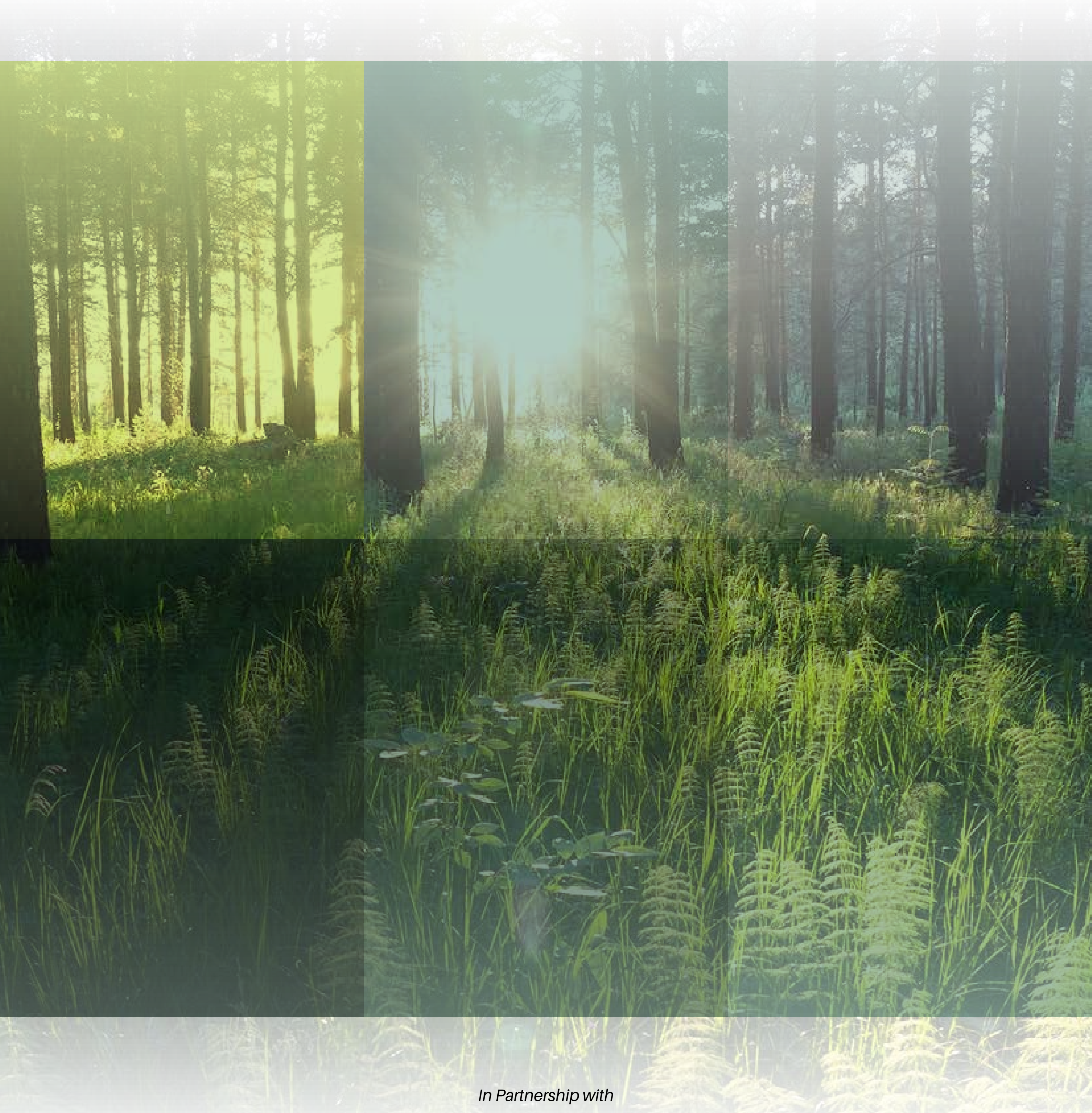
IFN ISLAMIC SUSTAINABLE INVESTING THOUGHT LEADERSHIP REPORT



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at Fitch Ratings, about US$5.5 billion were raised through sustainability-linked Sukuk in 2020; this figure has been superseded in the first three quarters of 2021 alone, with almost US$7 billion already raised.

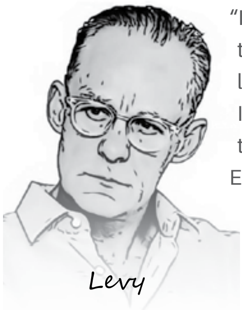
"If I look at how much was issued since 2017, it is less than US$20 billion, which is small compared to the size of the global Sukuk market which is around US$800 billion currently. So, in terms of actual size, the sustainable Sukuk market is still tiny," Bashar explained, adding that over 10% of Fitch's 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.

Bashar

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.

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 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.

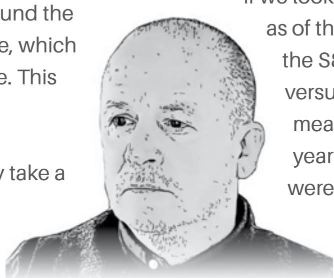
"The commercial necessity of doing so isn't quite clear enough," Dr Levy highlighted. "If [issuers] can tap into the markets the way they have always done and take a very conservative and traditional approach, why do they need to do this? And there isn't yet a commercial imperative in the same way there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

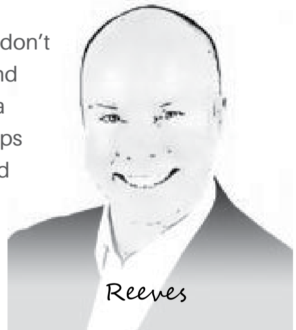
Making it worthwhile

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.


Haines

"(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.


Reeves

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.


Orzano

"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.

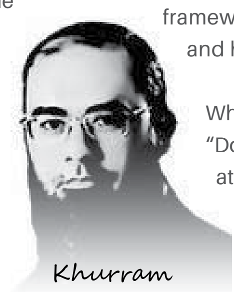
The Islamic Finance Council UK expects US$30-50 billion in capital for green and sustainability Sukuk up to 2025.

"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.

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."

The rise of green and sustainable Sukuk and the road ahead

By Bashar Al-Natoor, the global head of Islamic finance, Fitch Ratings.

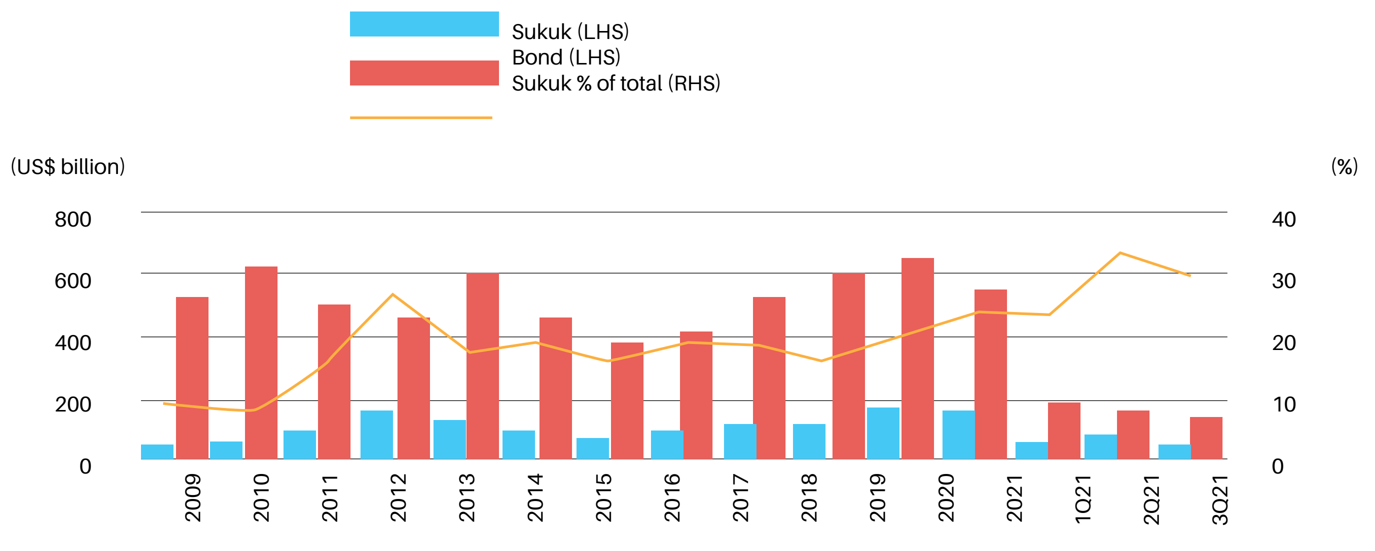
Authored by

FitchRatings

The link between the world of ethical finance and Islamic finance is strong. In fact, the origins of the modern Islamic finance industry, which started off in the 1970s, are very similar to the ethical finance principles of not being solely focused on bottom-line profits and instead focusing on doing what is good for society and avoiding practices that are considered harmful. Investments must avoid providing income from alcohol, tobacco, gambling, pornography, prostitution and illegal arms trading, among others.

It is in this spirit that the global Islamic finance industry has been venturing into the world of environmental, social and governance (ESG)-linked products with innovative and diverse issuances like green, sustainable and transition Sukuk over the last few years.

Chart 1: Sukuk and conventional bond issuance in key Islamic finance jurisdictions



Sources: Fitch Ratings, Bloomberg

Government support has also been witnessed among a number of key Islamic countries. While Islamic finance is a growing subsegment, more can be done to better align it with the ESG world. Tools from Islamic economics such as Zakat, Sadaqah and Waqf could also be utilized to promote financial inclusion, sustainability and positive impact.

The global Sukuk landscape

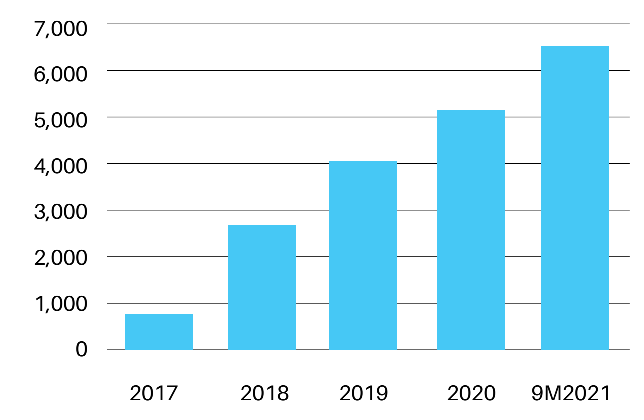
Islamic finance is systemically important in many jurisdictions and growing in the wider regions of the Middle East, Asia and Africa. Sukuk remain an important funding tool, with the share of Sukuk issuance in the total funding mix for key Islamic finance jurisdictions reaching 30% in the third quarter of 2021 (Q321) (2020: 23.6%). Global outstanding Sukuk volumes reached US$775.4 billion in Q321.

Key drivers of green and sustainability Sukuk

More than US$19 billion-worth of green and sustainable (GS) Sukuk have been issued since the market's inception in 2017. GS Sukuk issuance is driven by sovereigns and multilateral development banks in key Islamic finance jurisdictions. This is because various OIC countries are signatories to the 2015 Paris Agreement on climate change, and have adopted the UN Sustainable Development Goals (SDGs) and set net-zero emission targets. These issuers require sizable funding to meet targets and to finance COVID-19 relief measures, part of which could be funded through GS Sukuk. Corporates have also issued GS Sukuk to diversify their funding.

Issuers have also been opportunistic in leveraging the spike in global investor appetite for green, sustainable and social bonds, of which more than US$790 billion were issued in the first nine months of 2021, a 145% increase from 2019. Many GS Sukuk were oversubscribed multiple times over in the past three years, with sizable interest from US, Asian and European investors. We expect that more first-time issuers are likely to enter the GS Sukuk market in the short to medium term.

Chart 2: Green and sustainability Sukuk issuance by year (US$ million)



Sources: Fitch Ratings, Bloomberg

Sukuk, rather than conventional bonds, were the preferred format for GS instruments in key Islamic finance countries. This is indicated by Sukuk accounting for more than 60% of the outstanding GS securities in the top 10 Islamic finance countries in the first half of 2021. This is driven by issuers' need to attract the sizable Islamic investor base in these countries who can only invest in Shariah compliant securities. In the ASEAN region, green Sukuk represented 19% of green financing instruments in 2020, based on research from Climate Bonds Initiative.

Issuers' concern for ESG issues is also driven by regulatory requirements, along with rising pressures from customers and employees, according to the HSBC MENAT report titled 'Sustainable financing and investing survey 2021'. According to the report, around 63% of Middle East, North Africa and Turkey (MENAT) issuers expect their company to actively seek advice on green, social or sustainability issues in relation to capital market transactions in the next 12 months.

Investors' interest is being driven by their recognition that paying attention to ESG issues can improve returns and reduce risk, along with meeting regulatory demands. Consequently, investors are increasingly incorporating ESG considerations into their corporate and investment strategies. The HSBC report also said around 19% of MENAT investors have a firm-wide policy on responsible investing or ESG issues.

Key market developments

Countries such as Malaysia, Indonesia and the UAE are the most active out of the top 10 key Islamic finance markets.

In 2017, the world's first green Sukuk facility was issued in Malaysia by Tadau Energy. In 2021, Malaysia issued the world's first US dollar sustainability Sukuk issued by a sovereign. The country issued the Sustainable and Responsible Investment (SRI) Sukuk Framework in 2014, and SRI Sukuk issuers in the country are granted cost and tax incentives under the SRI Sukuk and Bond Grant Scheme, which was expanded in 2021. Supported by it, the country houses the largest number of active GS Sukuk at 156 issues in September 2021, out of a total of 172 GS Sukuk globally.

In 2017, Bank Negara Malaysia launched the Value-based Intermediation initiative, a Shariah equivalent of sustainable and impact financing, with many Malaysian Islamic banks committing to integrating its principles into their own core practices. In 2018, HSBC Amanah, the Malaysian Islamic banking arm of HSBC Holdings, issued the world's first UN SDGs Sukuk, raising RM500 million (US$120.63 million).

Indonesia issued the first sovereign green Sukuk in the world in 2018, and is a regular issuer with issues in 2019, 2020 and 2021, raising a total of US$3.5 billion to date. Indonesia also launched its Green Bond and Green Sukuk Framework in 2018.

The UAE is also increasingly active in the SRI space. In 2019, Majid Al Futtaim issued the GCC region's first green Sukuk. In 2020, the first transition Sukuk facility was issued by Etihad Airways. The UAE launched its Sustainable Finance Framework in 2021. Dubai Financial Market, Dubai's stock exchange, had also updated its Shariah standards to cover green Sukuk.

In 2020, Saudi Arabia-based IsDB issued the world's first sustainability Sukuk to support responses to COVID-19 in its member countries, and followed it up with another issue in 2021. Saudi Arabia's Public Investment Fund and National Debt Management Center have also announced plans to issue green Sukuk.

In 2021, the world's first sustainability Tier 2 Sukuk facility was issued out of Turkey by Kuveyt Turk Katilim Bankasi. In 2021, Bangladesh's first green Sukuk facility was issued by Bangladesh Export Import Company or BEXIMCO, and the government issued a circular that allowed banks to invest in private sector-issued green Sukuk.

Key challenges for GS Sukuk

While GS Sukuk are experiencing notable growth in key Islamic jurisdictions, they are still nascent products equaling 2.4% of the total Sukuk market. To ignite growth for GS Sukuk and bonds, especially in the GCC region, government support, attractive incentives and infrastructure are required.

Key challenges impeding GS Sukuk's growth potential include the still-evolving market infrastructure, regulations and ecosystem for GS financing and projects in most OIC countries.

Issuance is also constrained by the lack of regulatory and/or tax incentives for GS Sukuk and bond issuers and investors in most OIC countries. While Sukuk issuance is often linked to an underlying pool of assets which can support GS securities, issuance is often still constrained by the lack of available and appropriately-sized GS assets which can enable Sukuk issuance, especially for non-sovereign issuers.

Lack of standardization of Sukuk is also a key challenge as the time spent drafting green Sukuk structures and frameworks that are acceptable to governments, investors and the Sukuk's Shariah boards can mean substantially longer time to market, leading to higher costs, at least until a standardized framework is established.

This is in addition to the lack of standardization around GS bonds as the market norms and standards for GS products are also still evolving, again reflecting the market's nascent status. It is essentially a self-regulated market although various voluntary guidelines exist, like the Green Bond Principles supported by the International Capital Market Association or the Climate Bonds Initiative.

According to the HSBC MENAT report, an ESG skills gap is also a challenge as investors in a number of OIC countries face a shortage of expertise and qualified staff which limits their ability to pursue ESG investing more broadly. The report also noted that environment and social performance disclosures by companies remain inadequate in a number of OIC countries, while some investors reported a lack of demand among their clients.

Conclusion

The GS Sukuk market has exhibited promising growth to date, with this trend likely to continue at least in the medium term. Islamic finance seems to be a logical area where GS Sukuk could flourish as Sukuk issuance is confined to a pool of assets, which by nature makes it easy to focus only on GS assets. Indeed, OIC countries have a clear potential to engage further with this growing market. Nevertheless, the segment faces significant challenges, and achieving a large, sustainable and established GS Sukuk market still seems to be a long way down the road.

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We cover more Islamic finance-based issuers than any other international credit ratings agency, as well as over 150 outstanding Islamic finance instruments worldwide. Fitch produces in-depth analysis, ratings and research with a dedicated Sukuk rating criteria, as well as ESG considerations for Islamic finance ratings. We also incorporate Takaful-specific considerations within our global insurance rating criteria.

Fitch has rated a number of sustainability-linked Sukuk including Etihad Airways PJSC’s Unity 1 Sukuk Limited and Kuveyt Turk Katilim Bankasi A.S.’s Fixed Rate Resettable Sustainability Tier 2 Sukuk.

For more news and analysis, please visit Fitch’s dedicated Islamic finance website at:

https://www.fitchratings.com/site/islamicfinance

Kuveyt Turk's Sukuk: Landmark sustainability issuance

Kuveyt Turk Katilim Bankasi, a leading Turkish Islamic bank majority-owned by Kuwait Finance House, has issued what is said to be the world's first regulatory capital Tier 2 environmental, social and governance (ESG) Sukuk paper, which will support its Sustainable Finance Framework.

The fixed-rate resettable sustainability trust certificates facility issued by KT21 T2 Company, the bank's SPV, was oversubscribed 12 times, receiving an orderbook of US$4 billion.

"The issuance also achieved the tightest pricing for any Tier 2 issuance out of Turkey since 2017, at 6.125%, reflecting strong fundamentals and positive market sentiments," a statement read. Proceeds from the landmark issuance will be used to finance or refinance eligible green and social projects by the bank.

"We are honored to be in the market with the first-ever sustainable Tier 2 Sukuk issuance globally. Our management philosophy is governed by sustainability which is also very much in line with principles of Islamic finance. We are very happy to be issuing a Sukuk intended to preserve nature, not exhaust it," noted Ufuk Uyan, CEO of Kuveyt Turk.

Rizwan Kanji, a partner at Akin Gump Strass Hauer & Feld, which acted as the legal advisor to the issuance, added: "This is a ground-breaking transaction which complies with multiple facets including ESG and sustainability, Basel III regulatory capital and principles of Islamic finance. We are delighted to have assisted Kuveyt Turk on yet another first-of-its-kind issuance."

Kuveyt Turk regularly issues Islamic lease certificates, but its last foray into the international Sukuk market was a US$500 million Sukuk Wakalah paper issued in 2016 that was oversubscribed four times.

Kuveyt Turk's Sukuk

US$350 million

16th September 2021

Trustee	KT21 T2 Company
Obligor	Kuveyt Turk Katilim Bankasi
Type	Fixed rate resettable sustainability Tier 2 certificates
Structure	Wakalah/Murabahah
Purpose of issuance	To finance and/or refinance eligible green and/or social projects
Tenor	10 years
Profit rate	6.13%
Maturity date	September 2031
Periodic distribution dates	Every 16th June and 16th December commencing on the 16th December 2021
Joint bookrunners	Bank ABC; Citi; Dubai Islamic Bank; Emirates NBD Capital; KFH Capital; HSBC
Legal advisor	Akin Gump Strauss Hauer & Feld
Listing	Irish Stock Exchange
Governing law	Turkish law
Rating	Final long-term rating of 'B'/'RR5' by Fitch Ratings

Etihad Airways's Sukuk: A gradual switch to green

The UAE's national airlines and Abu Dhabi-owned Eithad Airways has issued a US dollar-denominated Sukuk facility worth US$600 million, touted as the world's first 'transition' Sukuk and also the first sustainability-linked financing in the global aviation industry, structured under a transition finance framework.

Proceeds from the issuance will be used by Etihad to raise capital focused on gradually switching to greener, more environmentally sustainable operations. The carrier plans to use more fuel-efficient planes and eliminate single-use plastic, aiming to cut its 2019 carbon emissions level by 50% by 2035 and achieve net zero carbon emissions by 2050.

"This follows the first aviation financing linked to the United Nations Sustainable Development Goals raised in December 2019, further confirming Etihad's role as an industry leader in sustainable finance," the company said.

Sustainability and responsible climate action are the most significant challenges facing the aviation industry

Transition bonds or Sukuk are typically targeted at industries with high greenhouse gas emissions, including aviation, energy, shipping and steel and cement manufacturing. "Sustainability and responsible climate action are the most significant challenges facing the aviation industry," Adam Boukadida, CFO of Etihad Aviation Group, said, adding: "By issuing a sustainability-linked Sukuk, Etihad is voluntarily adding to its existing commitments under CORSIA, and also committing to reduce carbon emissions intensity by over 20% from the 2017 baseline."

Etihad will be conducting research and development into sustainable aviation fuel, and has committed to paying a penalty in the form of carbon offsets should it fail to meet its short-term target of reducing the carbon intensity of its passenger fleet.

HSBC, which acted as the joint global coordinator with Standard Chartered, was also the joint sustainability structuring agent on the deal, which comes only weeks after the bank had announced an ambitious strategy to help drive the transition to a net zero economy.

"Many industries, including airlines, need to undertake complex and gradual transformations to reduce their carbon emissions, and the financial sector has a responsibility to help them," Ali Taufeeq, the director of HSBC's Middle East Debt Capital Markets division, said.

Etihad Airways last issued Sukuk in 2016 — a US$1.5 billion facility maturing on the 30th November 2021. The successful issuance of the transition Sukuk has secured US$300 million in early repayment for the company's outstanding facility.

Etihad Airways's Sukuk

US$600 million

الاتحاد
ETIHAD
AVIATION GROUP

29th October 2020

Issuer	Etihad Airways
Mode of issue	Private
Tenor	Five years
Currency	US dollar
Joint global coordinators/ joint sustainability structuring agents	HSBC, Standard Chartered
Joint lead managers and bookrunners	Abu Dhabi Islamic Bank, Dubai Islamic Bank, Emirates NBD Capital, First Abu Dhabi Bank, HSBC, Standard Chartered
Joint lead manager	Abu Dhabi Commercial Bank
Financial advisor	Mashreq Bank
Rating	Rated 'A' by Fitch Ratings (published 9th November 2020)