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Potential Development of SRI *Sukuk* Models for Higher Learning Institutions in Malaysia based on *Wakalah* and *Waqf*

Engku Rabiah Adawiah Engku Ali[a], Syed Marwan Mujahid Syed Azman[a], Nor Razinah Mohd Zain[a], Rusni Hassan[a], Salina Kassim[a]

[a]*IIUM Institute of Islamic Banking and Finance, International Islamic University, Malaysia*

Abstract

Funding for Higher Learning Institutions (HLIs) in Malaysia has become increasingly constrained as the government faces increasing costs and global economic slowdown. Central to this issue is the challenge to raise the funds needed to sustain HLIs' operations and development. It has therefore become a necessity for HLIs to come up with innovative ways to raise funds and move towards to becoming more self-sustainable. Malaysia can possibly learn from HLIs in the UK, US, and Australia where universities have managed to obtain funds through the capital market by issuing bonds. This paper focuses on exploring alternative financing modes for HLIs through Socially Responsible Investment (SRI) *sukuk* and Social Impact Bonds (SIBs). The methods utilized in this study are critical review of literature, case study analyses and interview sessions with experts. This study recommends two SRI *sukuk* models: firstly, in the situation where the proceeds are used for income-generating activities, *sukuk* based on *wakalah* is proposed; while secondly for non-income generating activities, a cash-*waqf sukuk* with temporary and permanent features is suggested. In term of the structure of the *sukuk*, the returns and repayments of both *sukuk* are dependent on key performance indicators (KPIs) being achieved. In both cases, it is recommended that the *sukuk* be issued by a consortium consisting of a number of different universities in order to lower the cost of issuance and fund management, as well as efficiently utilizing resources. It is also recommended that the *sukuk* is guaranteed by a third party, preferably by the government.

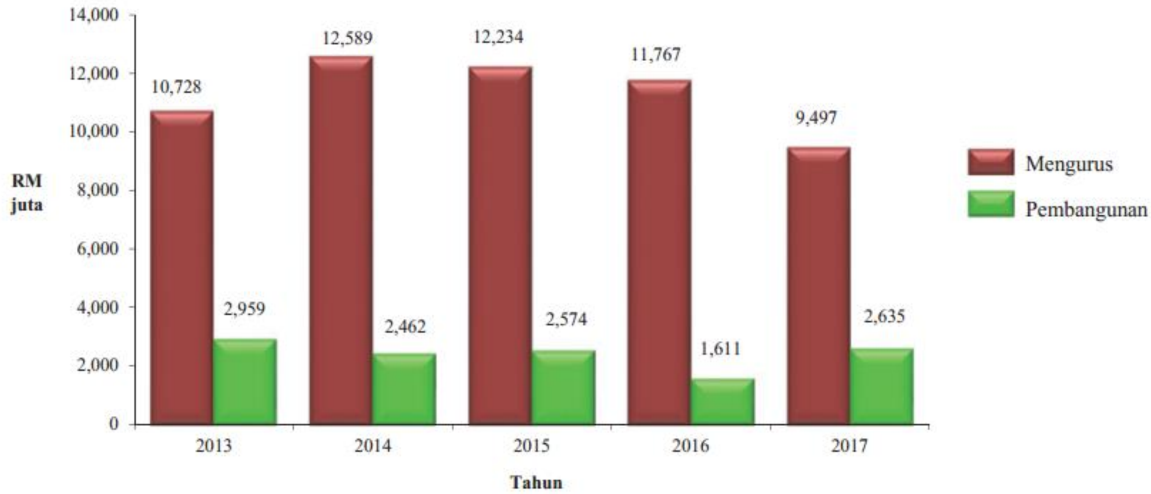
Keywords: SRI *sukuk*, Social impact bonds, Alternative financing, Higher learning institutions, Islamic finance

1. Introduction

Higher learning institutions (HLIs) in Malaysia consist of 20 public universities and more than 500 private HLIs catering for increasing number of student enrolments (Ministry of Education Malaysia, 2015). However, funding for HLIs has become increasingly constrained as the government faces mounting costs and economic slowdown. This gives rise to the ever-increasing concern on the issue of self-sustainability of HLIs. This is not an issue unique to Malaysia, but also globally where HLIs are facing similar challenges in achieving self-sustainability.

In Malaysia, the government allocates a certain amount of budget to the Ministry of Education (MOE) annually, which in turn will channel part of the funds to HLIs. According to Ministry of Education Malaysia (2015), 90% of public HLI expenditure is funded by the government. However, HLIs saw a decline in overall funds allocated by the government since 2014. For budget 2017, the allocated estimated expenditure for HLIs decreased by 10.27% from RM 13.378 billion in 2016 to RM 12.132 billion in 2017. As a result, funds channeled towards public universities have also decreased from RM7.573 billion in 2016 to RM6.117 billion in 2017, with a 23.8% cut (Ministry of Finance Malaysia, 2016) – refer Figure 1.

Figure 1: Expenditure (2013-2015) and allocation (2016-2017) for operations and development: Ministry of Higher Education Malaysia



Source: Ministry of Finance Malaysia (2016)

With such drastic budget cuts, HLIs may find that it is hard to recalibrate their operations and activities especially in the short term. Despite an increase in the allocation in recent years, the challenge of funding and sustainability of HLIs remain. It has therefore become a necessity for HLIs in Malaysia to come up with innovative ways to raise funds and move towards becoming more self-sustainable. In the Malaysian Education Blueprint 2015-2025 on Higher Education, the government outlined "10 shifts" to spur excellence in Higher Education, including the shift towards financial sustainability which emphasizes on the need for HLIs to move away from reliance on government resources (Ministry of Education Malaysia, 2015). The blueprint mentions the need for a long-term financing system for HLIs that is sustainable and at the same time can provide accessible, equitable, high quality education that meets international standards. Possible lessons can be learned from the route taken by HLIs in the UK, US, and Australia where universities have enriched their source of finance including their involvement in the capital market to raise funds through bonds.

2. HLI Financial Sustainability and Alternative Funding Initiatives

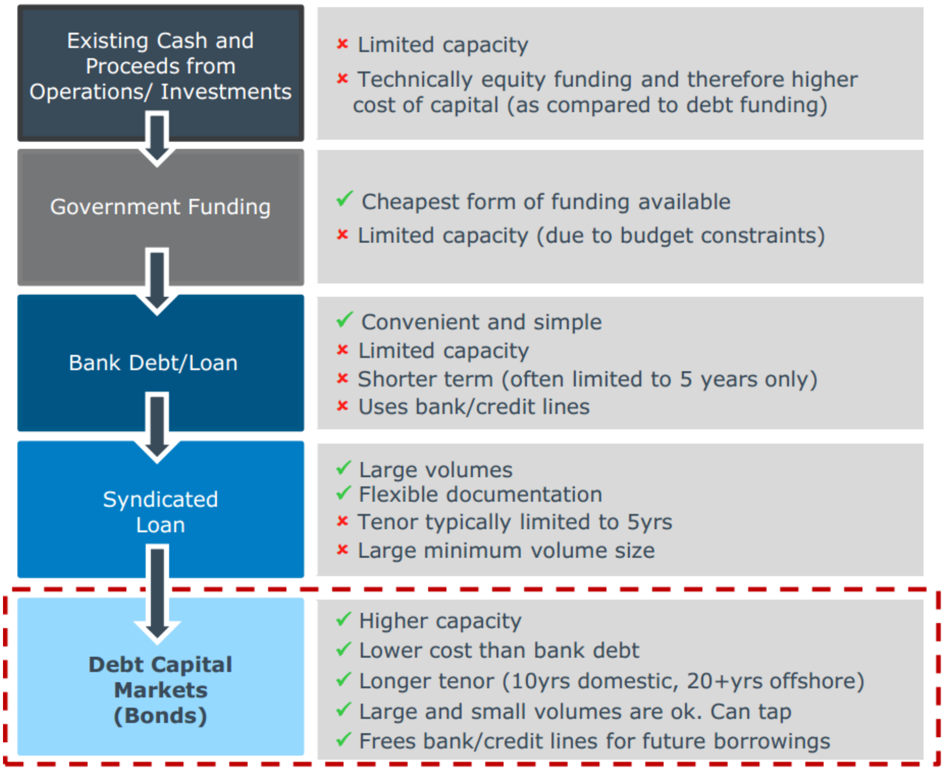
Several Malaysian universities have taken initiatives to strengthen their financial sustainability. For example, Institute of Education in Islamic Finance (INCEIF), International Islamic University Malaysia (IIUM), Universiti Teknologi Malaysia (UTM), Universiti Teknologi Petronas (UTP) and Sunway University have established various forms of endowment funds to sustain their operations (Ministry of Education Malaysia, 2015). Although these endowments are comparatively small and nascent, they indicate a step in the right direction for HLIs to become financially independent.

However, other initiatives such as raising funds through the capital market are yet to be explored. Surprisingly, there is no mention of these types of funding initiatives in the Malaysia education blueprint although they are quite prominent in countries such as the United States, United Kingdom and Australia. Therefore, this study is undertaken to look into these initiatives, highlighting their potential towards ensuring self-sustainability of HLIs in Malaysia. The following section analyses HLIs funding through the capital market in further detail.

2.1. HLI Funding Through the Capital Market

HLIs globally face significant challenges to meet their short and long-term expenditure and development needs. To meet these needs, HLIs are looking to expand their source of funds. This can be from their own revenue, government funding, bank loans, and even syndicated loans. In recent years, there has been a significant shift of HLIs looking towards the capital market to raise funds. Among others, this is due to the challenge of HLIs obtaining long-term bank loans especially in the current financial climate (Robinson, 2016). With limited capacity from its own operation and decreasing government funding, the capital market can potentially offer better and more flexible deal for HLIs as compared to the banking sector. Financing through the capital market is highly attractive as it provides a convenient alternative for HLIs to raise funds for their operations and development. Essentially, it offers simplicity, relatively lower cost, a longer tenor, relatively limited covenants, as well as strong and reliable borrowing capacity (ANZ, 2015).

Figure 2: Fund Raising Options for HLIs



Source: ANZ (2015)

According to ANZ (2015), HLIs have a number of characteristics that make them highly desirable to investors. Among others is familiarity and trust, which can be provided by HLIs in term of their name recognition and brand value. Furthermore, HLIs usually offer strong corporate reputation and good governance with easily understandable business operations and strategy. Additionally, HLIs can potentially obtain high quality rating for their bonds with long tenor that can add to investors' portfolio. Investors of HLI bonds can vary from asset managers, private banks, insurance groups, and insurers. HLIs' fund raising activity in the capital market is still relatively nascent but has gained significant traction. In terms of the global private placement market, bonds raised from the education sector represents a significant share of around 13% (Robinson, 2016). The trend is expected to continue especially with increasing interest from investors.

Robinson (2016) notes that there are two routes for HLI to issue bonds: public bonds and private placements. Public bonds are the typical conventional bond in the capital market while private placement is essentially borrowing from a small number of private or institutional investors (Finer, 2016). Among the distinguishing features, public bonds would require credit rating, a minimum transaction size, and are usually long term. Hence, they are more suitable for large and long-term programmes. On the other hand, private placements can offer medium to long term maturity with no minimum transaction size, thus more flexible for small and medium projects. Furthermore, they do not require credit rating, thus, reducing the cost of transaction. Both methods have their own advantages and disadvantages, depending on the short- and long-term needs of the HLIs.

In the following sections, we will look at several cases of HLIs capital market fund-raising in the United States, the United Kingdom and Australia.

2.1.1. The United States of America

Harvard University in America is well known for its academic excellence and reputable alumni. Equally excellent and reputable is its endowment fund which as of 30th June 2016, is valued at USD35.7 billion (Harvard Management Company, 2016). The annualized return for this endowment fund over the past 20 years has been more than 10% per annum. In 2016, the returns from this endowment were used to fund more than 33% of Harvard's operating expenses (Harvard Management Company, 2016). Another aspect of its financial management is its fund-raising exercises through the capital market. In 2006, Harvard raised hundreds of millions of dollars' worth of bonds. In the same year, other HLIs such as University of Texas and Cornell University also sold bonds with USD250 million raised for the latter (The Economist, 2006). More recently in 2014, Princeton University raised USD200 million to fund the construction and restoration of its library, arts centre, and dormitories, while Yale University and Massachusetts Institute of Technology (MIT) also went to the capital market and raised USD250 million and USD550 million worth of funds respectively (Purvis, 2014).

According to an article by The Economist (2006), the overall market for higher-education bonds was already USD33 billion – which is triple the value from 2000. Although raising funds through the capital market is nothing new, it is noted that it did not come soon enough. Most notably because HLIs were not aware of the potential usefulness of the capital market. Furthermore, there was a cultural barrier that made academicians reluctant to look at universities in business terms, and they misconstrued what needed to be done in order for their institutions to grow. Some HLIs thought that they do not have the ability to service debt because they did not have any, or had relatively small endowments. Investors however, saw things differently – they considered the buildings and assets that universities have, the reputation that universities hold, as well as the backing of the government. Most universities are also public and non-profit, therefore they can have tax-related advantages such as issuing tax-exempt debt. This makes HLI-issued bonds more attractive for investors. As a result, since 2000, raising higher education funds through the capital market in the United States has flourished. Outside the US, HLIs were hesitant to follow this approach as their spending and operations are closely linked with the state, but this is changing, with universities from the United Kingdom, Australia, Spain, Canada and Japan also issuing bonds to fund their operations and development (The Economist, 2006).

2.1.2. The United Kingdom

Historically, in the UK, universities have been borrowing from banks for quite some time, but have recently shifted towards the capital market. This was caused by two major driving factors: significant reduction in government grants, as well as changed bank lending standards which became relatively less attractive (Blum, 2014). As a result, HLIs began to look towards the capital market. In 2012, De Montfort University from Leicester raised £120 million, and Cambridge University raised £350 million from bonds in the capital market. Cambridge's issuance was for the purpose of constructing a new stem-cell research laboratory and accommodation for students (Cook, 2012). While in 2013, Manchester University issued a 40-year bond, raising £300 million to help fund their 10-year capital investment plan which included the building of a new engineering and physical sciences campus (Blum, 2014). On a similar route, in 2015 Oxford University launched a £40 million bond with a coupon of 3.1% and maturity of 50 years (Hale, 2015). In the same year, the University of Liverpool issued a £250 million public bond to fund their residential investment strategy (Robinson, 2016). The bond issued by Northampton University in 2014 became the first guaranteed by the UK treasury. The £231.5 million bond with a 40-year tenor was issued to support the development of its campus following extensive research. It allowed for the university to secure a low, fixed interest rate of below 4 percent, making it a relatively low-risk option (Times Higher Education, 2015). Since 2012, a total of 34 bonds have been issued in the UK, raising around £3.2 billion worth of funds. The size of transactions range between £20 million to £350 million, with maturity between 10 to 50 years, showcasing the diverse range and potential of education bonds (Robinson, 2016).

2.1.3. Australia

In Australia, HLIs have traditionally relied on funds from the government to provide new facility development. However, in recent years government funds for new infrastructure were reduced. Furthermore, the Higher Education Endowment Fund has withdrawn its annual funding of AUD500 million for funding of HLIs capital expenditure. Thus, HLIs have looked towards banks and the capital market for their infrastructure financing needs (National Australia Bank, 2014). According to ANZ (2015), a number of Australia HLIs have successfully raised financing through the debt capital market. Among others are: Macquarie University (Aa2), Australian National University, University of Wollongong, The University of Sydney (Aa1), The University of Melbourne (AA+), and Monash University (NAIC-1). Macquarie University, based in Sydney, issued the first HLI bond in Australia back in 2010 with a 10-year maturity. In 2014, the University of Melbourne raised AUD250 million for its debut fund-raising exercise through the capital market. While the University of Sydney raised AUD200 million in the same year. The success of these issuances was supported by an increase in demand for Australian-dollar denominated bonds from issuers that were not banks and governments (Purvis, 2014). While almost 30% of investors of the University of Melbourne's bonds came from Asia as European bond yield dropped. According to ANZ (2015), Australian HLIs are attractive to investors and can achieve high ratings as they offer a unique combination of strong corporate reputation, strong non-discretionary cash-flows, reliable long-term credit quality and implicit government support.

3. Social Impact Bonds

Social Impact Bonds (SIBs) can be defined as a financial instrument where investors pay for a set of interventions to improve social outcomes that are of financial interest to the government or commissioner. If the social outcome improves, the government or commissioner will repay the investors for their initial investment, plus a return for the financial risk that they have undertaken. However, if the results do not improve according to the pre-agreed metrics, then the investors stand to lose their investment (Henderson, 2014). It is also known as "Pay for Success Bonds", "Human Capital Performance Bonds", and "Social Benefit Bonds". Due to more common use in literature and in practice, the term "Social Impact Bond" is used.

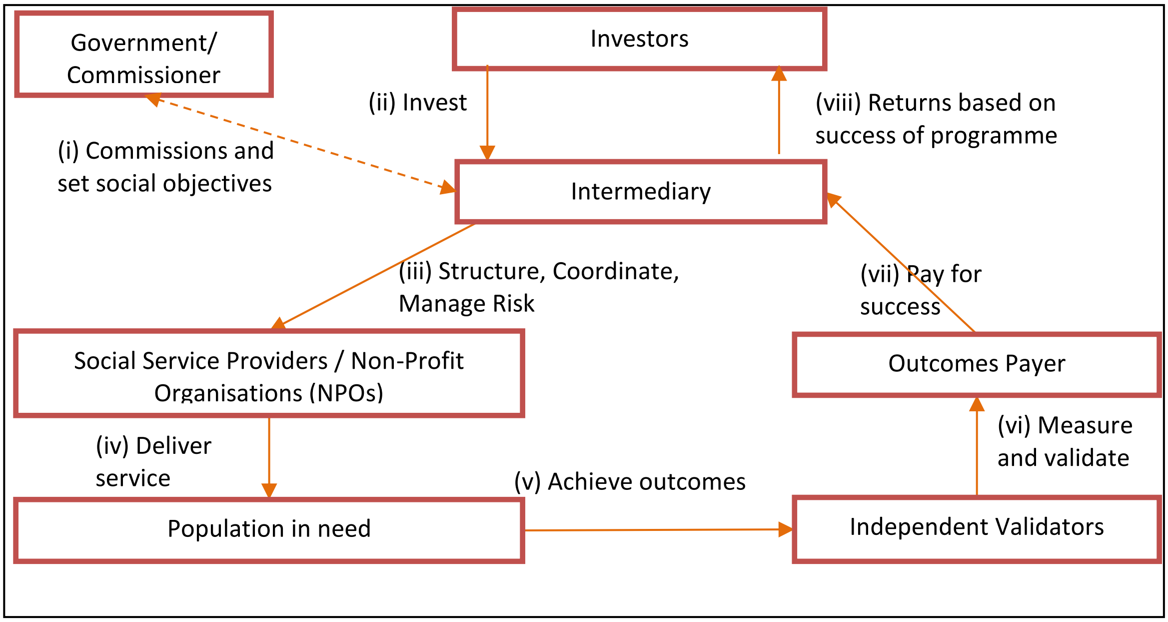
Despite having the word "bond" in its name, the characteristics of SIB differ from the typical conventional bonds. Among others, in a typical conventional bond, capital investment is usually guaranteed, depending on the rating and risks involved. In a SIB however, capital is not guaranteed and is fully dependent on whether or not the programmes funded by the SIB succeeds in achieving its goals (Disley *et al.*, 2011). Third party guarantee however is allowed, as with the case of a SIB in the US where 70% of the capital was guaranteed by Bloomberg Foundation (Azemati *et al*., 2013).

Another significant difference is that returns on conventional bonds are usually based on interest rates and yields. Returns in SIBs however, are dependent on the degree of success of the SIB programme (Disley et al., 2011). Nonetheless, SIB structures are flexible and may be developed to include coupon payments during the tenor, as with the case of certain SIBs in the US and in Spain (Tomkinson, 2015). Furthermore, unlike conventional bonds, SIBs are not rated by rating agencies and cannot be traded in the secondary market. However, this may not be the case for all SIBs, especially if Ihsan SRI *sukuk* were to be considered as a form of SIB (Chew, 2015; CIMB, 2015). This will be discussed further in the relevant section on sustainable and responsible investment (SRI) *sukuk*.

3.1. The SIB Structure

Figure 3 below shows the general structure of a SIB.

Figure 3: General SIB structure



Source: Marwan and Adawiah (2016)

As shown in Figure 3, several stakeholders are involved in a general SIB structure. The issuance starts off with the government or a commissioner identifying a social area of interest. The commissioner then contracts a financial intermediary to issue SIBs to investors. Investors can be institutional investors, philanthropies, Non-Government Organisations (NGOs) or even private individuals. The funds are then channeled to a social service provider who will then deliver the services to the population in need. An independent validator will then evaluate whether the programme is successful or otherwise, and report to the outcome payers. In the event of success, payment is made towards the investors for the initial investment. The returns will depend on the degree of success of the programme. However, if the goals of the programme are not achieved, the investors may lose their capital and no return will be provided (Marwan and Adawiah, 2016).

4. SRI *Sukuk*

"SRI" is defined as Sustainable, Responsible, and Impactful investments (CIWM, 2015), Socially Responsible Investments (Bennet and Iqbal, 2013; Renneboog *et al.*, 2008), Social Responsible Investment (Ministry of Finance Malaysia, 2013), and Sustainable and Responsible Investment (CIMB, 2015; Securities Commission Malaysia, 2014). Therefore, "SRI" can be said to be a generic terminology which includes any type of investment process that combines investors' financial objectives together with their concerns towards issues of environment, society, and governance (ESG) (Moghul and Safar-Aly, 2014). As such, this study will simply use the generic short-form, "SRI", to represent all these terms interchangeably.

4.1. Malaysia's SRI *Sukuk* Framework

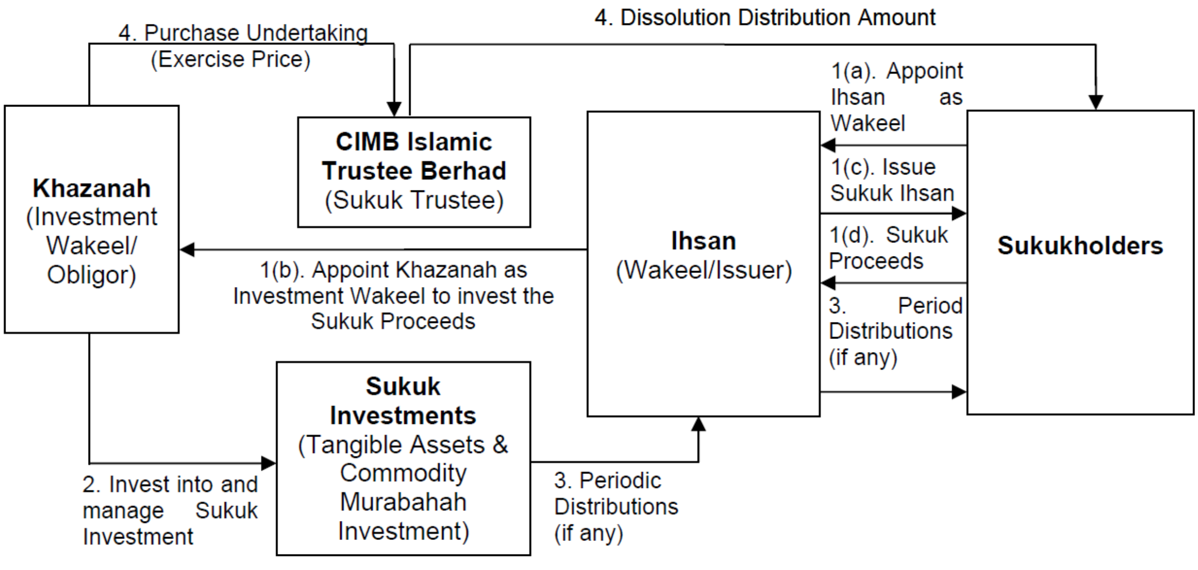
In 2011, Securities Commission Malaysia (SC) launched its Capital Market Masterplan 2, which seeks to develop a conducive environment for the development of innovative financial instruments such as green bonds and SIBs (Securities Commission Malaysia, 2011). Accordingly, in 2014 the Sustainable and

Responsible Investment (SRI) *sukuk* framework was launched, promoting socially responsible financing and investment. The framework provides a guideline on the issuance of SRI *sukuk*, the definition of SRI projects, the utilisation of proceeds from the *sukuk* issuance, the disclosure and reporting requirements, as well as impact assessments (RAM Ratings, 2015). The framework also provides a classification of the definition of SRI projects, encompassing environmental, social, and community objectives.

4.2. Khazanah's Ihsan SRI *Sukuk*

In 2015, the first SRI *sukuk* was launched by Khazanah Malaysia Berhad through a Special Purpose Vehicle (SPV), Ihsan *Sukuk* Bhd (Ihsan) (Khazanah Nasional, 2015). The total Ihsan SRI *sukuk* programme has a RM1.0 billion nominal value with a tenure of 25 years from its first issuance. The first issuance was valued at RM100 million and provided a 4.3% return per annum over 7 years (The Star Online, 2015). Given the tax incentives accorded by the tax authorities, the issuance gained significant interest and was fully subscribed. Rating Agency Malaysia (RAM) assigned the SRI *sukuk* a rating of AAA(s) which reflected Khazanah's role as the credit obligor under the structure. CIMB Investment Bank Berhad (CIMB) acted as Lead Arranger and Lead Manager of the issuance. While CIMB Islamic Bank Berhad together with Amanie Advisors Sdn. Bhd. were appointed as the Joint-*Shari'ah* Advisors. The underlying contract of the SRI *sukuk* was based on the principle of "agency with the purpose of investment" (*Wakalah bi Al-Istithmar*) which allows the funds to be utilised for investment in a combination of tangible assets and commodities (CIMB, 2015). The following Figure 4 illustrates the structure in further detail.

Figure 4: Ihsan SRI *Sukuk* Structure



Source: CIMB (2015)

Under this structure the proceeds of the issuance shall be invested by Khazanah on behalf of the issuer and *sukuk* holders. The proceeds from the *sukuk* investment will then be used to fund the eligible SRI project, in the case of Ihsan SRI *sukuk*, to fund Trust Schools Programme under Yayasan AMIR, a non-profit foundation established to improve the quality and accessibility of education in public schools through a Public Private Partnership (PPP) with the Ministry of Education (MOE) (CIMB, 2015).

Several success metrics or Key Performance Indicators (KPIs) were set for the Ihsan SRI *sukuk* programme. Among others were:

i. At least 20 schools selected under the Trust Schools Programme for a 5-year intervention period during the tenor of the programme.

ii. A minimum of 50% of teachers under the Trust Schools are rated at least at "Establishing level" by the end of the 5-year intervention period. This includes improvement in terms of: Pedagogy (method and practice of teaching); curriculum and subject knowledge; planning and effectiveness of teaching; collaborative and cooperative learning; and problem solving and thinking skills.

iii. A minimum of 50% of senior leadership under the Trust Schools are rated at least at "Establishing level" by the end of the 5-year intervention period. As such the senior leadership must demonstrate that they can: Develop and articulate the school vision; implement the Trust School Standards; deliver improvement plans for the school; practice distributed leadership; exercise strategic and curriculum-led financial planning; have appropriate level of stakeholder engagement, etc.

Prior to the maturity date, the KPIs of the programme will be evaluated by an independent auditor, and reported to the *sukuk* Trustee, the Facility agency, as well as the *sukuk* holders. The returns towards the investors will depend on the success of the programme. A "step-down" method will be applied if the KPIs are met. Under this method the *sukuk* holders will forego a pre-agreed percentage (6.22%) of the nominal amount due. This is part of their recognition of the positive social impact gained and social obligation that they have.

Another unique feature that the Ihsan SRI *sukuk* has is that it allows for *sukuk* holders to convert their holdings on the *sukuk* into donations during any time throughout the tenure. In other words, they can forego their claims on the *sukuk* that they hold. In doing so, they are entitled to receive tax vouchers from Khazanah for the amount equal to their claims. The *sukuk* can also be sold and traded in the secondary market (CIMB, 2015).

The Ihsan SRI *sukuk* shows the potential for education sector, including HLIs to utilise the capital market, in particular, *sukuk* and raise funds for their development and expenditure. A structure similar to Ihsan SRI *sukuk* where returns would be dependent on the KPIs achieved can be developed. With proper investment strategies and efficient usage of funds, the proceeds of the investments can be used to sustain the HLIs in the long run.

5. Research Methodology

A semi-structured interview is adopted for this study whereby a set of structured questions are prepared beforehand. In terms of financial instruments researched in this study, they are limited to SRI *sukuk* and SIB. However, this is not strictly restricted as the overall results will depend on the feedback received from the interviews. For example, interviewees may suggest mechanisms of *waqf* to be included in the models.

In order to ensure that the data gathered is of high quality, it is important to obtain information from those who are expert and directly involved in the field that are related to the objectives of the study. The area of research which is related to SRI *sukuk* and SIB is also very specialized niche areas where experts in this field are very concentrated. Therefore, interviewees are chosen based on their relevant experience and understanding of the subject matter at hand. The participants were contacted via email, phone, and mobile phone messaging apps. However, not all the proposed interviewees were able to participate in the interview sessions. A summary of the participants is presented in Table 1 below.

Table 1: Summary of Interviewees

No.	Name	Description
1	A	A *Shari'ah* scholar associated with over 40 *Shari'ah* Advisory Boards in the finance, banking, and advisory industry including Citibank, S&P Dow Jones, Saudi Hollandi Bank, Standard Chartered, The Islamic Bank of Asia, and Accounting and Auditing Organisation for Islamic Institutions (AAOFI).
2	B	A *Shari'ah* scholar who has been teaching *Tafsir*, *Hadith* and *Fiqh* in Bahrain since 1976; had around 500 lectures and lessons in both English and Arabic. He also sits on over 40 *Shari'ah* Advisory Boards globally, including Standard Chartered, BNP Paribas, Al Rayan Bank, Abu Dhabi Islamic Bank, S&P Dow Jones, Lloyds Bank, and AAOFI.
3	C	A *Shari'ah* scholar who sits on various *Shari'ah* Advisory Boards globally including Asian Islamic Investment Management, BNP Paribas, National Bank of Fujairah, and S&P Dow Jones; had published over 30 articles on Islamic Finance and presented over 150 papers at international conferences. He received "The Asset Triple A Industry Leadership Award" at

		The Asset Triple A Islamic Finance Award 2014. He was named as the "Most Outstanding Individual" awarded by His Majesty, the King of Malaysia.
4	D	A *Shari'ah* scholar who is a Chairman and member of various *Shari'ah* committees; Senior Researcher; with more than 20 years' experience in Islamic banking, finance and economy.
5	E	An industry practitioner who has active involvement in *sukuk* issuance and has more than 10 years' experience in Islamic banking, business and economy.
6	F	An industry practitioner who has active involvement in *sukuk* issuance and has more than 10 years' experience in Islamic banking, business and economy.
7	G	A *Shari'ah* scholar who sits on various *Shari'ah* Advisory Boards globally, has active involvement in more than 100 *sukuk* issuance, and has more than 20 years' experience in Islamic banking and finance, and Islamic law of transactions.
8	H	An academician who has more than 20 years' experience in Islamic banking, business and economy.

The interviews were undertaken starting from November 2017 to January 2018. The interviews were conducted in Kuala Lumpur and surrounding areas and took between 30 to 60 minutes each. The interviewees gave permission to record the audio of the interviews for the purpose of this research.

6. Research Findings

6.1 Preliminary Models of HLIs Capital Market Fundraising

Preliminary models for capital market fundraising were generated through literature review and consultation with selected experts. The models are constructed based on the nature of funding needs of the HLIs and whether the activity from the usage of funds would generate any income. Consideration are given to whether the specific HLI project can have the ability to repay the funds provided from their fundraising activities. As such, the models are divided into two main groups: (i) income generating and (ii) non-income generating. Under the first group of "income generating" model, normal SRI *sukuk* structures are used. For the second group of non-income generating model, the SRI *sukuk* with SIB principles are used for this purpose. Generally, for this second group, funds are only repaid if targeted outcomes or pre-set Key Performance Indicators (KPIs) are met. Based on these categorization, 3 preliminary models are proposed for the interviews to gather feedback from the experts. The models are: normal SRI *sukuk* based on *Wakalah bil Istithmar*; SRI *sukuk* with cash *waqf*; and SRI *sukuk* with Payment by Results mechanisms.

This section analyses the responses from the interviews and discusses the findings. Based on the open-ended nature of the questions, the sequences of questions asked during the interview were varied. As a result, the answers from respondents are very extensive and rich. Overall, the interviews managed to capture the pertinent data that are needed to address the objectives of the research.

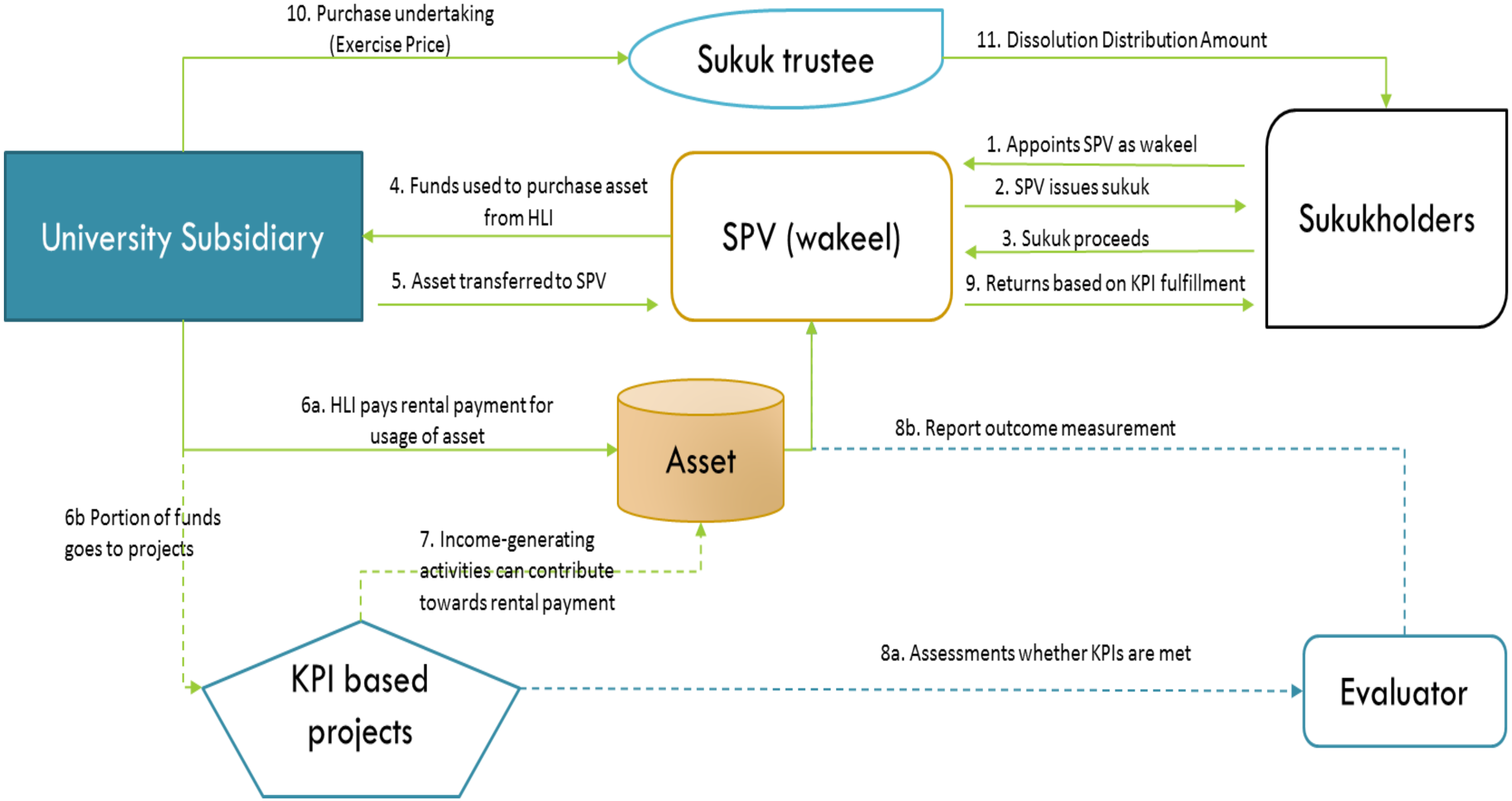
6.1 Proposed SRI *Sukuk* Models for Adoption

Based on the findings and analysis in the previous sections, the research proposes 2 models. There are several iterations for each model. The iterations would depend on the needs and resources of the HLIs as well as the acceptance of the market. Taking into consideration the comments and feedback by the respondents, the revised version of the 2 models are as follows:

6.1.1 1st Model: SRI *Sukuk* Based on *Wakalah Bil-Istithmar* and Payment by Results Mechanism

For this model, the structure is primarily based on a *Shari'ah* contract of *wakalah bil-istithmar*. It is proposed that this model be considered only when HLIs assets are available for the *sukuk* purpose and a significant part of the *sukuk* funds are used for income-generating activities. The following Figure 5 illustrates the flow of the proposed model:

Figure 5: SRI *Sukuk* Based on Wakalah Bil-Istithmar and Payment by Results Mechanism



1. Investors/ *sukuk* holders enter into a contract with the SPV and appoint the SPV as a representative (*wakeel*).
2. The SPV issues the *sukuk* document to the *sukuk* holders.
3. The *sukuk* holders provide the cash proceeds.
4. The funds are used to purchase assets from HLIs.
5. Asset ownership is transferred to SPV.
    a. A portion of the proceeds are used by the university subsidiary as rental payment for the assets.
    b. Another portion is used to fund projects with underlying KPIs.
6. Income generated from the projects can contribute towards the rental payments.
    a. External evaluators come in and evaluate whether the KPIs are achieved.
    b. The outcome is reported to the SPV and *sukuk* holders.
7. Returns to *sukuk* holders are dependent on outcomes.

6.1.2 Iterations and Suggestions

a. Guarantee of Capital

Under this structure, it is suggested that the investors' capital should be fully guaranteed, either by the government or by a Government-Linked Corporation (GLC) to attract investors' confidence in the asset. As a suggestion, government guarantee can be provided through the savings arising from not having to allocate funding to HLIs in the year that the *sukuk* is issued.

b. Returns Based on Performance

In term of the returns to investors, it is suggested that the return are tied to the HLI achieving certain KPI goals. These KPIs may be tied directly to the income-generating performance of the *sukuk* projects as well as other non-income generating KPIs such as increase in university rankings, research publications and awards received.

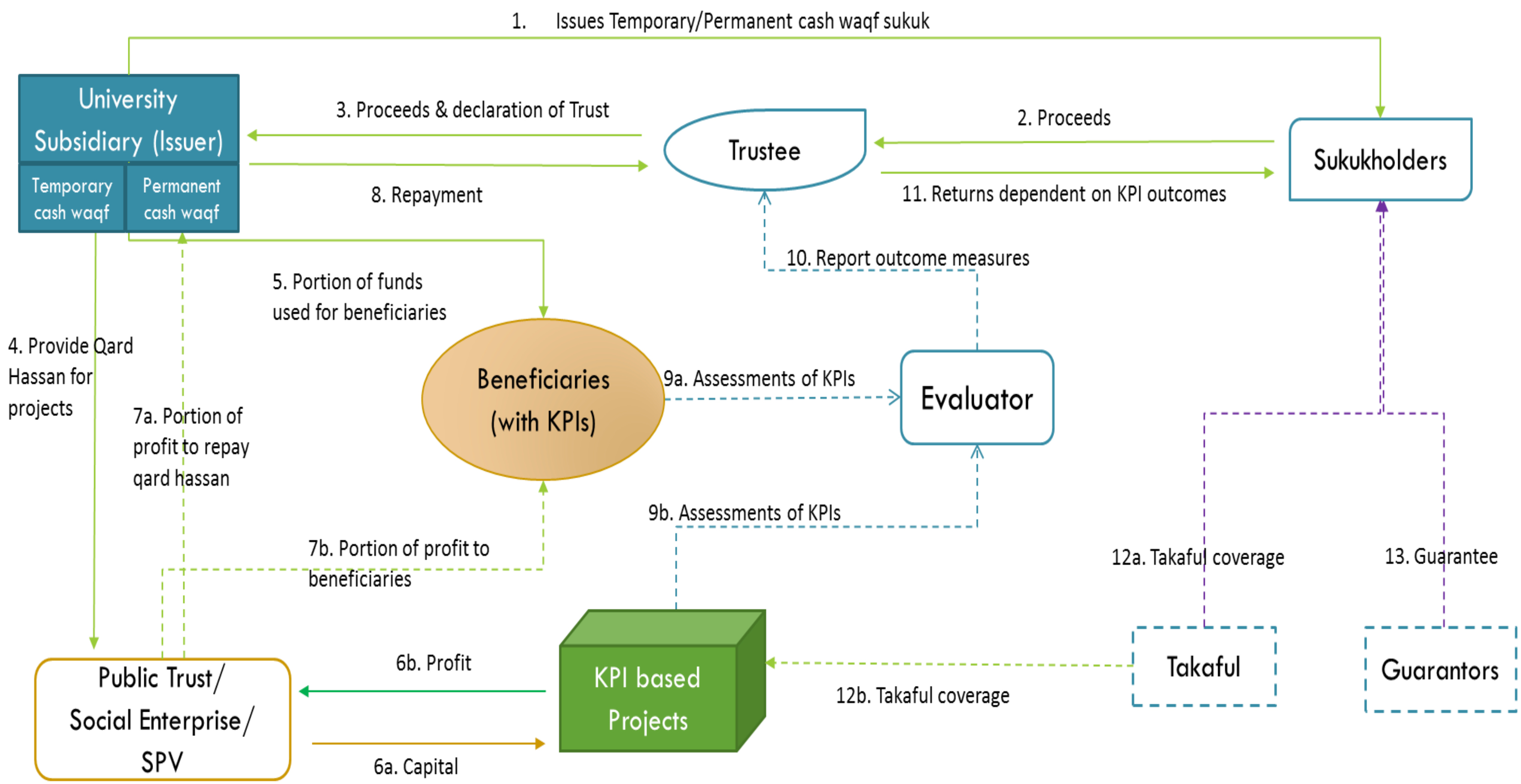
c. Returns Step-up or Step-down Depending on Investor Appetite

Returns can be structured either as step-down or step-up depending on the appetite of investors. This can be determined through market research and roadshows. In the case of step up, returns are provided parallel to performance or achievement of KPIs. The higher the success rate, the higher the returns to *sukuk* holders, up to a certain maximum cap. This is similar to the structure implemented in Social Impact Bonds (SIB) return mechanism. While for step down, returns are opposite to performance. For example, if KPIs are achieved, returns may not be provided, or lower returns are provided as investors waive-off a certain portion of their claims to their profit or initial capital, as recognition to their contribution towards the social cause. This is similar to the mechanism found in the first SRI *sukuk* in Malaysia, the Ihsan SRI *sukuk*.

6.1.3 2nd Model: Cash *Waqf Sukuk* with Payment by Results

This Model can be considered when there are both income generating and non-income generating programmes of the HLIs. Furthermore, it can only be considered if there is market acceptance for it, which can be determined through comprehensive market research. The model is based on the temporary and permanent cash *waqf sukuk* structure. The main *Shari'ah* contracts under this structure is *Waqf*, *Qard hassan* (Benevolent loan), *wakalah* and takaful. Under this model, there are two types of *sukuk* holders involved: temporary and permanent cash *waqf sukuk* holders. The permanent cash *waqf sukuk* holders do not get back their initial capital as their investment is fully utilised perpetually for the benefit of the beneficiaries. While for the temporary cash *waqf sukuk* holders, the return of their initial investment may depend on the performance or achievement of certain KPIs. The following Figure 6 illustrates the flow of the proposed model.

Figure 8: Cash *Waqf Sukuk* with Payment by Results



1. The Trustee will enter into a Trust Agreement with the major parties of the transaction to receive and manage the *waqf* funds from the *sukuk* holders. Pursuant to this, the Issuer (university subsidiary) will issue the temporary and permanent cash *waqf sukuk* to the investors.
2. The *sukuk* holders will subscribe the *sukuk* and provide the cash to the trustee.
3. The funds will be disbursed to the Issuer and who will manage two pools of cash *waqf*: temporary cash *waqf* which requires repayment, and permanent cash *waqf* which does not require repayment. However, the temporary cash *waqf sukuk* holders may also relinquish their rights to the repayment of their capital and convert to a permanent cash *waqf*.
4. The funds from both pools will be disbursed to an SPV in the form of non-interest-bearing *Qard Hassan* (Benevolent loan).
5. A portion of the funds are also used to fund programmes for the beneficiaries of the *waqf*.
6. a) Proceeds of the benevolent loan will be used to fund income generating projects with agreed upon KPIs.
   b) The surplus profit is returned to the SPV.
7. a) Depending on the profit, the SPV will repay the benevolent loan to the Issuer over time for the temporary cash *waqf* portion of the *sukuk*.
   b) A portion of the profit from the permanent *waqf* portion can be channelled to the beneficiaries.
8. The Issuer will transfer the amount to the Trustee for the purpose of repayment.
9. a) An External Evaluator will assess whether the programmes for the beneficiaries have achieved its KPI.
   b) The External Evaluator will also assess KPI of the projects funded by the *qard*.
10. The External Evaluator then reports the outcomes to the Trustee.
11. The Trustee repays the temporary cash *waqf sukuk* holders based on the KPI outcomes. If the KPIs are achieved, a portion or the full amount of the temporary cash *waqf* becomes a permanent waqf.
12. Takaful coverage may also be procured to mitigate any losses to the project and
13. Takaful coverage to mitigate losses to the *sukuk* holders.
14. A guarantor may come in and provide irrevocable guarantee and other related obligations to the temporary cash *waqf sukuk* holders.

6.1.4 Iterations and Suggestions

a) Guarantee of Capital

It is suggested that the investment provided by the temporary cash *waqf sukuk* holders should be fully guaranteed, either by the government or a Government-Linked Corporation (GLC) or a *waqf* entity such as the state *waqf* agency. This is done to increase investors' confidence in the model.

b) Takaful Coverage

Takaful coverage may also be provided which functions as a mitigation mechanism in the case of operation loss of the projects and risks towards the temporary *sukuk* holders arising from the loan (*qard hassan*) repayments.

c) Conversion to Permanent *Waqf* Depending on Performance

It is recommended that the conversion of temporary cash *waqf* contribution to permanent contribution is linked towards the achievement of KPIs. These KPIs may be tied directly to the income-generating performance of the *sukuk* projects as well as other non-income generating KPIs such as how many university students have received a certain amount of financial assistance, and improvement in students' performance.

d) Step-up or Step-down Depending on Investor Appetite

Returns to temporary *sukuk* holders may be structured to either a step-up or step-down mechanism depending on the appetite of potential investors. For example, for step-up mechanism, if the KPIs are achieved, the temporary cash *sukuk* holders gets back their initial investment. While in the case of step-down, if KPIs are achieved, the temporary cash *sukuk* holders may fully convert their investment into a permanent *waqf*, or partially convert into permanent *waqf* depending on the degree of success in achieving the KPIs.

6.2 Other Considerations

Based on the expert interviews and research findings, there are several considerations that must be made for the issuance. This applies to all *sukuk* issuances by HLIs in the future.

6.2.1 Form a Consortium

Firstly, it is proposed that universities form a consortium for the purpose of issuing and managing the proceeds from *sukuk*. This is to allow for the cost of issuing the *sukuk* and the resources used to do the paperwork, roadshows, and advertisement to be shared through a consortium. Issuing separate *sukuk* for different HLIs is inefficient and may raise the overall cost of issuing.

6.2.2 Set Up Professionally Run SPV to Issue and Manage *Sukuk* Funds

An SPV must be set up to manage the proceeds from the *sukuk* and run the programmes professionally. This cannot be left with the university administration and academicians who do not have the experience and expertise in managing such funds. Harvard University and Oxford University are prime examples of how professionally run investment managers are established to manage their endowment and investment funds.

6.2.3 Put in Place Risk Mitigation and Guarantee

Mechanisms that mitigate risks must be put in place, specifically, some sort of guarantee has to be given in order to attract investors. To do so, the government can set up a special fund reserve allocated from the budget to act as guarantee. While for cash *waqf* funds, mechanisms must be put in place to mitigate effects from inflation and exchange rate changes to avoid diminishing the value of the *waqf*.

6.2.4 Provide Special Treatments for Funds Invested

It is also recommended that special treatments are given to funds invested in these alternative financing modes. For example, tax incentives are given in the form of tax vouchers or tax relief. Another suggestion is that the amount spent on investing in these alternative financing modes is treated similar to CSR funds which have their own unique advantages.

6.2.5 Investors Do Not Prioritise Structure of *Sukuk*

Feedback from experts reveals that investors do not prioritize the structure of the *sukuk* or the *Shari'ah* contracts used in the model. Investors look more towards the estimated returns, the existence of guarantee, incentives provided, and also purpose of the funds. Relating to this aspect, the study identifies the Critical Success Factors (CSFs) that must be addressed and resolved in order to ensure that the development and issuance of the *sukuk* can be realized and maintained in a sustainable manner.

7. Conclusion

The study explores alternative financing modes for higher learning institutions (HLIs). In doing so, the study focuses on capital market instruments: Social Impact Bonds and Sustainable and Responsible Investment (SRI) *sukuk*.

A critical review of literature was undertaken, exploring the issue of financial sustainability and HLIs funding which includes channels from the capital market, i.e. Social impact Bonds and SRI *sukuk*. Based on the critical review, several preliminary models were developed and proposed during the interviews with experts. The respondents provided valuable feedback and comments related to the research and also the models proposed.

Based on the feedback received from the respondents, the study proposes 2 models for consideration. Firstly, to fund income-generating programmes, the SRI *sukuk* based on *wakalah bil istithmar* with payment by results mechanism is suggested. While for non-income generating programmes, the SRI *sukuk* based on permanent and temporary *waqf* with KPI measurements is suggested. For the issuance of both models, guarantee mechanism preferably from the government is recommended. Furthermore, it is highly recommended that the management of SRI *sukuk* issuance and proceeds is done through a consortium of HLIs. This is a more efficient method that can help reduce the cost and avoid wastage of resources.

The findings can be a useful reference for interested parties when developing alternative financing modes. The proposed model can help support the development of payment-by-result mechanisms and *waqf* assets. Furthermore, they may also help close the gap between the theory and practice of Islamic finance especially in terms of social finance and social impact.

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