

# IFSB WORKING PAPER SERIES

WP-20/12/2021

## THE ROLE OF SOCIAL IMPACT *ŞUKŪK* IN THE RECOVERY PHASE OF THE COVID-19 PANDEMIC

December 2021



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**THE ROLE OF SOCIAL IMPACT *ŞUKŪK* IN THE RECOVERY PHASE OF THE COVID-19 PANDEMIC**

Mohammad Kabir Hassan

**December 2021**

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## ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a lengthy due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which involves, among others, the issuance of exposure drafts, holding of workshops and, where necessary, public hearings. The IFSB also conducts research and coordinates initiatives on industry-related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

For more information about the IFSB, please visit [www.ifsb.org](http://www.ifsb.org).

## ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
CWLS	Cash <i>waqf</i> -linked <i>sukūk</i>
FDI	Foreign direct investment
GAVI	Global Alliance for Vaccines and Immunizations
HEF	Health Endowment Fund
IFFIm	International Finance Facility for Immunisation
IFSB	Islamic Financial Services Board
IFSI	Islamic financial services industry
IIFM	International Islamic financial market
IMF	International Monetary Fund
IsDB	Islamic Development Bank
MDB	Multilateral development bank
MNC	Multinational corporation
NBFC	Non-banking financial corporation
OIC	Organisation of Islamic Cooperation
SAR	Saudi Riyal
SDG	Sustainable Development Goals
SME	Small and medium enterprise
SPO	Second party opinion
SRI	Socially responsible investment
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WHO	World Health Organization

## GLOSSARY

<i>Fatwā</i>	A juristic opinion given by the Sharī'ah board, on any matter pertinent to Sharī'ah issues, based on the appropriate methodology.
<i>Mudaraba</i>	A partnership contract between the capital provider ( <i>rabb al-māl</i> ) and an entrepreneur ( <i>muḍārib</i> ) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless they are due to misconduct, negligence or breach of contracted terms.
<i>Musharaka</i>	A contract between the institution offering Islamic financial services and a customer whereby both would contribute capital to an enterprise, whether existing or new, or to ownership of real estate or a movable asset, on either a temporary or a permanent basis. Profits generated by that enterprise or real estate/asset are shared in accordance with the terms of the <i>mushārah</i> agreement, while losses are shared in proportion to each partner's share of capital.
<i>Qard-al-hasan</i>	The payment of money to someone who will benefit from it provided that its equivalent is repaid. The repayment of the money is due at any point in time, even if it is deferred.
Sharī'ah	The practical divine law deduced from its legitimate sources: the Qur'ān, Sunnah, consensus ( <i>ijmā'</i> ), analogy ( <i>qiyās</i> ) and other approved sources of the Sharī'ah.
<i>Şukūk</i>	Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or specific investment activity that is Sharī'ah-compliant.
<i>Wakala</i>	An agency contract where the <i>takāful</i> or <i>retakāful</i> participants (as principal) appoint the <i>takāful</i> or <i>retakāful</i> operator (as agent) to carry out the underwriting and investment activities of the <i>takāful</i> or <i>retakāful</i> funds on their behalf in return for a known fee.
<i>Zakāh</i>	An obligatory financial contribution disbursed to specified recipients that is prescribed by the Sharī'ah on those who possess wealth exceeding a minimum amount that is maintained in their possession for one lunar year.

## ABSTRACT

This working paper addresses the role of social *şukūk* in the recovery phase of the COVID-19 pandemic. Notwithstanding the pandemic has done a considerable amount of economic, social and emotional damage to the global economy and people the world over, the Islamic financial system's resilience, sustainability, and contribution during the recovery from Global Financial Crisis of 2008 suggests it will also play a crucial role in the recovery from recent events as well. To achieve this, Islamic financial services have a bundle of social financial services at their disposal – in particular, social *sukūk*. The present working paper, based on extant literature and notable examples of the use of social impact *şukūk* in mitigating the impact of COVID-19, analyses the potential role of social impact *şukūk* in the recovery phase from the perspective of both investors and issuers. The findings of the study indicate that this role may be a critical one.

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## SECTION 1: INTRODUCTION

Unlike the Global Financial Crisis of 2007–8, which started in real estate and slowly spread to the financial and real economies, the COVID-19 pandemic started as a health crisis that later morphed into an economic crisis. The pandemic has caused severe and immediate damage to the real economy and brought about disruption on an unprecedented scale, forcing the world economy to implement precautionary and social distancing measures to bring down the infection rate that resulted in a global shutdown (Ozili, 2020; Hassan et al., 2020, 2021; Rabbani et al., 2020, 2021a).

The COVID-19 pandemic disrupted the world economy beginning in 2020 and negatively affected global economic growth beyond anything experienced in nearly a century (Rabbani et al., 2021a). It is estimated that the pandemic reduced annual economic growth in 2020 by between 3.4% and 7.6%, with a recovery of between 4.2% and 5.6% projected for 2021 (Jackson, 2021). The magnitude of the disruption will only become apparent when the long-term implications of the pandemic's effects on people's lives and livelihoods become clearer with time (Sachs et al., 2020; Saglietto et al., 2020).

Prior to the pandemic, funds were raised in international capital markets for the purpose of providing child immunisation vaccines and health-care facilities to the poor countries of the world. Such efforts created opportunities for investors to invest in securities that provided both economic returns as well as social benefits. As the world enters the recovery phase of the pandemic, the speed of the recovery process and the avoidance of a resurgence in the form of further waves of infection will depend on the extent to which herd immunity is achieved via comprehensive vaccination outreach. As the World Health Organization (WHO) has noted, the poor countries of the world may be left behind in this recovery effort due to (among other reasons) a lack of the requisite funding.

Given the underlying theologically communitarian philosophy of Islam, all aspects of its practice, including Islamic finance, have a crucial role in addressing the socio-economic instability induced by the pandemic. The Islamic Financial Services Board's (IFSB) *Islamic Financial Services Industry [IFSI] Stability Report 2020* devotes a full chapter to the role of Islamic social finance in this regard. Social impact *ṣukūk* is another means through which Islamic finance can play a role, especially as the world

commences mass vaccination and prepares to enter the recovery phase of the COVID-19 pandemic.

This paper aims to analyse the role of social impact *ṣukūk* as an Islamic financial instrument in the post-COVID-19 recovery phase for resource mobilisation, and as an alternative financing tool for small and medium enterprises (SMEs) and private-sector and public-sector firms impacted by COVID-19. Based on an extensive review and analysis, this working paper also highlights the concept of socio-economic support in Islamic finance, and discusses some notable social *ṣukūk* policy responses by both multilateral organisations and organisations in some IFSB member jurisdictions.

Other matters addressed in the paper include those arising from current practices of social impact *ṣukūk* and Islamic social funds in general, as well as their associated regulatory, supervisory, operational and prudential issues. Finally, the paper provides recommendations on how to leverage the potential of social impact *ṣukūk* as the world enters the recovery phase of the COVID-19 pandemic.

## **SECTION 2: SOCIO-ECONOMIC IMPACT OF THE PANDEMIC IN ISLAMIC FINANCE JURISDICTIONS**

Although it is a global phenomenon, the COVID-19 pandemic has adversely affected numerous jurisdictions where Islamic finance is practised, especially among the Organisation of Islamic Cooperation (OIC) countries, as well as those non-OIC countries that have embraced Islamic finance due to the ethical and socially responsible nature of this form of financing (Suci & Hardi, 2019). Governments in a number of countries are making regulatory changes to provide a level playing field for Islamic finance. Germany, France, Italy and the United States have all devised a comprehensive and effective legal framework to secure the enforceability of Islamic finance (Mbawuni & Nimako, 2018).

The differences in infrastructure in terms of social and political structure, health care and economic conditions across the OIC nations translate into large variations among countries in regard to their ability to cope with, and to overcome, the challenges posed by the pandemic and its adverse consequences. These differences are inevitable given that, according to the WHO's report on countries' preparedness and status with respect to COVID-19 – measured on a scale from 1 (no capacity) to 5 (sustainable capacity) – only a few OIC countries registered a commendable capacity to cope with the challenges posed by the pandemic (WHO, 2020).

The OIC member countries also have huge numbers of cases reported. As of 19 November 2021, there were 37,141,773 total confirmed cases and 640,717 deaths across the OIC member countries.<sup>1</sup>

The impact of the pandemic across the OIC countries is unevenly distributed and not easy to account for, as the pattern, severity and duration of infections is still unclear given the newly discovered variants. Various OIC countries have already introduced stimulus packages to minimise the negative social impact of the pandemic (Caldecott, 2020; Pollard & Samers, 2007). Governments across the globe are in a dilemma about whether or not to dispense with physical distancing and other restrictive measures and to resume normal economic activity, given that previous relaxations of restrictions have seen a spike in infection numbers, necessitating the reintroduction of lockdowns.

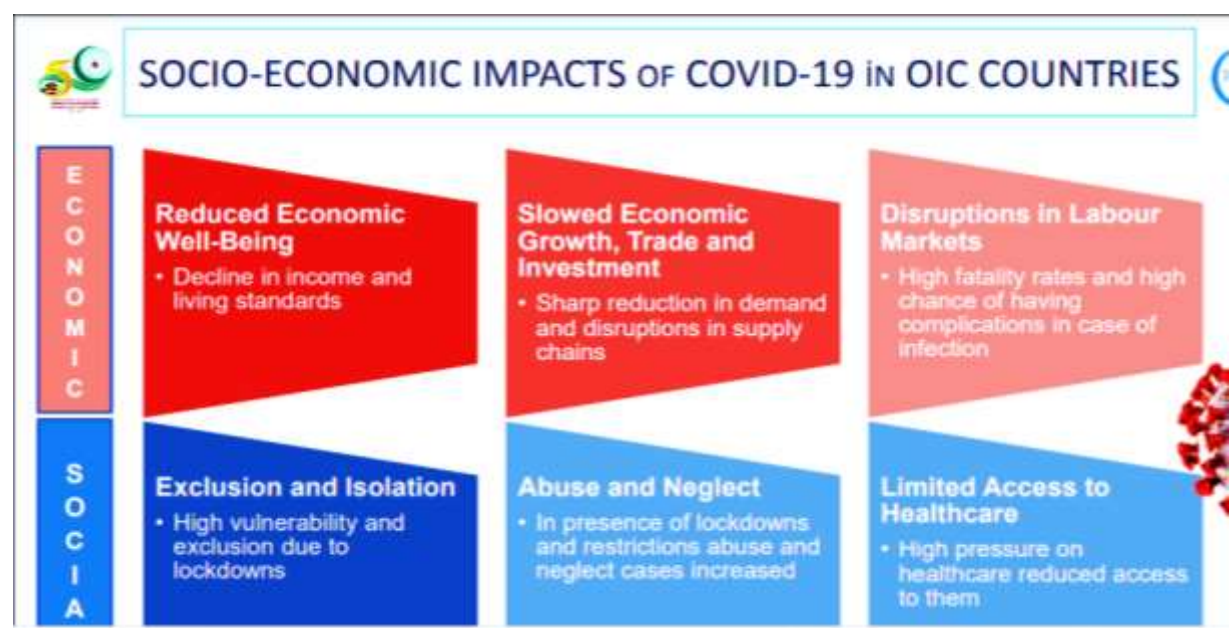
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<sup>1</sup> SESRIC Pandemic Database and Worldometers Database, as of 22 February 2021.

As shown in Figure 1, the pandemic has reduced income and living standards and created massive unemployment in OIC countries, thus slowing down economic growth and lowering future projections due to the impact on trade and investment. Labour markets have also been disrupted due to high fatality rates and the high risk of complications in the event of infection. The social cost of the pandemic is even more severe than its economic cost (Hassan et al., 2021b; Ozili, 2020).

A significant social consequence of the pandemic is the high level of exclusion and isolation, due to fear and panic among the population and the strict social distancing measures announced by OIC governmental agencies. The pandemic has also resulted in an increase in social and domestic crimes, such as the abuse and neglect of women and of underprivileged members of society (Heffron & Sheehan, 2020). It has also placed severe pressure on most countries' health-care systems while reducing access by many socially and economically disadvantaged people to those overburdened facilities (Alandijany et al., 2020).

**Figure 1: Socio-economic Impacts of COVID-19 in OIC Countries**



Source: <https://www.sesric.org/files/article/724.pdf>

Figure 2 shows the dramatic decline in inward foreign direct investment (FDI) flow in OIC countries due to the pandemic. From USD 106.3 billion in 2019, FDI inflow plummeted to USD 63.8 billion in 2020, a loss of around USD 42.5 billion. The decline can be attributed mainly to the fact that global investors worldwide have been panicked by recent events and, with no clear sign of the direction in which the world is moving,

they are reluctant to commit their funds (Mehtar, 2021; Raghu Ram Kishore et al., 2020).

**Figure 2: Inward FDI Flow in OIC Countries**



*Source:* SESRIC staff calculations based on UNCTAD STAT Database, June 2019. (\*) represents estimations and projections for 2019 and 2020.

### SECTION 3: SOCIO-ECONOMIC SUPPORT IN ISLAM

“Socio-economic support” is a broad term and one whose definition needs careful consideration in respect to Islamic finance. All-round development in terms of social, biological, political, cultural, scientific and economic areas is required in order to achieve socio-economic development and to empower the poor (Francis et al., 2005; Stec et al., 2014). In the context of a country’s socio-economic framework, it requires an effort to enhance the standard of living of the poor and vulnerable members of society by creating more employment opportunities, developing people’s skills, increasing literacy and education, increasing per capita income, and providing respect and opportunities equally to everyone (Ali & Hassan, 2019; Hassan & Kayed, 2009).

The Islamic economy, like any other economy, considers socio-economic support as achieving efficiency and equity in the allocation of resources while taking account of the role of market forces and individual freedoms (Hassan & Kayed, 2009). It is within the basic tenets of Islamic finance to achieve the objective of equal distribution of resources and the removal of inequality of income by providing social justice (Rabbani et al., 2020). The central characteristics of an Islamic economy are often summarised as follows:

- behavioural norms and moral values derived from the Holy Qur’an and Sunnah of Prophet Muhammad (peace be upon him)
- the collection of *zakāh* and Islamic taxes to distribute to those who are deserving or have no income and the provision of financial assistance to ensure social justice
- prohibition of interest (*riba*) to ensure equity in exchange transactions and to protect the poor from unjust and unequal exchanges
- removal of inequality of income by promoting charity and social welfare schemes
- promotion of community welfare and socio-economic justice to achieve the goals of socialism by acting as a moral check on the pursuit of self-serving goals.

In an Islamic economy, an individual’s identity is not separate from the society or the environment they live in. Their own ambitions and welfare are bound up with the welfare of society as a whole. More precisely, individuals are not parasites on society; rather, their instincts support social welfare (Ahmed, 2014).

The uniqueness of an Islamic economy in terms of socio-economic support lies in the fact that it prescribes clear guidelines for individual and social behaviour which are

derived from the Holy Qur'an and Sunnah. It also empowers the state and legislative bodies to enforce those guidelines and to make them obligatory, using additional measures if needed (Ahmed, 2014; Cahen, 2021). For example, *zakāh* is one of the five obligations in Islam, and every eligible individual and organisation must distribute it to eligible recipients as a way to promote social welfare and justice. The state must take all necessary measures to collect *zakāh* and distribute it to the poor, and take harsh action against those who refuse to pay it. Also, if *zakāh* is not sufficient to cover the needs of the state and the poor sections of society, the state must impose additional taxes on the rich and more resourceful members of society, whose duty it is to take care of the needs of those less fortunate.

Islamic finance has various financial instruments that can be used to provide socio-economic support to individuals or organisations in case of need or in the event of an emergency such as the ongoing pandemic (Ali et al., 2020; Rabbani et al., 2020a). Islamic social finance instruments such as *zakāh*, *qard-al-hasan*, *saqadah*, *awqaf*, and *takaful*.

In addition, *ṣukūk* in general can be utilised to overcome the economic consequences of the pandemic (Atif et al., 2021; Mohammad et al., 2020; Rabbani et al., 2021b). “*Ṣukūk*” is an Arabic word that literally means “certificate”; in this context, it is the Arabic term for “financial certificate”. It is regarded as similar to the conventional bond, with the only difference being compliance with the rigorous rules and regulations prescribed by the Sharī'ah (Oseni & Hassan, 2014). Social *ṣukūk* is one such instrument that has the potential to play a key role in countering the economic adversities caused by the COVID-19 pandemic (Hassan et al., 2021b). Social *ṣukūk* not only provides valuable financial services, but has the objective of focusing specifically on social and environmental issues (Syed Azman & Engku Ali, 2016). The COVID-19 pandemic has increased people's trust in financial instruments such as social impact bonds (SIBs) and socially responsible investment (SRI) *ṣukūk* (Hasan et al., 2021; Naeem et al., 2022), since the pandemic has forced governments across the globe to employ more of their funds in the health and education sectors.

Regulators, researchers and industries are searching for new and alternative sources of funding that meet development and infrastructure needs while supporting a socially responsible global economy. The intent is to eradicate inequality of income, unemployment, poverty, and lack of access to quality education, while also aiming to achieve the core Islamic finance objectives of social justice and socio-economic security for all, economic development, and inclusion. Specifically, during the ongoing

COVID-19 pandemic, important characteristics of social impact *şukūk* in terms of supply of health equipment, vaccination programmes, Micro and Small Enterprises (MSEs), and household supports, etc., include the following:

1. Social *şukūk* is best suited to financing large capital investment projects that are difficult to finance by a single or few investors. It is also used as a financing source by large companies, including multinational corporations (MNCs) and governmental organisations (Hanefah et al., 2013).
2. Social *şukūk* is an excellent choice for financing infrastructure projects such as health equipment to enhance a country's ability to fight against COVID-19 (Rabbani et al., 2021d).
3. There is already a World Bank treasury initiative along with the International Finance Facility for Immunisation (IFFIm) to boost health infrastructure by issuing *şukūk*. For instance, the IFFIm issued *sukūk* to raise USD 500 million for boosting children's immunisation programmes in the world's poorest countries. This socially responsible investment is called the "Vaccine *sukūk*" (Hafsa & Oumaima, 2021). A similar initiative is possible with the help of international organisations such as the World Bank, the Islamic Development Bank (IsDB), the International Islamic financial market (IIFM), etc.
4. One criticism of conventional bonds is the unequal and unfair distribution of wealth among stakeholders. This is corrected by *şukūk*, which achieves the equitable and fair distribution of wealth as profits are distributed to investors on the basis of actual profit made by the Islamic financial institutions (Ahmed et al., 2018; Paltrinieri et al., 2020). This may also depend on the contract used.
5. The forward lease *şukūk*, one of the most vibrant and dynamic Sharī'ah-compliant financial instruments in the Islamic capital market, has recently been regarded as an important source of funding for infrastructural projects that can be used for social uplifting (Lahsasna et al., 2018). The idea behind the social *şukūk* is to raise funds from assets that do not yet exist at the time of the *şukūk* issuance.
6. *Şukūk* comes with multiple benefits to the parties concerned. To the originators, it provides an additional source of funding at reduced cost, access to the capital market, a tax shield and reduced risks; while to the investors, it provides a safe investment avenue with stable income, an appropriate risk–reward relationship with increased liquidity, and a fair and equitable profit distribution arrangement (Hassan et al., 2019; Oseni & Hassan, 2014).



## **SECTION 4: MITIGATING EFFECT OF THE PANDEMIC THROUGH SOCIAL IMPACT *ŞUKŪK***

*Şukūk* has the potential to emerge as the most potent Islamic financial instrument and to play a decisive role in the growth and development of the Islamic finance business, thereby contributing to the noble objective of the Holy Qur'an and Sunnah of Prophet Muhammad (peace be upon him) (Usmani, 2007).

Social impact *şukūk* is one of the key Islamic social finance services and can play an important role in countering the adversities of the COVID-19 pandemic. The objective of this valuable type of financial service is to focus on social and environmental issues (Syed Azman & Engku Ali, 2016). Social *şukūk* strives to eradicate social evils such as inequality of income, unemployment, poverty, and lack of access to quality education, and to achieve the core Islamic finance objectives of social justice and socio-economic security for all and economic development with inclusion (Marwan et al., 2021; Raghibi & Oubdi, 2020).

The social *şukūk* investment can be used to attract socially responsible investors wishing to engage in social welfare activities and socially responsible investment projects such as educational programmes, feeding of the poor and malnourished, vaccination programmes, renewable energy projects, and provision of housing and transport for the poor and for those affected by war, the pandemic and other emergencies (Mohamad et al., 2017). It is important, therefore, to ensure that the issuance process follows traditional socially responsible investment protocols to gain the trust and confidence of investors with a preference for this type of socially impacting investment (Rahman et al., 2020).

The pandemic-induced economic disruptions forced governments across the globe to provide stimulus and economic relief, including fiscal and monetary measures targeting individuals, poor and vulnerable households, and SMEs, all of which have been most affected by the pandemic (Caldecott, 2020; Islamic Development Bank Group, 2020; Siddik, 2020). Islamic social finance tools such as *şukūk* have much to offer in terms of helping to bring their situations back to normalcy (Mohammad et al., 2020) and of raising funds for building health-care infrastructure (Damak et al., 2020; Naeem et al., 2021).

Since they were first introduced around three decades ago, *şukūk* have enjoyed consistent growth and have proved to be resilient during the COVID-19 pandemic (Marwan et al., 2021). Financing of hefty stimulus packages has increased the total

*ṣukūk* issuance to USD 163.4 billion, thus further increasing total global *ṣukūk* outstanding to USD 703 billion in 2020 (IFSB *IFSI Stability Report 2020*). *Sukūk* issuances experienced strong momentum throughout 2020 as the pandemic-induced panic and the crash in oil prices and in the equity market prompted sovereign issuances in the key *ṣukūk* markets. These sovereign issuances were mainly aimed to finance the stimulus packages and to work as an Islamic social finance tool to alleviate the adverse economic impacts of the pandemic on COVID-affected individuals, the poor, SMEs and other vulnerable sections of society (Atif et al., 2021; Khan et al., 2021).

The pandemic saw a manifold increase in the demand for Islamic social finance services due to the ethical and compassionate nature of those services (Dharani et al., 2022). A number of prominent global funds have recently been issued to support individuals, organisations and governments. The United Kingdom's one endowment trust fund, which aims to raise GBP 1 billion, was introduced in March 2020. The trust is expected to invest in Islamic funds such as real estate, *sukūk* and private equity.

The National Waqf Fund (NWF) is another fund from the UK that aims to help and support the growing Muslim population in that country. Islamic social finance includes tailor-made financial services such as *zakāh*, *qard-al-hasan*, *awqaf*, *sadaqa* and social impact *ṣukūk* which aim to achieve objective inclusion, socio-economic growth and to help the vulnerable and deprived sections of society (Hassan, 2017; Uddin & Mohiuddin, 2020; IFSB *IFSI Stability Report 2021*).

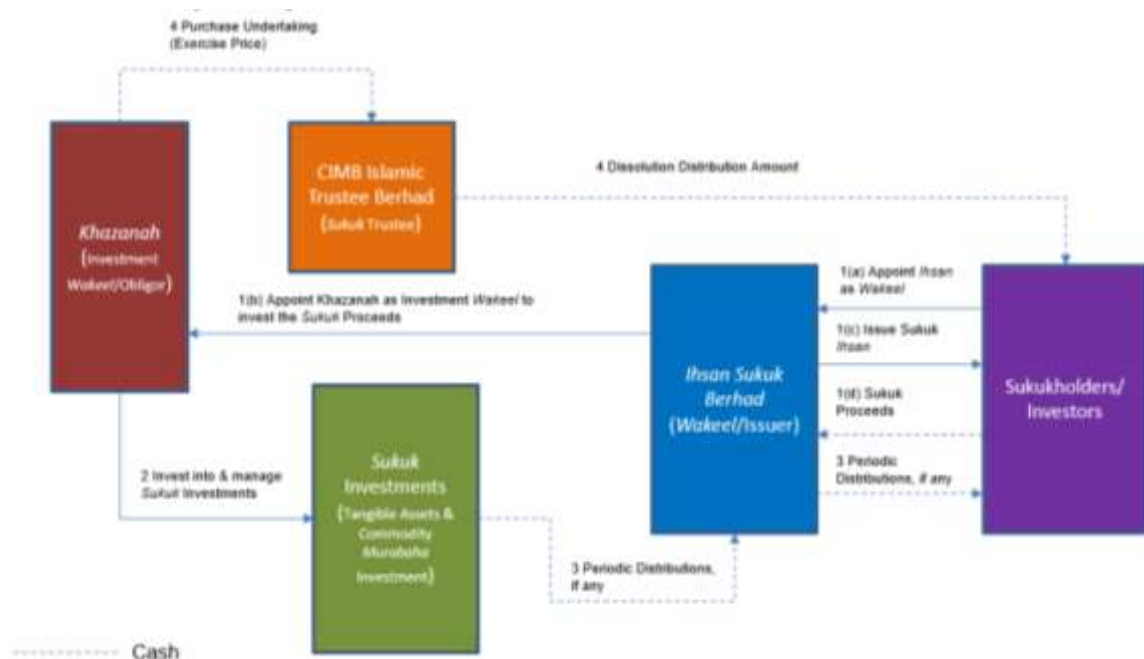
## SECTION 5: SUSTAINABILITY *ŞUKŪK* STRUCTURES

Sustainable and socially responsible *şukūk* (SRI *şukūk*) are an innovative financial arrangement used to facilitate the financing of sustainable and responsible investment initiatives. It is an extension of the existing *şukūk* structure and, hence, the existing guidelines continue to apply to the SRI *sukūk* structure. Two *sukūk* structures – *wakala*-based and *istisna*-based *sukūk* – and one *zakat*-based Islamic social finance structure are outlined below.

### 5.1 *Wakala*-Based SRI *Sukūk* Structure

It can be observed from Figure 3 that a *wakala*-based SRI structure is one where the *sukūk* trustee in this case CIMB Islamic Trustee Berhad (on behalf of the investors – *sukūk* holders) appoints an SPV Ihsan *Sukūk* Berhad to act as its agent (*wakeel*) to invest the *sukūk* proceeds in *sukūk* investments. The *wakeel* in turn also appointed a sub-*wakeel* (Khazanah) as the investment obligor to invest, on its behalf as the main *wakeel*, the *sukūk* proceeds on behalf of the shareholders. That is, the Ihsan *Sukūk* Berhad shall operate in the best interests of the shareholders. The *wakeel* is responsible for investing the *sukūk* proceeds in investment projects that are Shari‘ah-compliant, 33% of which must be investments in tangible assets. These Shari‘ah-compliant tangible assets in this case are traded according to *murabahah* arrangements, and are collectively known as the “*sukūk* investment”.

**Figure 3: *Wakala*-Based SRI *Sukūk* Structure**

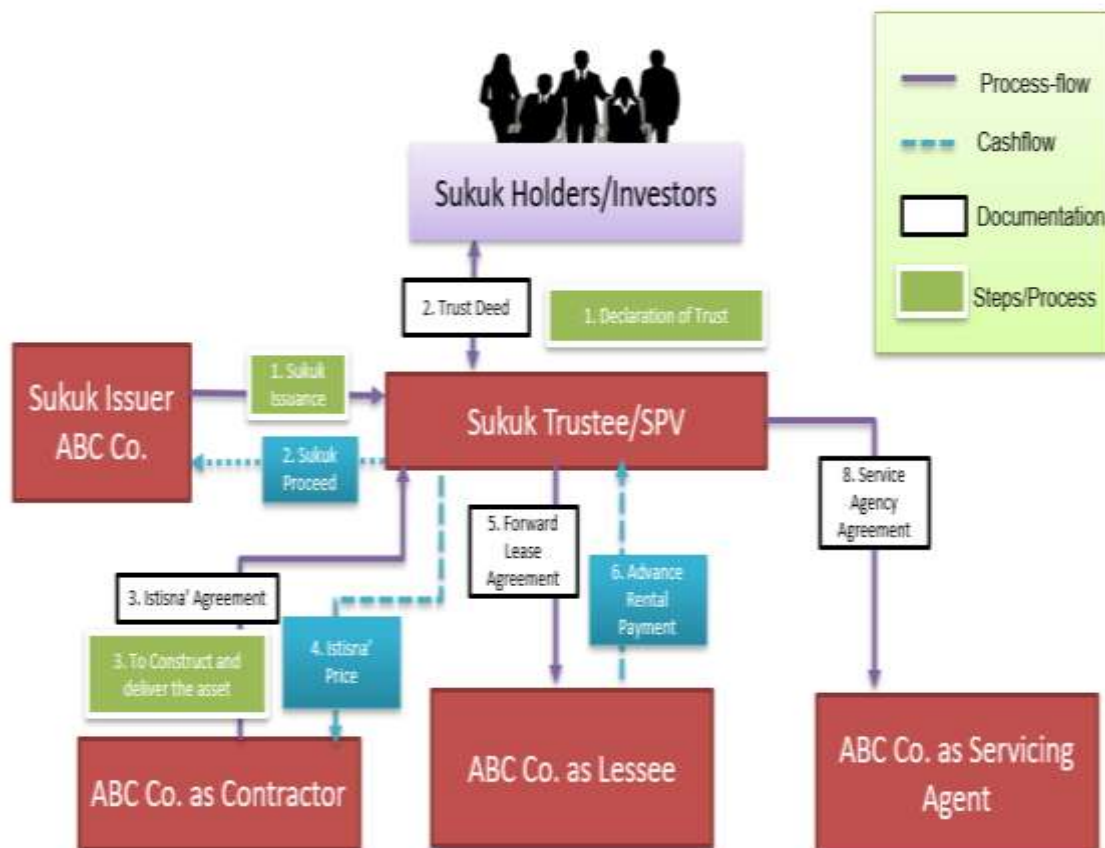


Source: Adapted from Ihsan *Şukūk* Berhad. Memorandum Information. Annexure I, p. 39.

## 5.2 Istisna-Based SRI Sukūk Structure

The *istisna sukūk* structure is based on the successful *şukūk* issuance worth RM 250 million by the solar energy firm Tadau Energy. The proceeds raised by Tadau Energy were used to finance a 50 MWac in Kudat Sabah, Malaysia. The SRI *istisna*-based *sukūk* framework must ensure that proceeds are invested in eligible SRI projects. Under this *sukūk* structure, the *sukūk* holder/investor signs a trust deed with the *sukūk* issuer (ABC Co.). The three underlying contracts signed between the *sukūk* issuer, the investor and the trustee are the *istisna* agreement, the forward lease agreement and the service agency agreement. The *sukūk* issuer (ABC Co.) acts as the contractor, lessee and servicing agent (see Figure 4).

**Figure 4: Istisna-Based SRI Şukūk Structure**

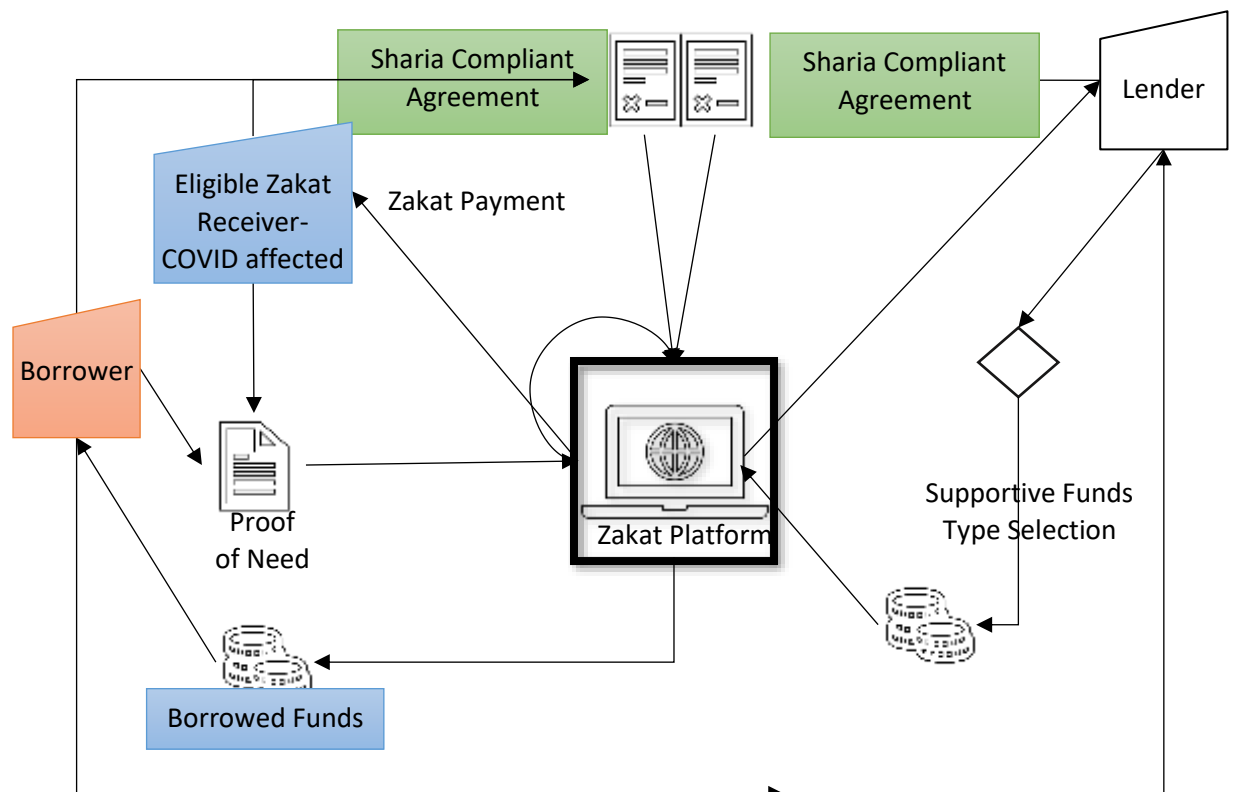


Source: Adapted from Ihsan Şukūk Berhad. Memorandum Information. Annexure I, p. 39.

### 5.3 Zakat-Based Islamic Social Finance

While the earlier two structures are based on actual issuances, a theoretical model for *zakat*-based Islamic social finance/socially responsible investment is proposed in Figure 5. “*Zakat*” is an Islamic finance term used to refer to a compulsory obligation for an eligible Muslim to donate each year to a charitable cause (Ab Rahman et al., 2012). This mandatory requirement for a Muslim is one of the five pillars of Islamic belief. The legal beneficiaries of this powerful Islamic social finance tool are the needy and poor, other vulnerable members of society, and those people temporarily affected by adverse events such as the COVID-19 pandemic (Syed et al., 2020). In the proposed structure, *Zakat* can be deposited with the fintech-based platform, to which COVID-19-affected individuals and other eligible candidates can apply to receive an amount of *zakat*. Each user of the *zakat* platform must provide proof of the Shari‘ah compliance of the amount of *zakat* donated. The amount received by the borrower must also be spent in a Shari‘ah-compliant manner.

**Figure 5: Zakat-Based SRI Structure**



Source: Adapted from Syed et al. (2020).

## SECTION 6: NOTABLE SOCIAL IMPACT *ŞUKŪK* ISSUED IN RESPONSE TO THE COVID-19 PANDEMIC

Global issues of sustainable bonds reached around USD 100 billion during the second quarter of 2020. The COVID-19 pandemic paved the way for greater popularity and larger acceptance of socially responsible investments as they are positively related to the pandemic uncertainty index (Zhu et al., 2021). USD 1.5 billion worth of debut *19ukuk* were issued by the IsDB to finance and help member states affected by the pandemic; Saudi Electricity Company issued dual-traded green *19ukuk* worth USD 1.3 billion; and six green and one sustainable *19ukuk* worth USD 6.6 billion were issued by Nasdaq Dubai. Table 1 summarises the major *19ukuk* issuances during the pandemic.

**Table 1: Major *Şukūk* Issuances during the COVID-19 Pandemic**

<b>Issuer</b>	<b>Value billion</b>	<b>USD</b>	<b>Period</b>
<b>IsDB</b>	1.5		February 2020
<b>Saudi Electricity Company</b>	1.3		September 2020
<b>Nasdaq Dubai</b>	6.6		July 2020
<b>Bahrain</b>	1.0		September 2020
<b>Indonesia</b>	6.1		October 2021

More and more individuals and corporations are making investments in projects that support society and benefit the community at large. It is no surprise, then, that *şukūk* are the world's fastest-growing financial instrument. Sharī'ah-compliant social impact *şukūk* invest only in those projects that satisfy social purposes such as health care, poverty alleviation and education (Syed & Ali, 2016; Mohamad et al., 2017).

Major international Islamic financial organisations including the IsDB, the International Finance Facility for Immunisation Co, (IFFIm) have started various initiatives to provide

financial and other assistance to COVID-19-affected nations including those that are predominantly Muslims (Shaharuddin, 2020). These schemes are intended to provide urgently needed support to control the spread of the virus and reduce the rate of infection and to finance COVID-19 vaccine initiatives (Arfah et al., 2020). They are expected to strengthen a country’s overall health-care infrastructure and protect the population against the pandemic by means of a coordinated response involving surveillance, laboratory capacity and treatment.

The IsDB is a multilateral development bank (MDB) working to bring positive changes in people’s lives by promoting social justice and economic welfare in the member countries and the global Muslim community (Pericoli, 2020). The IsDB has the objective of providing equal rights for all to live with dignity and prosperity and to build collaborative community partnerships. It has an important role to play in helping, and bailing out, those poor and vulnerable Muslim nations that have been severely affected by the COVID-19 pandemic (Faturhman et al., 2021).

Following the successful issuance in 2019 of its debut green *ṣukūk* worth EUR 1 billion, the IsDB identified a pool of eligible green and social assets worth over USD 6 billion. Based on its Sustainable Finance Framework, and after obtaining a “medium green shading” based on a second party opinion obtained from CICRO AS in Norway, the IsDB issued its first-ever AAA-rated sustainability *ṣukūk* (worth USD 1.5 billion). The proceeds were to provide needed assistance to its member countries to tackle the challenges posed by the COVID-19 pandemic. Table 2 lists the IsDB’s key initiatives during the pandemic.

**Table 2: Key Initiatives of the IsDB during the COVID-19 Pandemic**

<b>Country/Territory</b>	<b>Amount (USD million)</b>	<b>Funding overview</b>
Benin	20.0	To provide emergency support to enhance the country’s preparedness and response plan against the COVID-19 pandemic.
Burkina Faso	6.0	In response to phase 2 of the country’s COVID-19 project.
Cameroon	1.5	The first of three phases of support for essential reproductive health activities.

Cameroon	27.4	To help strengthen the health system and improve the case management of COVID-19 patients.
Chad	20.0	To provide an emergency support and response plan for strengthening health-care infrastructure, providing food security, and implementing management and evaluation.
Ivory Coast	46.	To provide financial assistance in building COVID-19 treatment centres with all the required medical facilities such as ventilators, ICU beds and other medical equipment.
Djibouti	7.4	To help build a resilient system under the COVID-19 response plan.
Uzbekistan	63.3	To build a 10,000-bed medical facility for the treatment of COVID-19 patients and to provide national support to enhance COVID-19 preparedness.
Uganda	13.8	To provide assistance in response to COVID-19 preparedness.
Tunisia	100.0	To provide emergency support to fight the pandemic and to help in purchasing natural gas under the Mornaguia Turbine Power Plant project.
Tajikistan	9.4	To help in COVID-19 response and preparedness.
Sudan	35.0	To help in COVID-19 response and preparedness.
Sierra Leone	10.0	To strengthen the COVID-19 response plan and to help build essential health-care infrastructure.
Senegal	132.8	Emergency support to help with the COVID-19 response plan and to help provide assistance with food security under the plan.
Palestine	24.0	To provide financial assistance to the sick and vulnerable by means of an enterprise



		project under the IsDB, SPRB COVID-19 plan.
Mozambique	28.0	To provide emergency support to the national COVID-19 response plan and preparedness.
Morocco	68.3	To provide emergency support to the national COVID-19 response plan and preparedness.
Mauritania	12.9	To provide financial assistance in the acquisition of health-care equipment and to support the national COVID-19 response plan and preparedness.
Mali	22.5	To provide emergency support to the national COVID-19 response plan and preparedness.
Maldives	0.6	To help in providing emergency support against COVID-19.
Kyrgyz	15.0	To help in building a COVID-19 response plan and assist in preparedness.
Guinea	20.0	To help in COVID-19 response and preparedness.
Indonesia	262.0	To upgrade COVID-19 preparedness and build six national referral hospitals.

It can be observed from the table that the IsDB has played a key role in providing financial assistance to the world's poorest and most vulnerable people, and to war-ridden and COVID-19-affected countries, in their fight against the pandemic. Its efforts should be commended.

Some notable examples across OIC member countries were also highlighted in the IFSB *IFSI Stability Report 2021*. Examples from Malaysia, Indonesia and Saudi Arabia (as culled from the report) are provided in Box 1.

## Box 1: Examples of Social *Sukūk* and Intervention in Some IFSB Member Jurisdictions

### Malaysia

Malaysia is one of the few countries that explicitly identified Islamic social finance as a policy tool for dealing with COVID-19. In response to the pandemic, the Government of Malaysia launched a national-level comprehensive programme, the Prihatin Rakyat Economic Stimulus Package 2020, on 27 March 2020 with the objectives of protecting *rakyat* (people), supporting businesses and strengthening the economy. The stimulus package consisted of a total of RM 250 billion, of which an amount of RM 100 billion was allocated to the supporting businesses. The government issued *şukūk* Prihatin in September 2020 to raise RM 500 million that will be used to support the National Economy Recovery Plan. With a two-year tenure and paying 2% return, the tax-exempt *şukūk* is open to both retail and institutional investors with an option of waiving a part or the whole of the principal amount at maturity. The issuance recorded commendable acceptance as it was oversubscribed to the tune of RM 666 million.

### Indonesia

To finance recovery from COVID-19, the Indonesian government issued retail cash *waqf*-linked *sukūk* (CWLS) SWR001. By purchasing CWLS, the donors (*waqif*) donate funds, either temporarily or permanently, which are then used in public projects such as public markets, hospitals, schools, etc. The returns on these investments will be distributed to social programmes such as education, health and financing MSMEs [micro, small and medium enterprises]. Priced at IDR 1 million (USD 68) per unit, the *wakala*-based *şukūk* SWR001 had a two-year tenure paying an annual return of 5.5%. A *wakala* is similar to an agency contract where one party acts as an agent for the principal in the best interest of the principal. A *wakala sukūk* is an arrangement where one party entrusts another party to work on his behalf. In other words, it is a financing instrument with a reducing risk approach (Safei ., 2015). A total of IDR 14.91 billion (USD 1.07 million) was raised during October–November 2020 from 1,041 donors (*waqifs*). While in the case of temporary *waqf* the donated amounts are returned to the donors at maturity, in permanent *waqf* the principal amount is reused for other public projects.

### **Saudi Arabia**

While the Health Endowment Fund (HEF) was established in Saudi Arabia in 2008, many companies and financial institutions contributed around Saudi Riyal (SAR) 370 million to this fund after the outbreak of COVID-19. The HEF, which has since received over SAR 1 billion in contributions, uses its resources to provide health-related services to combat the effects of the pandemic. The Saudi Ministry of Human Resources and Social Development launched a SAR 500 million Community Fund to which the Ministry donated SAR 50 million and the General Authority of Awqaf contributed SAR 100 million; SAR 50 million came from other endowments and companies. The charitable funds were used to provide subsidies and grants to people who were affected by loss of income or work due to lockdowns and curfews. The Saudi Arabia Ministry of Finance (SAMA) announced a hefty stimulus package to support the private public and government sector amounting to USD61 billion. The detail of the package includes USD 13.3 billion to support the banking and SME sector, and USD 18.6 billion for exemption and postponement of certain government dues.

## **SECTION 7: CHALLENGES OF SOCIAL *ŞUKŪK* POST-COVID-19 PANDEMIC**

Social impact *şukūk* has emerged as a highly promising financial instrument for helping to overcome the impact of the pandemic on individuals and SMEs. Nonetheless, it has its own challenges to overcome if it is to sustain, consolidate and validate its position as the most robust Islamic financial service for helping the poor and vulnerable in society. These potential challenges include:

- legislative challenges
- tax framework
- development of sustainable and socially responsible social *sukūk*
- role of stakeholders such as investors, financial institutions and regulatory bodies
- role of standardisation in financial reporting.

### **7.1 Legislative Challenges**

Like other Islamic financial instruments, the contract of social *şukūk* is characterised by the trust and beneficial interest. However, the essence and validity of the contract is a key element and outscore the trust factor, due to the fact that it upholds the rights of *şukūk* investors over the underlying *şukūk* assets and cash flows that are attached to those assets. In fact, the concept of trust and beneficial interest is recognised legislatively under the common law but not under civil law. It is essential, therefore, for those countries that adopt civil law to recognise trust and beneficial interest to ensure the commercial viability of social *şukūk* issuances. Some countries, such as Turkey, have already emulated the recognition of trust certificates for successful *şukūk* issuances.

### **7.2 Tax Framework**

Issuing *şukūk* seems more complex than issuing conventional bonds or other fixed-interest securities, as it involves multiple asset transfers from special purpose vehicles to entities seeking funding. Each transfer is subject to different type of tax obligations at different stages – for example, capital gains tax on the transfer of income, and stamp duty on the transfer of assets – which puts *şukūk* in a disadvantageous position as compared to conventional bonds. There is a need to address the tax framework in

*ṣukūk* transfers, due mainly to the asset-backed or asset-based nature of the social *ṣukūk* instrument, for greater outreach to the stakeholders.

It is also important to address the tax issue from the social *ṣukūk* issuer's perspective, so that an excessive tax liability does not rule out the potential of social *ṣukūk* to be a credible funding source for all-important infrastructure projects. There is a need to consider income from the social *ṣukūk* in the same way as interest received from conventional bonds is considered from a tax perspective, and necessary legislative changes must be made in this regard.

The COVID-19 pandemic has seen the case for social *ṣukūk* gain momentum and traction globally, as more countries are trying to integrate social *ṣukūk* in their legal and tax frameworks (Al-Sayed, 2013; Franco & Sallustio, 2017). The UK, France, Japan, Oman, Turkey, Morocco and other countries have already started to change their tax frameworks to incorporate social *ṣukūk* and to pave the way for developing a vibrant and dynamic islamic finance market, including a *ṣukūk* market (Radzi & Lewis, 2015). It is increasingly important, therefore, to create a robust legal and tax structure as a basic building block of the Islamic finance ecosystem.

### **7.3 Development of Sustainable and Socially Responsible Social *Sukūk***

The COVID-19 pandemic has exposed the finance world, including academic researchers, policymakers, government institutions, investors and business practitioners, to the need to build and develop sustainable and socially responsible financial instruments (Hassan et al., 2021b; Ibrahim & Shahid Ebrahim, 2018). It has been observed that the performance of the corporate sectors, including the quasi-government sector, remains the best yardstick for taking the pulse of the local *ṣukūk* market. It is important to make a sovereign benchmark yield curve in order to provide a sustainable supply of products for the *ṣukūk* market. Countries such as Saudi Arabia, Bahrain, Malaysia and the United Arab Emirates have strong, large and successful sovereign *ṣukūk* issuers and have managed to provide the market with a sustainable supply. There are many reasons to focus on SRI *sukūk* after the COVID-19 pandemic, as this market is dominated by the developing economies, whereas emerging economies are still largely dependent on public-private partnerships (PPPs) to fund their development projects, especially in the areas of health and education (Hasan et al., 2021). The issuance of social impact *sukūk* is expected to provide valuable funds for financing education and health projects in developing countries, as the majority of

Muslim countries are unable to use conventional SRI due to Sharī'ah compliance requirements.

#### **7.4 Role of Stakeholders Such as Investors, Financial Institutions and Regulating Bodies**

It is essential to have a strong presence of stakeholders including non-banking financial corporations (NBFCs), Islamic banks and standard setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the IFSB to enable governments to execute funding strategies under varying market conditions by minimising refinancing risk (Alvi, 2006). Organisations such as NBFCs play an important role in ensuring the liquidity of the primary and secondary markets. Funding efficiency increases with intermediation by these organisations enabling the negative impact of the public debt and facilitating bank credits to the private sectors. It is a challenge to provide clear guidelines as to the roles and responsibilities of each stakeholder to ensure greater efficiency and transparency and smooth functioning of the social *ṣukūk* market.

#### **7.5 Role of Standardisation in Financial Reporting**

The prudential standards provided by the IFSB and the financial reporting standards of the AAOIFI are the most widely adopted and accepted by Islamic financial institutions across the globe for social *ṣukūk* issuance purpose (Naim et al., 2013). The challenge lies in the fact that the approach to the type of *ṣukūk* structure and Sharī'ah guideline varies based on the jurisdiction of the *ṣukūk* issuance. Although proper international Sharī'ah guidelines are available, the differing views of Sharī'ah advisers create a significant challenge in terms of financial reporting, especially in countries that do not adopt a standard Sharī'ah framework.

In some countries, in the absence of a standard Sharī'ah framework, a fatwa is procured from Sharī'ah scholars to ensure the *ṣukūk* issuance is Sharī'ah-compliant and follows the proper Sharī'ah-compliant procedure for reporting purposes. This is not a standard mechanism, as different interpretations can create volatility and doubts about how Sharī'ah compliance might affect the marketability of the *ṣukūk* (Ulusoy & Ela, 2017).

The S&P IFO 2019 suggests that the process of standardisation across Islamic financial institutions in terms of financial reporting is still slow despite several efforts having been made by the standard-setting bodies. Some market participants are still

not in favour of standardisation, considering it to be unrealistic, and advocate a more flexible approach in implementation. More efforts are needed to bring Islamic financial institutions together on the same page. There is a need to have a global standard-issuing body such as the IFSB or the AAOIFI make standardisation a requirement for all *şukūk*-issuing originations irrespective of the type, nature or geographical location of the *şukūk* issue.

Some of the specific challenges related to the SRI *sukūk* include high risk profile, investors' confidence, small secondary market and absence of standard performance measurement.

## SECTION 8: CONCLUSION

Although the way forward looks difficult and there is no one country that can be considered as a model for overcoming the economic and social adversities of the pandemic, there remains some hope. Given their relative importance for economic development and job creation, it is suggested that the OIC member countries must pay special attention to the already struggling SMEs and bail them out of this precarious situation by offering them generous stimulus packages. It is suggested that such businesses had difficulty in accessing finance even before the pandemic, which has only made their predicament even more precarious (Akın & Iqbal, 2020). Suggested policy measures to help SMEs could include providing them with tax rebates, offering exemptions from electricity and other utilities costs, and providing direct cash transfers (Varshney et al., 2021).

To overcome the damage caused by the COVID-19 pandemic, economies worldwide are implementing stimulus packages to provide financial assistance to individual businesses and the business community. Such packages raise the need for sustainable social financing tools. During these uncertain times, the appraisal of social impact *şukūk* and its capability for fulfilling the financing needs of the pandemic-affected poor and vulnerable members of society and of the government to meet infrastructure needs has become a topic of peculiar interest among investors within the Islamic finance community and other decision makers. Such analysis provides essential insights that could help in designing social impact *şukūk* and diversified portfolios that are appealing to investors.

Against this backdrop, the present study explores the potential benefits of social impact *şukūk* and its potential for acting as a catalyst during the COVID-19 recovery phase. To this end, we have employed a qualitative analysis approach using extensive review of the available scientific literature on the potential of social impact *şukūk* to be utilised during this time. The analysis provides a better understanding of social *şukūk* and its potential benefits under different market conditions.

OIC countries must use Islamic financial instruments, such as *musharakah*, *mudarabah* and social *şukūk*, etc., in recovery, as these instruments have the greatest potential to help those people and businesses that are most affected and most vulnerable (Hassan et al., 2021a; Rabbani et al., 2020a, 2021,). These countries must combine Islamic finance with financial technology (fintech) in order to provide customers with innovative and interesting financial solutions that are inclusive and diverse (Karim et al., 2021; Rabbani et al., 2021b). Finally, it is recommended to



enhance intra-OIC cooperation to increase the resilience of and to assist society's poorest and most severely affected members.

No one has escaped feeling the adverse impact of the COVID-19 pandemic, irrespective of the nature of their business or operation. The world has started to engage in economic recovery activities by engaging researchers, policymakers and financial institutions to find a solution that will support a stable and sustainable financial system. Although the nature of the current crisis is quite different from the Global Financial Crisis of 2008, the two crises share some basic aspects. For this reason, social financing tools could also potentially be an important tool in overcoming the current crisis. Islamic social finance tools such as *zakāh*, *qard-al-hassan* and social *ṣukūk* are regarded as the best-placed financial services for assisting the poor and vulnerable sections of society and SMEs to recover from the adversities of the pandemic.

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