

## Chapter 3

# Cash *Waqf* Linked *Ṣukūk* (CWLS) in Indonesia: An Innovation

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### Introduction

Indonesia is the largest Muslim country, with a total population of 281 million in 2024 (more than 207 million or equal to 87.2% are Muslims) and a GDP per capita of USD 4,788. The five biggest islands are Sumatra, our neighborhood, Java, Kalimantan, Sulawesi, and Papua Island. The current exchange rate is IDR 14,700–15,300 to USD 1. Given this fact, the potential and the future of the Islamic economics is very bright in this country.

Islamic banking, Islamic social finance and the Islamic capital market are developing very fast in Indonesia. First, we will focus on *Ṣukūk* as one of the Islamic capital market instruments and later we will mention *Waqf* and discuss collaboration of these two products (*Ṣukūk* and *Waqf*) under the name of Cash *Waqf* Linked *Ṣukūk*.

Among the various types of *Ṣukūk* is Sovereign *Ṣukūk*, which is defined as State Securities that are issued by the government based on Sharia principles, in rupiah as well as in foreign currencies. The goal of issuing State or Sovereign *Ṣukūk* is of course to obtain financing for the national budget to be used for building projects, infrastructure, and so on.

In many cases, the government raises funds through Sovereign Bonds and Sovereign *Ṣukūk*. If the government finances these projects by issuing bonds, then we will not know how the proceeds are being spent. However,

with Sovereign *Şukūk* we will be able to know what the proceeds of issuing the *Şukūk* will be used for, i.e., for developing infrastructure, for making tollways or for building energy infrastructure and so on.

Another goal for *Şukūk* issuance is developing the Islamic financing system. When the government issues Sovereign *Şukūk* it will introduce a variety of instruments into the Islamic capital market and so more people will engage in the market.

The first advantage of issuing *Şukūk* is that it creates financing diversification, and it can be used for financing government projects. Normally for financing, one way is for the government to rely on overseas loans, but sovereign *Şukūk* is another alternative for the national budget.

*Şukūk* can be used for financing government projects and for optimizing the utilization of the state-owned assets because in the context of *Şukūk*, the underlying asset should exist. So, in the context of *Şukūk*, some types of Sovereign *Şukūk* utilize state assets, such as buildings and other resources.

*Şukūk* can also contribute to developing the Islamic capital market and provides a *Şukūk* benchmark, because the rate of the yield that is offered to the investors, the profit shares, will be the benchmark for other private institutions to issue *Şukūk* as well. This will expand the investor base, because previously, when the government issued bonds, Muslims who were very strict did not want to interact with any interest, so they did not want to buy the bonds. So, by offering Sovereign *Şukūk* which is Sharia compliant, those Muslims can also contribute to the country's economic development.

There were some significant milestones in the introduction of Sovereign *Şukūk* in Indonesia. In 2008 we saw the debut of Islamic fixed rate issuance. Then, in 2009 came the debut of Retail *Şukūk*. In 2010 the first auction of Project-Based *Şukūk* took place. Then, in 2013 came the debut of Project Financing *Şukūk*, followed by Savings *Şukūk*

in 2016, and finally in 2020 Cash *Waqf* Linked *Şukūk* was introduced.

Regarding *Şukūk*, there is an innovation in Indonesia called Retail Sovereign *Şukūk* (SUKRI). In many cases, Sovereign *Şukūk* is directly issued to the institutions (the *Şukūk* holders), whether it is pension funds, Islamic banks, or others, and the nominal amount certainly is much larger than an individual can afford. The Government of Indonesia has therefore provided a chance for individuals to contribute to Indonesia's development by issuing Retail Sovereign *Şukūk*. There are various types of Sovereign *Şukūk* in Indonesia and one of them is Retail, but in the following section, I am going to explain another Sovereign *Şukūk* issued by the Indonesian Government which collaborates with *Waqf*.

## **1. *Waqf* and Cash *Waqf***

The Indonesian *Waqf* Act No.41 of 2004 states that *Waqf* is a legal act of the *Wāqif* (donor) for separating or giving up part of his property to be used forever or for a certain period of time for the purpose of general welfare based on Sharia principles. The *Waqf* assets can also be a form of movable object such as a Cash *Waqf* which is set up by a person, a group, an institution, or a legal entity in the form of cash, money, or securities.

Cash *Waqf* Linked *Şukūk* is an innovative financial instrument combining Cash *Waqf* and *Şukūk* for social purposes. As I mentioned earlier, if we buy *Şukūk* Retail we get the yield, because it is an investment, but if we buy CWLS we are buying for social purposes in the sense that later at maturity, we will get the principal only, since the profit will go for social purposes.

### **(1) Urgency of Cash *Waqf* Linked *Şukūk* (CWLS) Issuance**

There is an urgent need to strengthen the capacity of Islamic economics

and financial innovations. To the best of our knowledge there is no other country which issues *Ṣukūk* combined with *Waqf* other than Indonesia. This is unique since the utilization of *Waqf* is normally for social purposes, but it needs a source of funds which is coming from business. Hence collaboration in this case is needed to ensure sustainability.

Moreover, another urgency is to strengthen the National *Waqf* management industry. So far *Waqf* is in the form of land but rarely is it connected with other financial instruments.

The SDG's targets are another reason for the existence of CWLS, because one of the SDG's elements is health and this specific CWLS is used for health purposes, as it was during the COVID-19 pandemic. Finally, it is necessary to provide the *Wāqif*, the investors, with a secure and profitable financial instrument which is guaranteed by the state.

## (2) Business Process of CWLS

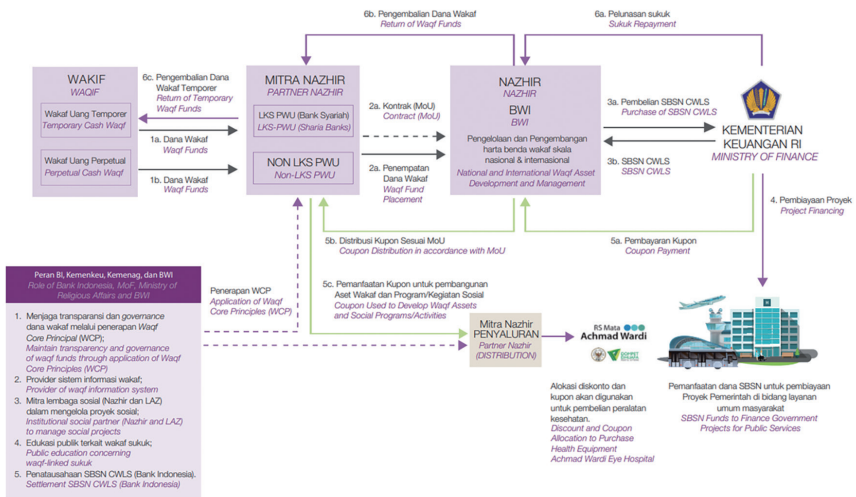


Figure 1 Business model of CWLS

Source: *Annual Report Cash Waqf Linked Sukuk* (Kementrian Keuangan Republik Indonesia 2021, 32–33).

The CWLS scheme integrates the financial sector, both commercial and social, with the real sector. Cash *Waqf* income is placed in Government Islamic Securities (SBSN) to support public development programs, such as health and education infrastructure. In general, the CWLS model consists of four main processes: (i) collecting funds; (ii) placing funds; (iii) distributing and utilizing the return; and (iv) returning the *Waqf* funds.

### **1) Fund Collection**

Islamic Bank as receivers or agent (LKS-PWU) of Cash *Waqf* to receive and collect Cash *Waqf* funds from a waqif, which are subsequently distributed to BWI as the *Nāẓir*.

### **2) Fund Placement**

BWI invests the Cash *Waqf* through private placement in government *Šukūk* or Government Islamic Securities (SBSN) issued by the Ministry of Finance. The funds received by the government from CWLS issuances are subsequently used to fund government projects for public services. At this stage, in its capacity as the SBSN administrator, Bank Indonesia records the ownership and engages in SBSN clearing and settlement.

### **3) Distribution and Utilization of Return**

The government pays the return to BWI in the form of coupons, which are distributed to the *Waqf* managers to fund social projects or activities in conjunction with BWI and the *Waqf* managers. The discount received from the first CWLS series was used for medical equipment and building development for an eye hospital in Serang, Banten. The coupons received periodically are used to cover the bank installment and some operational expenses. Investment in CWLS generates competitive returns because BWI is tax-exempt.

#### **4) Repayment/Return of *Waqf* Funds**

Upon maturity, the government repays the principal government *Šukūk* or SBSN to BWI for return in full by BWI to the *Wāqif* (in the case of a temporary Cash *Waqf*) or further management by BWI (in the case of a perpetual Cash *Waqf*).

In addition to the aforementioned parties, the Ministry of Religious Affairs also participates by issuing supporting policies concerning *Waqf* empowerment/management. This scheme demonstrates the tangible collaboration between authorities in order to optimize the development of *Waqf* assets in the form of cash to increase public prosperity.

#### **(3) How the Scheme works:**

**1a and 1b)** The *Wāqif* (*Waqf* donor) donates Cash *Waqf* for temporary or permanent contracts as agreed to the *Nāẓir* partners (*Waqf* managers) either from Sharia Financial Institutions Receiving Cash *Waqf* (LKS PWU), or other institutions (Non-LKS-PWU).

**2a)** *Nāẓir* Partners enter into a cooperation contract (MoU) with the *Nāẓir* (the Indonesian Waqf Board (Badan Waqf Indonesia BWI)

**3a)** The *Nāẓirs* and BWI purchase State Sharia Securities (SBSN) instruments in the form of Cash *Waqf* Linked *Šukūk* (CWLS) issued by the Ministry of Finance of the Republic of Indonesia

**3b)** The Ministry of Finance of the Republic of Indonesia sells and distributes SBSN CWLS asset ownership letters to the *Nāẓirs* and BWI

**4)** The Ministry of Finance of the Republic of Indonesia manages SBSN to finance state projects which in the long term can produce profitable management results.

**5a)** The Ministry of Finance of the Republic of Indonesia pays coupons or profit sharing for the management of SBSN CWLS to the *Nāẓir* (BWI)

for the SBSN CWLS holder.

**5b)** The *Nāzirs* and BWI distribute the return of SBSN CWLS management to *Nāzīr* Partners in accordance with the agreed MoU.

**5c)** *Nāzīr* Partners utilizes coupons from SBSN CWLS management for *Waqf* asset development programs and social programs/activities. One example is the allocation of discounts and coupons used to purchase health equipment as used to support the Achmad Wardi Eye Hospital which was developed by one of the *Waqf* institutions in Indonesia.

\* During this distribution process, there is an important role for Bank Indonesia, the Ministry of Finance of the Republic of Indonesia, the Ministry of Religion, and the Indonesian *Waqf* Board to:

- 1) Maintain transparency and governance of *Waqf* funds through the application of *Waqf* Core Principles (WCP)
- 2) Provide a *Waqf* information system
- 3) Be an Institutional social partner (*Nāzīr* and LAZ) to manage social projects
- 4) Provide Public education concerning *Waqf*-linked *Şukūk*
- 5) Pay Settlement of SBSN CWLS (Bank Indonesia)

**6a)** At the end of the SBSN CWLS contract period according to the contract, the Ministry of Finance of the Republic of Indonesia will pay off the *Şukūk* (return of Cash *Waqf* principal) to the *Nāzirs* and BWI

**6b)** *Nāzīr* and BWI redistributes the principal value of Cash *Waqf* to the *Nāzīr* partners when it matures

**6c)** The *Nāzīr* partners refund funds for temporary (temporary) *Waqf* contracts when they are due

#### **(4) The Benefits of CWLS**

CWLS has many benefits. Safety is guaranteed by the state and the *Şukūk* will be returned 100% to the temporary Cash *Waqf* investors at

maturity. It is productive because the benefits will be given directly to the *Waqf* beneficiaries. It is blessed, because the returns of CWLS will be used for social welfare through developing new *Waqf* assets and programs. It is competitive because the returns are quite profitable for the investors, and it is long lasting because *Waqf* assets are eternal.

### **(5) Features of CWLS**

The guarantor is the government of Indonesia, represented by the Ministry of Finance. Issuance is by a special purpose vehicle (SPV), the structure is time-based (*Wakāla*), and the issuing method is a private placement with Badan Waqf Indonesia BWI. The underlying asset is the government state-owned assets, and the market is domestic. The tenure is five years and nominal bullet payment is 100%. The minimum order is IDR 1 million, which is around USD 70, so every individual Indonesian can contribute by this CWLS. There is no maximum order.

CWLS was first issued on March 20, 2010, and for one share, one *Ṣukūk*, the nominal issuance was USD 3.45 million. The contract structure was time-based (*Wakāla*) and non-tradable. The fixed coupon rate is 5%, which for the government is quite high, and the contract reaches maturity in 2025. Also, there is a discount. What does this discount mean? When this amount is received by the government, it will give a discount so that the discounted amount can be used for developing a hospital.

The Eye Hospital can offer free cataract surgery to poor people. Also, because this is a *Ṣukūk*, the government will give a return, but that return will not go to the *Wāqif*, or to the investor, but the return will go regularly for social purposes, in this case an eye hospital.



## 2. CWLS Schemes

The one who issues *Şukūk* is the finance minister and the regulator of the *Waqf* is the Indonesian Waqf Board. This is a private placement. This means that the issue of Cash *Waqf* in *Şukūk* by the finance minister can only be bought by the Indonesian Waqf Board, at a cost of USD 34.5 million. The Indonesian Waqf Board gets money from the *Nāẓirs* who are the partners. The *Nāẓir*'s role in Indonesia is a bit different from in other countries. In Indonesia, the *Nāẓir* can be a privatized Cash *Waqf* institution, and this *Nāẓir* can collect from the *Wāqif* either temporary or perpetual *Waqf*. The *Wāqif* is allowed to donate temporary Cash *Waqf* or perpetual Cash *Waqf* to the partner or *Nāẓir* who has to distribute all the collected Cash *Waqf* from the *Wāqif* to the Indonesian Waqf Board. Once the collected amount reaches IDR 50 billion, or USD 34.5 million, only then the government will issue the *Şukūk*. Since this is *Şukūk* the government will give a return and discount payment. So, from this USD 34.5 million a small portion of it will be discounted then give to the Indonesian Waqf Board for *Waqf* projects for social purposes. The entities who buy this specific Cash *Waqf* Linked *Şukūk*, this IDR 50 billion or USD 34.5 million, are institutions, and many of them are Islamic banks. Then from USD 34.5 million, IDR 1.9 billion is discounted. Then, since this is *Şukūk*, the government will pay out a regular yield of IDR 181 million per month for social purposes.

The Retina Center Eye Hospital is such a project. This social project will use this as an income stream to get financing from the BNI Shariah, for services, equipment, and ambulances. Then to make a monthly installment to the bank the project uses the profit share, or the coupon issued by the government CWLS. So, every month IDR 181 million is used to make a payment for the installment of the *Murābaha* financing.

So, this project gets IDR 8.8 billion and this will be used for

construction, medical devices, working capital, ambulances and so on.

### **(1) Analysis of CWLS Performance**

Collecting Cash *Waqf* to build eye hospitals is not easy; it is a process that has many challenges since the literacy level is low, and promotion needs to be continuously done to make people aware of that Cash *Waqf* exists and is available to them. To be competitive, the return of 5% is quite high, and the higher the return, the greater the benefit.

In this context, *Waqf* land was supposed to be used for building a hospital, but since they did not have enough money to build the hospital, the government helped by issuing CWLS. So, this is a collaboration between the Government and the *Nāzir* and also the Indonesian *Waqf* Board. This certainly creates a value-added, because initially there was some idle *Waqf* land, but now with this money, the hospital will be built there, and many people will benefit from the health facility.

### **(2) How the Funds are Used**

The CWLS is being used for renovations, purchasing medical devices, equipment, and ambulances, and also for the social services to inform about surgery. As for the performance of the hospital, in 2018 it still experienced losses, but a year later its profits increased significantly because the patients of this hospital were enjoying an excellent facility, and they were mostly supported by National Insurance paid by the Government.

The number of surgeries performed also increased and so its assets increased because the profit goes back to the balance sheet. Thus, the Achmad Ward Eye Hospital recorded a revenue growth of 323% and finally since 2019 it has been able to record a profit.

The important factor in this project is collaboration. This hospital collaborates with the government and the City Office. Most of the employees in the City Office are treated in this hospital and the local government is paying their expenses. Also, patients are shuttled to the facility and there are other collaborations like social service events.

Why pay for an Eye hospital? If a person is visually impaired, they are three times more likely to be unemployed, three times more likely to be involved in motor vehicle collisions, three times more likely to suffer from depression, and two times more likely to have a fall while working. The point is that 84% of visual impairment could be avoided if diagnosed and treated early. 1.4 million children could benefit from vision rehabilitation. So, this is why proper eye care is important in the context of Indonesia.

In the world the majority of blindness is caused by cataracts, Glaucoma, and AMD, and there are many people suffering from such eye problems in Indonesia.

### **3. Opportunities and Challenges for CWLS Issuance**

There has been an opportunity for high economic growth, despite the COVID-19 pandemic. It is expected that after the pandemic there will be high economic growth as there was prior to the pandemic, when normally, in a year, we could reach 5% growth. The contribution from millennials here is very significant.

They are familiar with technology, so we hope that they will contribute to *Waqf* and other Islamic financial institutions. We also benefit from the high commitment of Indonesian government in developing this sector. The issuing of *Şukūk* Retail and also *Şukūk* Retail combinations with *Waqf* show that government has a high commitment to developing Islamic economics and also to developing and improving

health facilities and other infrastructure.

However, the challenge is that we need more society involvement. We have to increase the number of *Nāẓirs* and distribution partners, and we must encourage millennials to invest.

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