower/issuer, risks are not transferred by the lender upon the borrower. Instead, a compromise is reached by which, while the issuer/borrower redeems his debt at his discretion, the investor obtains the right to a fixed and regular annuity for as long as the issuer/borrower does not redeem. Meanwhile, the investor can sell his/her *Esham* at the stock exchange at market prices. All of this is in sharp contrast with a conventional credit transaction, where the date of redemption of the principal plus the rate of interest is fixed *ex ante* and is clearly stated in the contract.

Some scholars, who fail to understand the *modus operandi* of *Esham*, quickly condemn it on the grounds that it provides fixed income to investors. These scholars need to understand that Islam is not against fixed income as such – had it been so, then all the *ijara* transactions would have been rejected. What Islam prohibits is risk transfer or shifting¹⁶ and unjustified enrichment of one of the partners at the expense of the other. *Esham* providing a fair compromise between the investor and the borrower, is in conformity with the spirit of Islam and one of its most important principles, justice, *adl*. This idea, that is protection of the weak, and for the case at hand, the borrower, is confirmed definitively by the Qur'an:

“When ye deal with each other, in transactions involving future obligations...Let him who incurs the liability dictate” (II/282)

Consider also the following verse:

“If the debtor is in a difficulty, grant him time till it is easy for him to repay.” (II/280).

By allowing the borrower to decide when to repay the principal, *esham* follows perfectly the spirit as well the letter of these Qur'anic injunctions. Indeed, “Let him who incurs the liability dictate” is practically a verbatim expression of *esham* redemption.

Moreover, we have evidence that the system has always tried to protect the weak. Indeed, it can be argued, on the other hand, that the uncertainty about the life-span of the investor subjects him to a high risk. Historians have found cases

¹⁶ According to Abbas Mirakhor, risk transfer takes place when the lender transfers the risks upon the borrower with the latter's tacit agreement. Risk shifting is more sinister and transfers the risk upon the borrower without informing him.

that in the event of an unexpected death occurring shortly after the investor has made a large investment and bought *Esham*, his descendants could apply to the authorities and complain that the deceased has died before he has been able to receive any income from his *Esham*. In such cases, although, legally speaking, the investor had no recourse to any compensation, authorities did make payments to his family. There was apparently no fixed rule for such compensation, it was paid purely as a process of risk sharing and justice, *adl*.¹⁷

Thus we conclude, *esham* is neither a risk transfer nor a risk shifting instrument. Indeed, unlike such instruments, it does not transfer all the risks upon the borrower and, instead, following the Qur'an, protects him by giving the option of redemption at a suitable time. In history, it has also protected the investor in case of early death. In view of all the arguments presented above, it is concluded that *Esham* is not usurious. The fact that it was used by the Ottoman Caliphate for more than a century also supports this conclusion.

Finally, *Esham* has been examined from the perspective of the *maqasid al-Shari'ah*. This examination revealed that *Esham* affects all the components of the *maqasid* positively and should therefore be implemented.¹⁸

Looked from a longer perspective, thanks to *Esham*, the Ottomans were able to raise one-third of the war indemnity that they had to pay to the Russian Empire. Within ten years of its establishment, in 1785, *Esham* generated 11,500,000 grush revenue, which was more than half of the entire revenue of the Ottoman state. It has been calculated that what the previous fiscal system, the *malikane*, was able to generate in 90 years, *Esham* succeeded to generate in only ten years.¹⁹ So, we conclude, with confidence, that *Esham* enables the issuer to collect substantial revenue from the public. On the condition that this revenue is used wisely, it can certainly trigger sustained economic growth.

Most Recent *Esham*-like Instruments:

Recently some new forms of, what the industry insists on calling *sukuk*, have been issued, which from the perspective of institutional evolution appear to have been, not *sukuk* but rather, derivatives of *esham*. This is so, because they are perpetual instruments and should therefore be considered as *esham* rather than *sukuk*.

One of these, was issued in June 2012 by the Malaysian Airlines advised by Maybank. The first tranche of the junior *sukuk* amounting to RM 1 billion was

¹⁷ I owe this point to Mehmet Genç.

¹⁸ Çizakça, 2014(a).

¹⁹ Genç, 1995.

issued to *Kumpulan Wang Amanah Pesara* and firm commitments from other parties amounting to RM 1.5 billion were also received. Just like *esham*, this was a perpetual instrument without a maturity date and it does not obligate MAS to repay the principal. There was no government or third party guarantee and annuities were not fixed. The instrument is expected to pay 6.9 percent per year profit rate semi-annually, which makes it quite attractive for investors in search of higher returns. From the accounting perspective, this *sukuk* is considered as equity and does not affect negatively the gearing ratio of the issuer.

In November 2012 the Abu Dhabi Islamic Bank issued a USD 1 billion perpetual *sukuk*, also without a maturity date. The ADIB can choose to repay the principal from 2018 onwards, if it so wishes. ADIB has announced that it has issued this perpetual *sukuk* in order to meet the Tier 1 capital requirement in Basel III. An important feature of this issuance is that private banks were allocated only 60 percent with the remaining 40 percent allocated to the general public. This is in contrast to most regional bond issues, which are bought up entirely by banks. Thus, a whole new investor base appears to be opening up. It is possible that high net-worth individuals may be followed by the rising middle classes, a massive demographic phenomenon, of Islamic countries.²⁰

Conclusion:

Unlike human beings, institutions do not die! They may linger on for a long time, even centuries, but when circumstances change and there is a need for them they spring into being again. The fact that various *esham*-like perpetual instruments are beginning to appear indicates that, once again, they are being needed. There are number of reasons for this.

First, a mighty combination of demography and democratization in the Middle East as well as the rest of the Islamic world, will in all probability, create a totally new investor class: the rising middle classes. This huge group, quite possibly hundreds of millions strong, need an instrument that yields fixed returns without violating the *Shari`ah*. Muslims have always needed such instruments. They usually solved the problem by resorting to legal tricks, which obeyed the letter of the *Shari`ah* but violated its spirit. What makes *esham*

²⁰ (<http://biz.thestar.com.my/news/2012/11/23/business>, retrieved Nov. 30th)

unique is that through its special redemption structure, it obeys directly the Qur'an. *Esham* is not a loan and, for all practical purposes, where there is no loan, there is no *riba*.

Second, Basel III, has created an urgent need for raising capital without deteriorating the gearing ratios. *Esham* derivatives, being considered equity, not debt, are ideal for this purpose.

With respect to the establishment of a waqf with *sukuk*, unless the investors of *sukuk* forfeit their right of redemption, this method is tantamount to establishing a waqf with borrowed money, which must be paid back at a certain time. From the Shari'ah perspective, this is highly controversial. Perpetual *Esham* solves this problem by allowing the waqf not to redeem the shares purchased. Investors would simply be rewarded by the payment of annuities in perpetuity, while the waqf maintains its capital and can also function in perpetuity.

Finally, those planning to combine *sukuk* with waqfs need to understand that *sukuk* is by no means a perfect instrument. After explaining in detail how *sukuk* violates some important principles of Islamic finance in order to imitate conventional finance, one of the finest contemporary authorities on Islamic jurisprudence and the President of the AAOIFI Shari'ah Council, Muhammad Taqi Usmani confirmed this as follows:

“If Shari'ah supervisory boards have tolerated such irregularities (*mafasid*) when *sukuk* began to be issued, and at a time when Islamic financial institutions were few in number, the time has now come to revisit the matter and to rid *sukuk* from such blemishes...”²¹

In short any attempt to combine waqf, a genuine Islamic institution that has superbly served Islamic World for centuries, with *sukuk*, is tantamount to corrupting it. Such a combination should not be permitted. If the ultimate aim is to mobilize global funds to finance waqfs, in itself an excellent idea, then the correct instrument of choice should be *esham*.

In view of all this, my unsolicited advise to the founders of Awqaf NZ is as follows:

- 1) Establish a hybrid cash-real estate waqf with donated capital
- 2) Make sure the endowment deed permits the trustee of the waqf to use part of this capital as underlying asset for *esham* structuring.
- 3) Issue perpetual *esham*.
- 4) Once *esham* shares are sold to investors, allocate about one third of the waqf's annual revenue for the payment of *esham* annuities.

²¹ Usmani, 2016, p. 7.

- 5) Invest the remainder of the waqf capital plus *esham* proceeds prudently. Do not let yourself become overconfident that you will not have to pay back the principal. Learn from the Ottoman experience that if *esham* proceeds are not invested properly even the payment of annuities can be jeopardised.²²

²² Rather than investing prudently, nineteenth century political circumstances forced Ottomans to spend *esham* proceeds on the needs of the military.

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