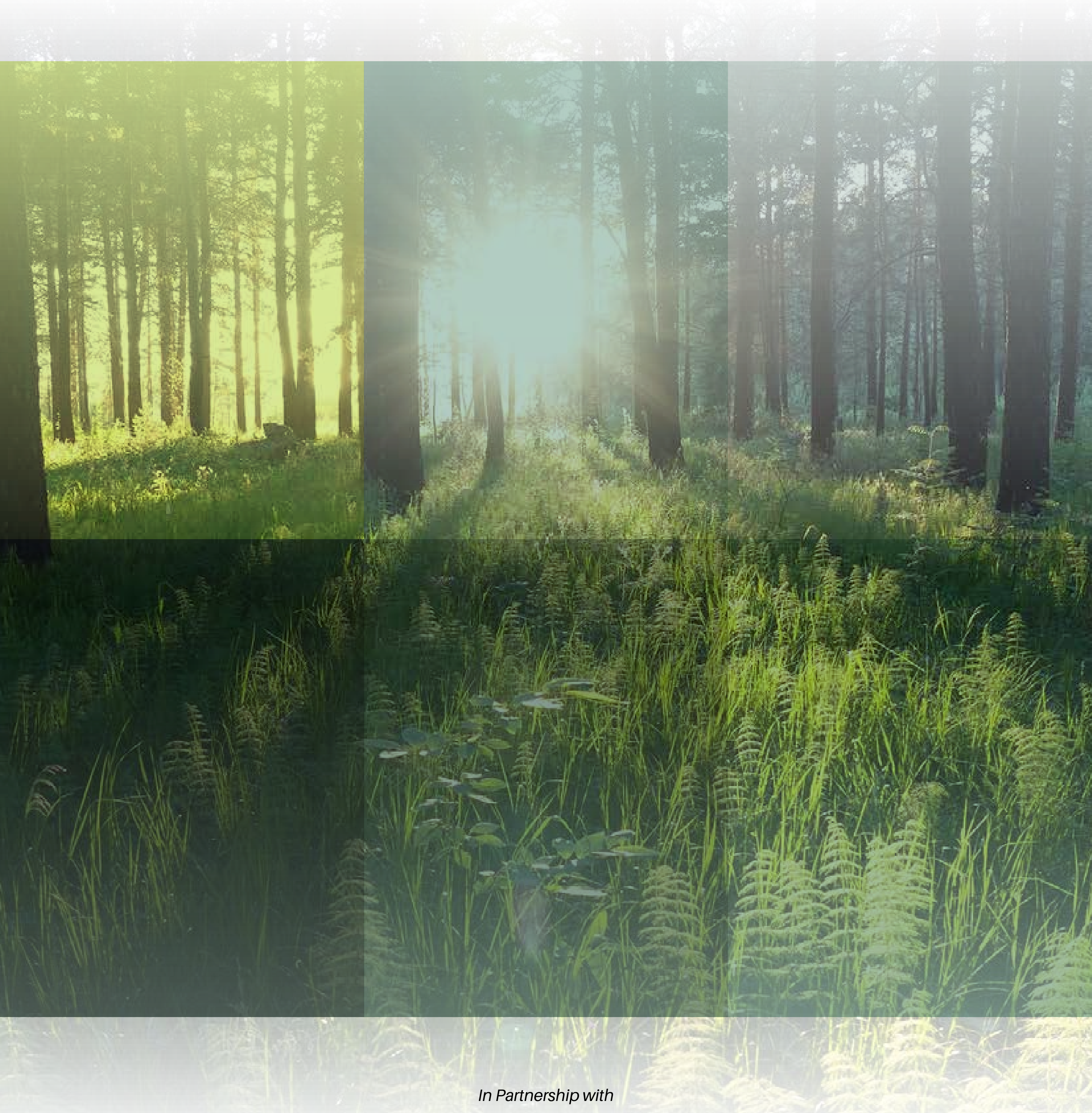
IFN ISLAMIC SUSTAINABLE INVESTING THOUGHT LEADERSHIP REPORT



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Sustainability: The future of Islamic finance

The call for finance to be a force for good has become more urgent than ever, and the Islamic finance industry is heeding that call. Despite practitioners often being quick to point out the similarities between it and the sustainable finance movement, Islamic sustainable finance remains but a drop in the multitrillion-dollar ethical finance industry. Industry leaders, however, believe we are moving in the right direction, and with the right steps, the industry could deliver more meaningful impact through Shariah instruments with a sustainable core. VINEETA TAN dives deeper.

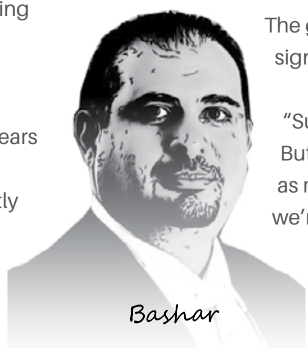
Slow and steady

Don't let the abbreviations confuse you. Be it ESG [environmental, social and governance], SRI [socially responsible investing] or impact investing, these terms are parked under the wider sustainable finance umbrella and are often used interchangeably albeit with delicate differences. ESG may be a jargon first coined in 2005 but the concept dates back earlier with SRI taking off in the 1960s. Within the Islamic finance sector, however, these concepts are a relatively new phenomenon, with Islamic ESG or Islamic sustainable finance gaining more momentum over the last half a decade or so.

Take green bonds as an example. The first climate awareness bond, or green bond, was issued by European Investment Bank back in 2007. The landmark EUR600 million (US$678.27 million) offering triggered a domino effect which led to an ESG finance market that is worth over a trillion dollars and growing exponentially. The Islamic finance industry, however, trailed behind and only issued its first green Sukuk 10 years later in 2017. From then until July 2020, only 17 green Sukuk issuances have entered the market, and are mostly concentrated in Malaysia and Indonesia.

According to Bashar Al Natoor, the global head of Islamic finance at Fitch Ratings, about US$5.5 billion were raised through sustainability-linked Sukuk in 2020; this figure has been superseded in the first three quarters of 2021 alone, with almost US$7 billion already raised.

"If I look at how much was issued since 2017, it is less than US$20 billion, which is small compared to the size of the global Sukuk market which is around US$800 billion currently. So, in terms of actual size, the sustainable Sukuk market is still tiny," Bashar explained, adding that over 10% of Fitch's US$130 billion rated Sukuk outstanding has some elements of sustainable, transition and green, indicating that this theme is more apparent within the dollar space. Malaysia is an exception, with corporates driving the Islamic sustainable agenda in the local currency market.



The growth may be slow, but market practitioners take this as a sign in the right direction.

"Sustainability has always been at the heart of Islamic finance. But I think perhaps in the past we didn't bring it to the fore as much as we're doing now. And one of the reasons that we're doing it now is because in the conventional markets, sustainability, ESG financing has grown enormously in the last 15 years or so, and increasingly so in the last five years. So that depth of funding liquidity that's available in the conventional sustainable markets is something that Islamic finance is becoming increasingly aware of and tapping into. The combination of liquidity plus the fundamental purpose of Islamic finance have come together in the last three or four years," observes Farmida Bi, Norton Rose Fulbright's chair for the Middle East, Europe and Asia and the firm's European head of Islamic finance.

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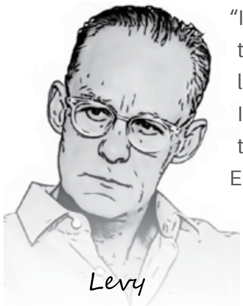


The Islamic and sustainable convergence is indeed gaining serious momentum, evident by the numbers.

"I think over the last 12 months, there's been a lot of discussion and the good news is that the discussion has basically crossed into almost every aspect of Islamic finance. Everybody is now talking about [Islamic sustainable finance], which is a good start," Dr Scott Levy, CEO of Bedford Row Capital, opined.

There is indeed a lot of talk, backed by meaningful measures, at the top of the industry and at government levels, with the likes of Malaysia, Indonesia, and several administrations in the Middle East putting together policies and incentives to spur the sector. Malaysia introduced its SRI Sukuk Framework in 2014, Indonesia launched its Green Bond and Green Sukuk Framework in 2017, and the UAE this year released its 10-year sustainable finance framework which features Islamic instruments while Oman is developing an ESG finance framework as well.

However, there is still a lot of work to be done, not only at policy level, but also at issuer level as we move from a mindset of maximizing profits to a mindset of profit with purpose.

Costly compliance

There is a cost to compliance, and this cannot be underestimated.

"In addition to complying with Shariah principles, you also have to comply with green bond principles and there are increasing layers of regulatory frameworks that are being built around Islamic sustainable finance," Farmida explained, adding that tapping the ESG market generally means having to get an ESG rating as well. "All of those are substantial obligations that you have to comply with, compared to going out into the market and issuing a conventional bond. So in order to jump through all of those different hoops, it has to be worthwhile."

There is a cost to compliance, and this cannot be underestimated

Disclosure is a central challenge Islamic financial institutions face in fully embracing the sustainability agenda. Perhaps the lack of Islamic

financial institutions committing to globally-recognized frameworks such as the UN Principles of Responsible Investment and the UN's Principles of Responsible Banking, which require regular detailed reporting of one's sustainability efforts and impact, is an indication of the severity of this challenge. To date, only a handful of entities have adopted these principles.

"The commercial necessity of doing so isn't quite clear enough," Dr Levy highlighted. "If [issuers] can tap into the markets the way they have always done and take a very conservative and traditional approach, why do they need to do this? And there isn't yet a commercial imperative in the same way there is on the conventional side to put the effort into the reporting that's required."

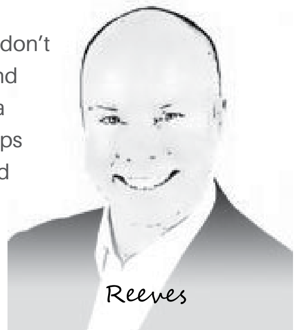
Professor Kevin Haines, Bedford Row Capital's head of social policy, echoes his colleague's sentiments: "There is an issue at the moment for Islamic finance about talking the kinds of language that is increasingly acceptable to investors. Investors are now expecting issuers to be conversant with these various regulatory frameworks and to be providing the data that investors need to demonstrate their compliance under these regulatory frameworks. This is early days but it is important for Islamic issuers to get conversant with these regulatory frameworks."

Making it worthwhile

The reality is: it is not easy to use finance for good without risking greenwashing. And it is costly too. These merely compound the concerns conventional issuers have with Shariah finance, which is already perceived as more complicated and expensive. This leads us to ask: is the payoff justified?

Market practitioners believe so, albeit the fact that it may take a while to realize such gains.

"(In general) getting a real yield that is actually positive is a challenge, and if you're an Islamic investor, then you have further restrictions. You don't have the entire universe available to invest in and so finding something that is going to generate a yield is one thing, finding something that perhaps can generate a positive inflation built in the yield is another. Islamic attributes attached is even more of a challenge and of course increasingly, Islamic investors also want sustainability, they're not different from everybody else. Having a sustainable Islamic investment I think is an incredibly positive and virtuous thing and I think in some respects they it could potentially lead this and certainly the opportunity is there," noted Craig Reeves, the founder of Prestige Funds.



When we compare the performance of conventional and Islamic indices, it does look like conventional edges ahead of its Islamic counterpart. The conventional S&P Global 1200 has modestly outperformed the S&P Global 1200 ESG Shariah. However, according to Michael Orzano, the senior director of global equity indices at S&P Dow Jones Indices, over the longer term, the ESG jurisprudence have led to outperformance and also some reduction in volatility.

"If we look at the trailing 10 years as of the 30th September 2021, the S&P Global 1200 Shariah gained an annualized 14.7% versus 13.1% for the conventional index, which is a pretty meaningful outperformance of over 1.5% per annum over 10 years. Interestingly on the volatility side, standard deviations were a little bit lower for the ESG SRI Index as well, which is interesting as it is a much narrower index," Orzano elaborated, adding: "Long-term outperformance was almost fully driven by the Shariah screens and the

ESG side of it didn't really have a large contribution because by design, the S&P ESG Index is constructed in an industry neutral basis so that it tends to closely track the conventional parent benchmark."

The ability to reach a wider investor base is often the driving reason to turn to Islamic sustainable finance. Beyond that, the trend toward doing good for the planet and people also attracts Islamic finance institutions to capitalize on this swelling demand.

Private capital really is vital and this presents a considerable opportunity for the Islamic capital markets to mobilize funding and is also a very unique opportunity for Islamic finance

"In Europe, you will see green issuances resulting in savings of at least up to 10 basis points as compared to normal issuances. But in the case of Asia, including Malaysia, generally the difference is very marginal," Chung Chee Leong, CEO of Cagamas, Malaysia's national mortgage corporation and the country's largest debt issuer, shared. "In our case, we managed to get two basis points (in savings) for our 2020 issuance. With increased awareness, we will probably see in the future, potentially some savings issuing sustainability Sukuk as compared to regular Islamic offerings." Cagamas in 2020 priced a combined issuance of its inaugural ASEAN Sustainability SRI Sukuk and Islamic medium-term notes totaling RM450 million (US$106.08 million). Proceeds from the SRI paper was used to specifically fund the purchase of eligible Islamic financing for affordable housing.

Urgent needs, attractive opportunities

For the most part, Islamic sustainable finance is here to stay, especially as the pandemic has created an urgent need for funding to recover.

"There is now a much greater focus on how to build back better as we come out of COVID. Many of the people who have been impacted the most by the coronavirus are in Muslim-majority countries and I think when those countries are looking at how they can rebuild that infrastructure, whether that's health, education, employment, there has been in Europe a very big focus on social bond issuances to try and ameliorate the effect of the pandemic. And those are structures and capital flows that these Muslim-majority countries can also tap into as the world generally tries to support development post-pandemic," noted Farmida.

The Islamic Finance Council UK expects US$30-50 billion in capital for green and sustainability Sukuk up to 2025.

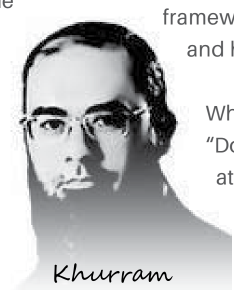
"It has been suggested that we need about US$7 trillion in infrastructure investment annually and between US$1.5 trillion to US$4 trillion every year for energy transition to meet the Paris [Agreement] targets; and with the commitments of the Glasgow Climate Pact, I'm sure

those numbers will then be increased and there aren't sufficient public funds to satisfy this. So, private capital really is vital and this presents a considerable opportunity for the Islamic capital markets to mobilize funding and is also a very unique opportunity for Islamic finance," according to Jennifer Schwalbenberg, the chief governance officer for the DDCAP Group.

The starting point is to understand and be aware of what the conventional [space] is doing, then look at your industry, see where you can capitalize on the things that you already have and then develop the things that you like

COP 26 [UN Climate Change Conference 2021], contentious as it may have been, nonetheless pushed various nations toward some serious climate commitments.

"The UAE was the first in the Middle East to announce their net zero ambition followed by Saudi Arabia and you must acknowledge that it's not easy for these countries. For these countries, which are some of the largest oil-producing countries in the world, to go next zero, they have to invest much more and they have to make much more effort as compared to other countries," said Khurram Hilal, CEO of group Islamic banking at Standard Chartered Bank.



Khurram

This year's UN Climate Change Conference saw the formation of the Glasgow Financial Alliance for Net Zero, a global coalition of 450 institutions from 45 countries committed to accelerating the decarbonization of the world economy and reaching net zero emissions by 2050. These institutions are not only augmenting their internal policies but also revising their investing and lending criteria for projects focusing on achieving net zero, signaling deep capital flows into the sustainable finance sector.

Turning words into action

So how do we, as an industry, capture these Islamic sustainable opportunities? As Schwalbenberg observed: "We had two weeks of moving intentions and wonderful announcements [at COP 26] but now we need to put that into reality and make it happen. It's no longer about goals and aspirations. It really needs to be about action. And with this, I think there really is a key role in the Islamic finance agenda for green finance, but also transition finance."

Bashar concurs. "I think the starting point is to understand and be aware of what the conventional [space] is doing, then look at your industry, see where you can capitalize on the things that you already have and then develop the things that you like. First is to build awareness, then realization of putting strategies and regulations and frameworks to improve that and then installing that in the system and having an ecosystem and incentivize issuers."

When it comes to regulations and policies, Dr Scott's advice is: "Don't be afraid of regulation – that's the first step. Look internally at your internal processes, have a brief read of the UN SDGs and understand where you fit into the things that the world is talking about at the moment."

At the heart of this movement is the importance of nurturing the right people to drive this change.

"We need to think about how do we get staff in Islamic banks to be equipped with the right knowledge? How do we create a future-ready workforce? We need our training and our learning institutions to focus in this area because this is the future of finance. They need to help develop the next generation of Islamic bankers who understand the dynamics of sustainable finance, who understand climate change, net zero carbon footprint, social finance and inclusion. They need to be fully up to speed with these concepts and not just knowing them, but also owning these concepts and also championing [them],” Khurram strongly believes.

Leveraging tech

And just as the Islamic finance industry is using technology to advance their cause, technology should also be leveraged in our journey of Islamic sustainability.

“Technology can definitely play a significant role in achieving environmental and social goals. We have instances of application of blockchain technology and Islamic social finance, such as the use of digital identities for monitoring the end-use of the contents of funds, as well as the preservation or development and proper use of Waqf or Islamic endowments for achieving various societal goals. Most of such goals find a place in the UN Sustainable Development Goals (SDGs),” according to Mohammed Alim, CEO-designate of IBF Net Group.

IBF Net is currently working on miniaturizing the Islamic economy, with a focus on Islamic social and sustainable finance using blockchain technology, and has launched several projects to this end. One of the projects is the Confluence platform which seeks to measure the impact of projects from the standpoint of Shariah and the UN SDGs.

“The platform combines the performance of the given projects against these metrics using an algorithm and produces a score or a classification scheme. This score reflects the impact of the projects using the lens of Shariah objectives, as well as the SDGs as perceived by the stakeholders. Given the availability of tools for measurement of environmental and social impact, for example carbon footprint, our platform identifies and adopts a suitable method for measurement and conversion of such impact into social cryptos. In this case, products can earn or liquidate such cryptos, which represent both types of impact acting at an exchange to alter their risk return impact profile in the market,” Mohammed explained.

Moving forward

The notions of sustainability and ethics are not new in Islamic finance, although it is only in recent years that the industry is focused on harnessing and delivering sustainable impact in a more formal and structured manner. To many, this is the future of Islamic finance.

“This trend is a growth trend and I think this has already been cemented in the past three years; even at the height of COVID-19, we saw this segment growing, and I think this will continue in the short to medium term at least. If the government’s strategies and milestones and objectives are really pursued in a very dedicated way, we could see more transformation of this segment, even in the long term, where it becomes a significant part of the industry,” Bashar opined.

The push is also seen from the demand side, encouraging the supply side.

"We're definitely seeing a high level of demand from clients around the world for both ESG and for Islamic indices. Both of these are big areas of focus for us as an index provider. There have been significant inflows into ESG index products, including ETFs [exchange-traded funds] around the world over the past year, and we've also started to see Islamic ETFs in the US and Canada really gather momentum," Orzano shared. "I think the investment community is really just starting to think about combining broad-based ESG and Shariah investing together. I think we're likely to see a lot of new product development in the space over the next few years."

Schwalbenberg concurred: "I think as the strength of this agenda in the market increases, and that momentum builds, we will see the different institutions increasing their offerings and their options to the market. And it will be organic because as the sustainable finance sector grows and the products and services and practices become more prevalent, institutions will become more cognizant of this and they will realize they will miss opportunities and be at a disadvantage if they don't participate. Islamic sustainable finance will be recognized as the new normal and commitment will follow."

Corporates and Islamic issuers are already lining up their ducks.

"We see a lot of our traditional energy clients setting up new projects in a sustainable and renewable way and we are expecting a number of projects that were conventionally financed now being refinanced in a sustainable way going forward. So as a firm, we are expecting to do a lot more sustainable finance, certainly in the conventional markets, but hopefully much more in the Islamic markets as well," Farmida shared. It is learned that Cagamas and Standard Chartered are each preparing to introduce new products. Chung, CEO of Cagamas, revealed that the firm is looking to issue green Sukuk while Standard Chartered is working on expanding its Islamic green mortgage offering, Islamic social finance tools and Islamic ESG wealth management services, and is building on creating sustainability solutions for the wider Halal market including Islamic sustainable supply chain instruments.

As the multitrillion-dollar Halal industry continues to grow in its own space and globalize, I think it is important that they harness the socially responsible funding mechanism

"I think it's a great opportunity for growth that and we have this great upside in front of us," Khurram explained. "As the multitrillion-dollar Halal industry continues to grow in its own space and globalize, I think it is important that they harness the socially responsible funding mechanism, mechanisms of Islamic finance and strive to give holistic Halal solutions to faith-conscious clients.

"We need more innovation, we need more solutions in this space. This is an open field for all banks, all partners to come in and play their role."

How ESG enhances Islamic asset management in the 'year of the taxonomy'

By Blake Goud,
CEO, RFI Foundation

Authored by

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Responsible finance encompasses everything from socially responsible investing (SRI), environmental, social and governance (ESG) and Islamic finance. Despite the growth of all segments of responsible finance, the evolution of our knowledge about how the different sectors interact in practice remains limited. In part, this is because although many objectives are shared, definitions are at varying stages of development.

What we have learned through intensive research is that it is not enough to just find the highest ESG-scoring investments and overlay it with a screen for Shariah compliance. The interaction between Shariah screening and ESG is more complicated. We find ways that promote better outcomes from combining the two than using them independently.

At the core to understanding responsible finance is understanding that the integration of ESG information into investment practices is not merely a compliance exercise. There is no set threshold for what constitutes compliant or non-compliance on the ESG spectrum. There is an institutionalization push underway in responsible investment to make actions by investors integrating ESG into their investment decisions more credible, but it is still unlikely to create clear thresholds.

The drive for national taxonomies and global standards like those proposed to be created by the International Sustainability Standards Board under the IFRS Foundation will help to provide some certainty about what we mean by 'ESG'. It mirrors the efforts taken over the past 20–30 years in Islamic finance to define a 'common ground' approach to Islamic finance as described by the standards issued by AAOIFI and IFSB.

The institutionalization gap between Islamic finance and ESG has stymied rigorous comparisons about the value of each and how they might work together in practice. One of the first efforts was undertaken when RFI was established in 2015 to show that the objectives shared between Islamic finance and responsible finance had more similarities than differences. We lined up the exclusionary screens of ethical and responsible investment against Islamic investment screens providing a side-by-side[1] lineup of the exclusionary screens common to the two.

[1] Thomson Reuters and RFI Foundation, 2015. The Thomson Reuters – RFI Responsible Finance Report 2015. Manama: Thomson Reuters, **https://www.zawya.com/mena/en/ifg-publications/260815053724N/**

We found similarities in some market practice relating to common exclusions against weapons, nuclear power and tobacco. Other sectoral screens were found in SRI, responsible finance or Islamic finance but were not found in the market practice of the whole responsible finance sector. For example, SRI screens that investors use that are focused on excluding genetically modified organisms which do not overlap with Shariah screens.

For many years, this has been the filter through which responsible finance and Islamic finance are viewed through — a shared set of negative screens with a few that differ between the two. One of the steps to clarify whether this 'exclusionary' approach was the element of the commonality and the financial value added or subtracted in responsible finance came in 2017 with research by SEDCO Capital. Rather than qualitatively lining up the negative screens of SRI and Islamic finance and seeing what was the same and what was different, it looked into the financial results of these ethical screens.[2]

SEDCO's analytical focus zeroed in on one often overlooked element of Islamic finance that goes beyond the issue of negative screening to avoid investing in prohibited businesses: the financial ratio screens. These screens are incorporated into Islamic finance primarily as a proxy for avoiding companies that are likely to have significant interest income or expense, although the most common exclusions that result are for companies with excessive debt.

> If there is less of a gap in ESG practices between leaders and laggards, it becomes harder to find any systematic financial benefit from improving ESG practices

The result of SEDCO's analysis focusing on this question of excessive debt was that the financial ratio screens in Islamic investing come out as more of a 'positive' screen than a 'negative' screen in both objectives and financial returns, and these results are linked. The positive objective that the financial ratio screens bring to the analysis is that it narrows the available investment universe so that they are more 'prudent'.

By adding positive screens, the slightly negative returns of the SRI screens (just the sectoral exclusions) are more than offset by the positive impact of more prudent screens, particularly during periods of financial stress like the global financial crisis. This leads to a question about whether other features of responsible finance — ESG — can have a similar impact on returns, making Shariah compliant ESG investing more appealing than conventionally screened ESG funds.

To explore this question, the RFI Foundation undertook a rigorous examination of the data together with the International Centre for Education in Islamic Finance or INCEIF, expanding the time period to both validate some of the results from SEDCO Capital, and extending the analysis to reflect a more comprehensive look at ESG. We find that ESG benefits companies in emerging markets, while Shariah screens provide more value in developed markets. The impact of combining the two screens is both more complex and more informative.

The financial impact of better ESG performance is much stronger in emerging markets than in developed markets. This in part reflects the nature of most ESG data as being more focused on the policies of companies and not always effective at measuring impacts, when viewed in tandem with a more limited ESG benefit in developed markets.

This could indicate that ESG scores as they are currently collected for emerging market issuers are better at gauging how well companies aspire toward best-in-class ESG policies. They could also act as a proxy for these companies being better governed. We find less of a difference between Shariah compliant and non-compliant company performance regardless of ESG scores in emerging markets.

As we mentioned, in most developed markets, better ESG-scoring companies underperformed lower ESG-scoring companies, but at each level of ESG score quartile, Shariah compliant companies outperformed similar scoring companies. This result is consistent with the 'policy'-focused approach to ESG scores.

Many ESG issues are legislated in developed markets with more rigorous enforcement than in emerging markets, which may result in a narrower gap between leaders and laggards in a particular sector and country. If there is less of a gap in ESG practices between leaders and laggards, it becomes harder to find any systematic financial benefit from improving ESG practices.

One explanation would be that best-in-class ESG screens are already factored into current prices, so buying higher ESG-scoring companies will be pursuing already fully valued (or overvalued) companies. Although this matches up with what some critics of ESG suggest, it does not fully explain the persistence of this finding across a long time frame with data going back to 2001, well before ESG became commonplace. A more compelling explanation is that, although we analyzed sources of risks in several different ways, there remain ESG-related risks that are not reflected fully in ESG scores.

For example, if an ESG score omitted some environmental or social risks, or this information was lost in the process of aggregating ESG data into a composite score, the higher returns we identify could be compensation for bearing additional ESG risk not picked up by the aggregated score. If this is the case, it offers significant opportunity for the use of the Shariah screens in responsible investment that extends some of the results uncovered by SEDCO.

Our findings suggest that the 'prudent' features of Islamic investing could help investors benefit from investing and engaging with lower ESG-scoring companies. In contrast, investors who simply overlay a best-in-class ESG screen with a Shariah screen may be sacrificing potential returns in exchange for lowering their ESG risk exposures (measured by the score). For investors willing to take on additional ESG risks, they can use Shariah screens to provide a 'margin of safety' while they work with investees to lower their overall ESG risk profile.

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[2] Gueckel, Christian. "How can responsible investors benefit from Islamic criteria?" SEDCO Capital White Paper, 17 February 2017, **https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2918849**

This raises a fundamental question about how to look at these results in terms of what responsible investment strategies will look like in the future. As the world's standards on ESG data are harmonized, there will be more consistency and comparability of ESG information (although its quality may improve only with a lag and after greater assurances are introduced).

As countries pursue taxonomies to define what is 'green' or 'sustainable' within their economies and financial markets, the way they set out these definitions will also affect how investors evaluate ESG data. To dig into one possible scenario, although there is no data yet to test the hypothesis in our research, countries which adopt a 'bright-line' taxonomy may find that the expected return for unsustainable companies rises while expected returns fall for green companies.

There is value to be had in looking at empirical data to understand how to link ESG and Shariah screens and engagement together

This could occur because 'green' companies find it easy to raise funding and maintain a stable investor base. They are included in indices that track 'green' companies that passive investors use to find the best-in-class ESG companies. The access to finance based on backward-looking ESG information or sustainability data about their products does not necessarily indicate higher returns for investors. We found this to be true in developed markets even in the absence of rigorous taxonomies.

By contrast, lower ESG-scoring companies that are labeled as 'unsustainable' tempt investors with higher returns in part because they are underinvested by ESG best-in-class investors. On average, these higher returns may persist, but the companies will be less resilient in part because of their less dependable access to finance.

Investors could see this as an opportunity to pursue higher returns by investing in and engaging with lower-scoring companies, with a Shariah screening overlay to provide a margin of safety for investors, while they engage to uplift the companies into the 'green' universe, lowering risk and broadening their access to a wider investor base.

However, in bright-line taxonomies, there is a sharper cliff between green and unsustainable companies. This may put more focus on improving companies near to the dividing line and reducing the value of improving lower ESG-scoring companies. Lower ESG-scoring companies that will not likely become qualified as 'green' are unlikely to get the uplift in investor appetite if they cannot cross the 'think green line'.

In contrast, in places that use what Mark Carney dubbed the 'fifty shades of green' taxonomy approaches (such as countries covered by the ASEAN Taxonomy including Malaysia and Singapore), the value of improving lower-scoring companies even if they do not end up becoming green may translate into higher returns for investors. What our research shows is that in these cases, there may be higher returns available through Shariah compliant screening of lower ESG-scoring companies to improve returns during the process of engagement to improve ESG characteristics.

Recognizing these nuances in ESG screening rules and taxonomies can help responsible investors to improve their process by considering Shariah screening. By taking a more active approach to pursue potentially riskier companies with lower ESG scores, Islamic investors can take advantage of the prudent characteristics of the Shariah screening process and engage with companies. The Shariah screens will help to increase the margin of safety against adverse realized ESG risks while the engagement can reduce their prevalence and significance.

As ESG data standards improve comparability across different types of data and narrow differing requirements across different markets, aggregate scores between companies may provide more forward-looking information about potential risks and returns. Until then, there is value to be had in looking at empirical data to understand how to link ESG and Shariah screens and engagement together, and to find new opportunities beyond the ones discussed above.

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