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at Fitch Ratings, about US$5.5 billion were raised through sustainability-linked Sukuk in 2020; this figure has been superseded in the first three quarters of 2021 alone, with almost US$7 billion already raised.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

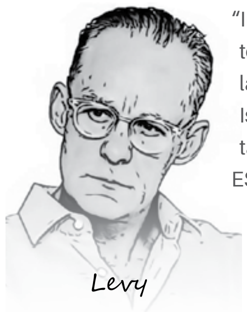
Bashar

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.



Levy

"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.

Farmida

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."

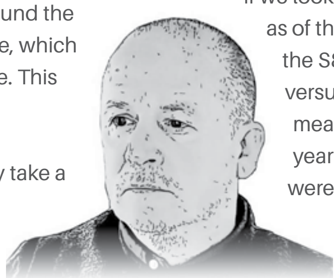
Professor Kevin Haines, Bedford Row Capital's head of social policy, echoes his colleague's sentiments: "There is an issue at the moment for Islamic finance about talking the kinds of language that is increasingly acceptable to investors. Investors are now expecting issuers to be conversant with these 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."

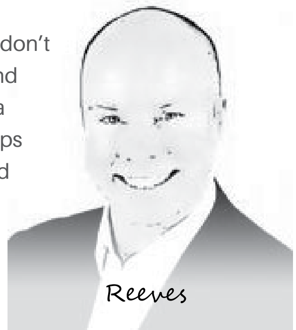
Making it worthwhile

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.


Haines


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.

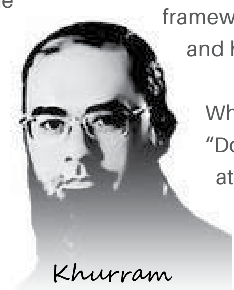
"It has been suggested that we need about US$7 trillion in infrastructure investment annually and between US$1.5 trillion to US$4 trillion every year for energy transition to meet the Paris [Agreement] targets; and with the commitments of the Glasgow Climate Pact, I'm sure

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."

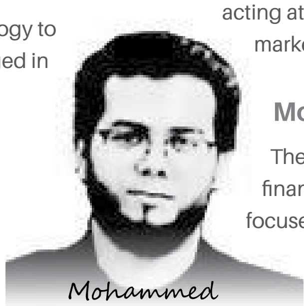
When it comes to regulations and policies, Dr Scott's advice is: "Don't be afraid of regulation – that's the first step. Look internally at your internal processes, have a brief read of the UN SDGs and understand where you fit into the things that the world is talking about at the moment."

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.



Mohammed

"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."

Sustainable finance: New markets for Islamic finance

Authored by NORTON ROSE FULBRIGHT

The opportunity

The combination of global crises from climate change to the COVID-19 pandemic, combined with a new political urgency reflected at COP26 [2021 United Nations Climate Change Conference] in Glasgow and increased investor willingness to fund impact-based products, provides a unique opportunity for Islamic finance to reconsider its purpose and to tap into much larger global flows of money than can be provided by its traditional investor base. Islamic finance has always had sustainability embedded in its core ethical principles, although this is not yet recognized by many conventional investors. The conventional market's increasing focus on finding investments that promote sustainability provides an unprecedented opportunity for Islamic finance to enter the mainstream and attract investment from a wider pool of investors.

COP26 highlighted both the climate challenge facing the world and the vital role that finance must play if the poorest countries are to make the necessary adaptations to live with higher temperatures and to achieve sustainable development. The COVID-19 crisis also highlighted global inequalities and slowed the progress of achieving the UN Sustainable Development Goals (SDGs) adopted by the UN in September 2015 as part of the 2030 Agenda for Sustainable Development. These twin emergencies of climate change and COVID-19 have galvanized the financial markets so that environmental, social and governance (ESG) is no longer a niche market but a core investment focus for many financial institutions. On the 3rd November 2021, at COP26, UN Special Envoy Mark Carney announced the Glasgow Financial Alliance for Net Zero of 450 financial firms across 45 countries, which have stated their intention to align not only their own businesses but also their lending and investment criteria to achieving net zero, harnessing up to US$130 trillion of assets to plug the US$150 trillion funding gap needed to mitigate the worst effects of climate change. Financial institutions are also increasingly using the SDGs as the basis of their reporting. As of April 2021, 220 banks are signatories to the UN Principles of Responsible Banking, which require the signatories to produce SDG-aligned reporting. This is a helpful development because the UN has estimated that the pandemic-related downturn has pushed between 119 and 124 million more people into extreme poverty and many of them live in the 57 countries which are members of the OIC which collectively represent 1.82 billion people, and where Shariah compliant solutions would be welcome.

The market

The market potential can be easily assessed when examining the public capital markets and comparing green bonds with green Sukuk. The global Sukuk market has grown from an estimated US$85 billion of Sukuk issuances in 2016 to an estimated US$172 billion in 2020. Green Sukuk issuances also increased from US$500 million in 2017 to US$3.5 billion in 2019. The market was affected by the pandemic with only US$6.1 billion of Sukuk issuances from January–July 2020, but has recovered in 2021, with notable issuances such as the IsDB raising US$2.5 billion in March 2021 through its sustainability Sukuk and the Republic of Indonesia issuing US$750 million of green Sukuk.

However, this is tiny compared with the conventional green bond market. Between 2007 and 2020, green-linked bonds raised over US$1 trillion of capital. After the first green bond in 2007 (the EUR600 million (US$676.85 million) issuance by the European Investment Bank), the market began to grow, and the Paris Agreement at COP21 [2015 United Nations Climate Change Conference] was a key driver in the further expansion of the market, with an annual average growth in the green bond market of 60% since 2015. It is likely that COP26 will result in the green bond market growing even faster.

The World Bank reported that 17 green Sukuk had been issued as of July 2020. The first green Sukuk facility was issued in Malaysia by Tadau Energy in 2017 and the Republic of Indonesia issued the world's first sovereign green Sukuk in March 2018, raising US$1.25 billion. The majority of green Sukuk issued have used the Murabahah and Wakalah structures (eight issuances, all by issuers in Malaysia), with the second-most popular structure being Wakalah Istithmar which was used for four issuances — three by Indonesian issuers and one by a Malaysian issuer. Although the majority of issuances so far have been from Malaysia or Indonesia, there is huge potential for issuers based in other jurisdictions, such as the UAE, Saudi Arabia, Turkey or Pakistan, to also tap into this market. Energy targets have been announced by Middle Eastern governments, such as the UAE Energy Strategy 2050 and Saudi Vision 2030, which will require significant investment that the green bond and Sukuk market will be well placed to fund.

The last year has seen unprecedented demand from investors for sustainability-linked vehicles, and Bloomberg predicts that assets under management invested globally in sustainability funds and portfolios could reach US$53 trillion by 2025, accounting for more than one-third of a projected total of US$140.5 trillion. Green and sustainable Sukuk could appeal to core Islamic investors in the region as well as a wider pool of international ESG investors. Market conditions are therefore ideal for this investor demand to be harnessed by Islamic finance. The Islamic Finance Council UK estimates that an additional US$30–50 billion of capital could be raised by 2025 through green and sustainability Sukuk.

The regulatory framework

The green Sukuk issuances that have taken place have been underpinned by existing global standards such as the Green Bond Principles issued by the International Capital Markets Association (ICMA) and aligned with a local framework established by the issuer, addressing the intended use of proceeds, the process for project selection, managing the proceeds raised (including segregating the funds received) and ongoing reporting. Typically, an independent second opinion to verify the sustainability of the issuance from a third party, such as the Center for International Climate and Environmental Research-Oslo, is also required. These are all steps that Sukuk issuers are familiar with, from selecting suitable projects or assets (although note that from the Green Bond Principles perspective, it is the use of the proceeds which is key rather than the nature of the asset itself, unlike Islamic finance where the asset underlying the transaction structure is important in determining Shariah compliance) to segregating proceeds to obtaining a Fatwa from a Shariah scholar in order to confirm Shariah compliance.

The EU implemented the Sustainable Finance Disclosure Regulation (SFDR) in March 2021, which sets out specific rules for how and what sustainability-related information financial market participants need to disclose. This additional disclosure will be significant, but as additional milestones for SFDR are met throughout 2022 and 2023, this could create a benchmark for other financial institutions, and Islamic issuers wishing to attract investment from European investors may need to align themselves to the requirements of SFDR.

If issuers want to attract investment from the wider market, in addition to implementing green Sukuk frameworks, they will also need to engage with ESG ratings criteria. Companies that currently provide ESG ratings include Bloomberg ESG Data Services and Dow Jones Sustainability Index. ESG ratings are designed to measure and assess a company's exposure to ESG risks and evaluate its performance in managing those risks relative to its peers. There is currently no specific industry standard for establishing an ESG rating, with each provider applying its own set of criteria to the evaluation process. It is worth noting that the lack of standardization in the Islamic finance market, which has often been viewed as a weakness, may in this case help prepare issuers for the uncertainty and lack of standardization in ESG ratings.

The products

In the conventional market, there are different types of products: green bonds, social bonds and sustainable bonds, which are bond instruments where the proceeds will be exclusively applied to eligible environmental and/or social projects; and sustainability-linked bonds, which are bond instruments where the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ESG objectives. Sukuk equivalents need to follow the ICMA principles for these products, in addition to any locally created frameworks such as the Republic of Indonesia's Green Bond and Green Sukuk Framework, the Sustainable & Responsible Investment Sukuk Framework issued by Malaysia's Securities Commission or the Sustainable Finance Framework introduced by the IsDB, as well as the usual Shariah principles that apply to all Sukuk issuances, creating a number of additional processes that potential issuers will need to satisfy when compared with a conventional bond issue. A pricing premium from the market or potential tax benefits are needed in order to incentivize issuers to go through these additional steps, but the increased focus from both investors and governments suggest these may be forthcoming in the near future.

The purpose of Islamic finance

A fundamental principle of Islamic finance is that investment should have a social and ethical benefit to wider society, and not focus purely on a financial return. The Maqasid Shariah, the objectives or purposes behind Islamic law (including Islamic finance), also include as

necessities the protection of life, lineage and intellect. There is therefore a natural alignment between the principles of Islamic finance and the SDGs, both in prohibitions and mandates. Prohibitions on activities that cause harm to society can be linked to SDG8 (Decent Work and Economic Growth), SDG12 (Responsible Consumption and Production) and SDG13 (Climate Action), and the benefits to society mandated for Islamic finance can be linked to many of the SDGS including SDG3 (Good Health and Well-Being), SDG4 (Quality Education), SDG6 (Clean Water and Sanitation), SDG7 (Affordable and Clean Energy) and SDG11 (Sustainable Cities and Communities).

There is already discussion in the global Islamic finance community about the benefit of shifting the focus of Islamic finance from the strictly legal requirements of Halal (permissible and lawful) to the broader ethical concept of Tayyib (pure and wholesome), which is more in line with the goals of the Maqasid Shariah. This is the moment for Islamic finance to use the SDGs to create a sustainability philosophy for Islamic finance that is easily understood and accepted by the wider markets and also answers concerns that Islamic finance is currently overly focused on formalistic compliance with Shariah principles. This will require a coordinated and consistent approach from national regulatory bodies and international bodies such as AAOIFI and possibly an increased awareness among Shariah scholars generally of the sustainability principles that are necessary in order for a Sukuk facility to appeal to the broadest range of investors, so that any negative impacts of the use of funds can be identified as part of the Shariah review and possible remediation steps identified.

There is nothing in the ICMA Green, Social, Sustainable Bond or Sustainability-Linked Bond Principles that is inconsistent with Islamic finance. There have already been green and social Sukuk issued by major Islamic issuers such as the governments of Indonesia and Malaysia and the IsDB, and the Saudi Electricity Company issued US$1.3 billion-worth of green Sukuk in September 2020 pursuant to its green Sukuk framework, with a second-party opinion on the sustainability credentials provided by Vigeo EIRIS.

Conclusion

Islamic finance, with its ethical underpinning in the Maqasid Shariah, has a significant head start on conventional finance in aligning itself to ethical standards such as the UN SDGs, although it has not yet capitalized on this advantage. Issuers such as the governments of Indonesia and Malaysia and the IsDB have produced green Sukuk frameworks and issued green Sukuk in the market with success, demonstrating that the technical requirements can be satisfied by other issuers wishing to engage the wider market. Perhaps the most important aspect of this engagement will be in communicating the congruence of the ethical dimension of Islamic finance with broader sustainable finance, which can be done through explicitly linking the ethical dimension of Islamic finance with widely recognized standards such as the UN SDGs, and engaging with other market standards such as ESG ratings by external organizations.

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