IFN ISLAMIC SUSTAINABLE INVESTING THOUGHT LEADERSHIP REPORT

In Partnership with

BURSA MALAYSIA

www.islamicfinancenews.com

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.

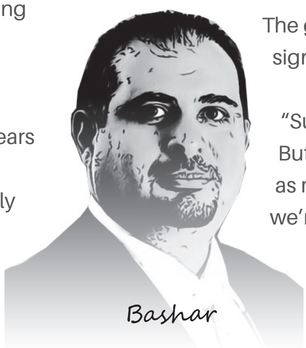
Slow and steady

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at Fitch Ratings, about US$5.5 billion were raised through sustainability-linked Sukuk in 2020; this figure has been superseded in the first three quarters of 2021 alone, with almost US$7 billion already raised.

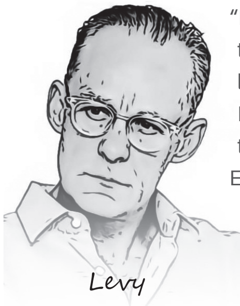
"If I look at how much was issued since 2017, it is less than US$20 billion, which is small compared to the size of the global Sukuk market which is around US$800 billion currently. So, in terms of actual size, the sustainable Sukuk market is still tiny," Bashar explained, adding that over 10% of Fitch's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

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.

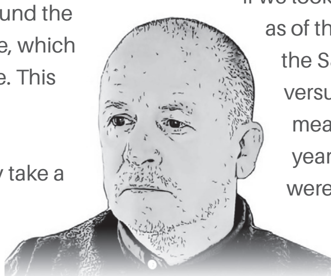
"The commercial necessity of doing so isn't quite clear enough," Dr Levy highlighted. "If [issuers] can tap into the markets the way they have always done and take a very conservative and traditional approach, why do they need to do this? And there isn't yet a commercial imperative in the same way there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

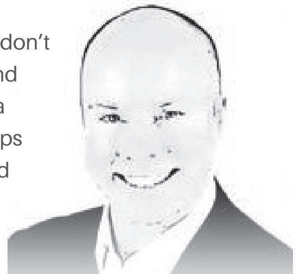
Making it worthwhile

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.

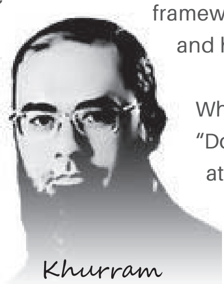
"It has been suggested that we need about US$7 trillion in infrastructure investment annually and between US$1.5 trillion to US$4 trillion every year for energy transition to meet the Paris [Agreement] targets; and with the commitments of the Glasgow Climate Pact, I'm sure

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."

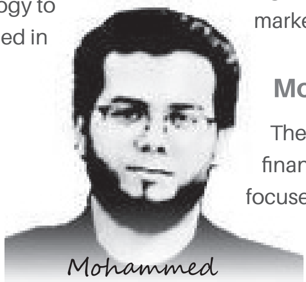
When it comes to regulations and policies, Dr Scott's advice is: "Don't be afraid of regulation – that's the first step. Look internally at your internal processes, have a brief read of the UN SDGs and understand where you fit into the things that the world is talking about at the moment."

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."

Authored by

How have you articulated and implemented a sustainability strategy at Bursa Malaysia? Who are the key stakeholders and what factors are critical for success for such an exercise?

The aim of assimilating sustainability into our organization as well as the marketplace was in line with the aspiration to establish Bursa Malaysia as the preferred marketplace for sustainable and responsible investment.

Following a thorough analysis of the materiality assessment exercise and consultation with key internal and external stakeholders, Bursa Malaysia had formulated the Sustainability Roadmap 2021–2023 in 2020. The roadmap is underpinned by five priority areas and 25 key strategies, which aims to integrate sustainability into our core operations and the wider ecosystem.

Stakeholder feedback was essential in formulating a robust and effective strategy. It aids in the identification of strategies that address our stakeholders' needs and concerns. Recognizing their significance, we conducted an annual materiality survey to collect feedback from our stakeholders on issues they consider to be important.

Stakeholders are categorized into nine key groups, namely Public Listed Companies (PLCs) or potential PLCs, Investors, Intermediaries, Regulators and Government Agencies, Employees, Shareholder and Analysts, Industry Associations, Professional Bodies and Industry Experts, Vendors and Suppliers, and Community Groups.

We believe the success of implementation of our sustainability strategy necessitated a holistic approach. Therefore, we have ensured that each strategy in the Roadmap is supported by an implementation plan with clear division of responsibilities across our functional units, enabling sufficient focus and allocation of resources.

Aside from the Sustainability Roadmap, we have a Sustainability Policy, which outlines our sustainability commitments and provide guidance on how to operate our business responsibly. The commitments are characterized by the following three pillars which help emphasize our behavior and conduct across our operations:

- Economic/Market
- Environment; and
- Social.

What key themes and objectives form the cornerstones of Bursa Malaysia's sustainability strategy?

Bursa Malaysia's 2021–2023 Sustainability Roadmap is built around three core pillars namely Marketplace, Internal and Community with five priority areas, as outlined below:

i) **Marketplace**
   a) Priority Area 1: Strengthening our core by building capacities of market participants to support a vibrant and sustainable capital market.
   b) Priority Area 2: Driving our growth. We aim to enhance a sustainable finance ecosystem through new investment products and high standards of sustainability practices and disclosures.

ii) **Internal**
   a) Priority Area 3: Protecting our Environment by reducing our environmental footprint and managing climate-related risks as we transition toward a low carbon future.
   b) Priority Area 4: Empowering our workforce. We aim to cultivate an empowered workforce to develop more sustainable approaches.

iii) **Community**
   a) Priority Area 5: Advancing our communities by creating a positive impact for society and demonstrate commitment to support social issues that are aligned with our community focus areas.

As an Exchange, we want to facilitate a sustainable capital market and assist the nation's transition toward a low-carbon future. This is aligned with our vision to be ASEAN's leading, sustainable and globally connected marketplace.

In addition to the five priority areas, we also developed a Thought Leadership Strategy to further galvanize our influencer role in the sustainability space.

The Thought Leadership Strategy is supported by a wide range of high-level content available on our BURSASUSTAIN platform. It includes a dedicated 'CEO's Thoughts' column where our CEO shares his views on various sustainability topics every month, and a video series 'CEO2CEO' in which our CEO engages in peer-to-peer conversation with other corporate CEOs about their approach and thoughts on sustainability.

Another important component of our Sustainability Strategy is our partnership with ecosystem players, the recent and strategic partnership being with the UN Global Compact Network Malaysia and Brunei, with whom we have developed the Corporate Sustainability Practitioner (CSP) Competency Framework.

The CSP Competency Framework is designed to help guide sustainability practitioners and support their work in transitioning their organization toward sustainable business models. Through this competency framework, corporate sustainability practitioners in Malaysia will be able to gain credentials and learn how to be the change agents for responsible and profitable business. Further, the CSP Competency Framework is also accompanied by a digital self-assessment tool to support practitioners to upskill and reskill on corporate sustainability.

With initiatives such as Bank Negara Malaysia (BNM)'s important Values-Based Intermediation (VBI) well established and understood, does Malaysia enjoy an inherent competitive advantage in the area of Islamic sustainable investment? Is it simply a case of building on these existing initiatives?

Since the adoption of VBI by Malaysian Islamic banks in 2017 and more recently by Takaful operators, BNM has observed positive momentum for the Islamic banking industry, intermediating around US$38.6 billion (RM161 billion)-worth of VBI-related transactions as of December 2020.[1] According to the Finance Minister, Tengku Datuk Seri Zafrul Tengku Abdul Aziz, the implementation of VBI reflects the industry's efforts to produce a positive and sustainable impact.[2]

VBI aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate a positive and sustainable impact to the economy, environment, as well as the community, and is consistent with the shareholders' long-term interests such as sustainable returns. Additionally, it aims to achieve the economy, society and environmental goals, all within the Maqasid Shariah, with Shariah outcomes including justice, wealth protection and wealth circulation, among others.

VBI is primarily based on intermediation in Islamic banking, while sustainable and responsible investment (SRI) is concerned with intermediation in capital markets. While values under VBI are derived from the Maqasid Shariah, the values under SRI, on the other hand, are derived from pure economic, social and environmental frameworks, and may be Shariah compliant.

VBI realigns Islamic banking toward 'substance over form' based on the Maqasid Shariah, whereas SRI realigns capital market activities also toward 'substance over form' but based on local and global sustainable strategy initiatives, such as the UN Sustainable Development Goals.

VBI and SRI share great similarities as both look beyond structures, contracts and agreements, and shift the focus toward the creation of impact. VBI and SRI could potentially leverage each other to create a comprehensive ecosystem that could positively impact the economy, society and the environment.

VBI is a game changer for Islamic finance as it pushes forward into proactive action toward sustainability and sets forth its ethical features, which are derived from the Maqasid Shariah with a strong resonance with the principles of Islamic finance, as well as an overlap with sustainable investment and environmental, social and governance (ESG).

Technological tools that enable substantial data recording, tracking and analysis have the ability to showcase VBI's positive influence in Islamic capital markets and will assist in its mainstream adoption.

---

[1] MalayMail (2021) Malaysia ranks first in Islamic finance development indicator 2021

[2] The Edge Markets (2021) IFDI 2021 recognition shows strength of Islamic finance in Malaysia

What role do you see Bursa Malaysia playing as a standard bearer for Islamic sustainable investment in Malaysia and the region? How important is this role in terms of encouraging issuers and investors to embrace a green and sustainable agenda?

Bursa Malaysia is home to the largest number of public listed companies in ASEAN, and one of the most vibrant and diverse marketplaces facilitating trade in both conventional and Islamic securities and derivatives.

Our crude palm oil futures serves as a global price benchmark for the commodity, while innovations such as its Bursa Suq Al-Sila' commodity Murabahah trading platform and Bursa Malaysia-i end-to-end Shariah compliant securities trading and investing platform are world's firsts in the Islamic capital market. These innovations offer unique value creation opportunities for its stakeholders and create strategic linkages to exchanges in key destinations.

Bursa Malaysia is delighted to be at the forefront of thought leadership in Islamic capital markets, with the largest portfolio of Islamic goods and services in ASEAN. Our expertise in providing Shariah compliant market-based solutions enables us to promote a better understanding of the value-based Shariah investment principles.

For instance, Bursa Malaysia-i, which offers faith-based investors a unique proposition and platform for Shariah compliant investing, positions the Exchange as a global marketplace for Shariah listing and investments.

As at the end of October 2021:

(i) 748 out of 948 listed companies on the Exchange, or 79%, are Shariah compliant;
(ii) Shariah market capitalization makes up 68% of the total market capitalization of RM1.8 trillion (US$424.42 billion), and
(iii) The average daily trading value of Shariah compliant securities makes up 79% of the overall average daily trading value of RM3.8 billion (US$895.99 million).

We also observe that our Shariah indices consistently outperformed their conventional counterparts over the last 10 years. For example, the FTSE Bursa Malaysia Hijrah Shariah Index, comprising the 30 largest Shariah compliant companies on the FTSE Bursa Malaysia EMAS Index, has surpassed the FTSE Bursa Malaysia KLCI and FTSE4Good Bursa Malaysia Index, growing about 24% between 2010 and October 2021. These facts serve to suggest that Shariah compliant investments are an attractive source of value for investors.

As sustainability and ESG considerations become more mainstream in the capital market and investment conversations around the globe, there is a growing number of investors that place greater emphasis on sustainable solutions.

As a leader in the Islamic finance landscape, the Malaysian Islamic capital market has taken the lead in promoting sustainability as well as the ESG proposition based on its shared values with Islamic finance.

We see ample scope to capitalize on the growing demand for asset diversification, SRI and ESG to expand the global reach of our innovative Shariah compliant product and service offerings. This

presents a strong growth opportunity for the Islamic capital market, due to the common principles between SRI, ESG and Shariah investing.

The convergence of SRI, ESG and Shariah plays a significant role in facilitating and delivering our unique proposition to further build our strength and competitive edge in the Islamic finance space. It has the potential to boost the expansion of sustainable and ESG investments across multiple Islamic finance asset classes, as well as the financial industry at large.

Additionally, the similarities between the ESG and the principles of Shariah open a wider choice for investors looking for opportunities in a broader socially responsible investment space. As a result, choosing investment activities anchored on Shariah and characterized by long-term socially responsible perspectives build greater stability and ensures the socioeconomic wellbeing of our nation. This will considerably broaden the appeal for Shariah investing.

ESG investing, much like Shariah investing, promotes responsible behavior and appeals to investors seeking products that advocate ethical investing, due to the selection criteria for the underlying investments.

At Bursa Malaysia, we play a crucial role in facilitating an enabling environment to unlock sustainable investments and improve access to SRI products and services. We are committed to advancing the sustainable finance agenda and adopted a multifaceted approach to create long-lasting positive impacts on the planet and society.

Bursa Malaysia is also driving the sustainability agenda, by encouraging the adoption and integration of SRI principles in the marketplace. PLCs are required to make sustainability-related disclosures in their annual reports as required by the Main Market and ACE Market Listing Requirements, and Bursa Malaysia supports their efforts to do so through our education and promotional programs.

Overall, sustainability within the Islamic proposition brings added advantages to the economy and society through the promotion of sustainable businesses and investment activities that entail positive results with stable prospects and the welfare of societies.

Sustainable and ESG investing is evolving quickly, particularly in terms of standards and taxonomies. As a capital market regulator, how do you factor in this dynamism and how do you help formalize the regulatory environment for market participants?

In the past few years, we have observed significant advancements across the international sustainability reporting ecosystem. Some of the most influential international sustainability reporting standard-setters have either issued, or are in the midst of making, revisions to their respective standards and/or frameworks (eg GRI, SASB, TCFD) — so this space is indeed highly dynamic.

The existence of distinct standards/frameworks is deemed problematic by a large number of market participants as each has its own set of requirements. The inevitable overlapping similarities as well as differences have led to much confusion and fragmentation — especially for preparers who are faced with the prospect of having to report using multiple standards that are both complex and costly.

Separately, there are increasing calls from key capital market stakeholders (eg institutional investors) to affect some degree of comparability or standardization of sustainability disclosures to facilitate benchmarking as well as decision-making.

Responding to the stakeholders' call, Bursa Malaysia is currently undertaking a major review of our Sustainability Reporting Framework to explore potential ways to enhance the availability, comparability as well as quality of certain sustainability-related disclosures. For instance, we intend to mandate the adoption or disclosure of certain sustainability-related themes and indicators.

What we mandate is also 'common' across the different international standards/frameworks in order to lessen our PLCs' overall reporting load, while simultaneously serving as a springboard for them to work toward full adherence of the said frameworks.

On the other hand, the enhancements would also cater to the evolving informational needs of our key capital market stakeholders. This is how we can give sustainability disclosures and practice more structure and 'formalize' them.

As for taxonomies, we view these favorably as they generally provide clarity, consistency and also transparency on what can be classified as being green or sustainable. Taxonomies encourage standardization and facilitates decision-making, and is a key enabler for scaling up and mainstreaming green or sustainable investments that mitigates potential market fragmentation. Bursa Malaysia actively contributes to the nation's taxonomy efforts and is currently involved in the development of the Securities Commission's SRI Taxonomy.

Are we (in Malaysia) in a position to be able to offer a range of financial services that satisfy both ESG and Shariah compliant investors?

The globally benchmarked F4GBM Index continues to play an important role in recognizing companies that demonstrate strong ESG practices and disclosures. It recognizes PLCs that have taken steps to improve their ESG practices and disclosures. Since its launch in 2014, the Exchange continuously engages with its stakeholders to see if there is interest or a need to incorporate more SRI elements in the ESG index that can better suit our local investment landscape.

In 2021, the number of F4GBM Index constituents rose to 76 (from 69 in 2019), with 54 out of the 75 (72%) constituents being Shariah compliant, prompting Bursa Malaysia to expand its ESG and Shariah Index portfolio by launching the FTSE4Good Bursa Malaysia Shariah Index (F4GBMS) in July 2021.

This new index comprises constituents that are Shariah compliant, based on the Securities Commission Malaysia's Shariah Advisory Council's screening methodology, and presently contains 54 PLCs.

In terms of index performance, the two ESG indices have outperformed our benchmark FBMKLCI. For the period of the 31st December 2014 to the 31st August 2021, the F4GBM Index outperformed FBMKLCI by 1.6%, while the F4GBMS outperformed FBMKLCI by 4%.

Recognizing the synergistic potential of Shariah compliance and sustainability, the Exchange has been leveraging its insights and pioneering Islamic programs to drive sustainability alongside its market-leading ESG initiatives and embed sustainability among listed issuers as well as within the Exchange itself. This has enabled the Exchange to effectively promote ESG and Shariah investing as complementary and has put us in a unique competitive position as demanded by global funds and investors, as SRI, ethical and Shariah investing continues to grow year on year.

Our end-to-end Shariah compliant securities trading and investing platform, Bursa Malaysia-i, showed a compound annual growth rate of a 33% increase since its launch in September 2016 to the end of October 2021. This is further testament to the growing demand for Shariah compliant financial solutions, driven by the shift toward value-based investing and heightened interest in Islamic capital market products and services by non-Muslim investors and SRI investors from around the world.

Moving forward, Bursa Malaysia aims to scale up its Shariah compliant offerings through product and service innovation to create greater alignment between Shariah investing and SRI, and broaden the product range across the Islamic wealth management solutions value chain. This is also expected to spur new market segments and attract greater domestic and international participation to accelerate the growth of Shariah compliant SRI. Bursa Malaysia will continue to drive thought leadership and advocacy to promote greater alignment between Shariah and SRI.

Ultimately, our goal is to build a vibrant ecosystem of SRI- and ESG-themed investment products that fulfill investors' needs and expectations. With this in mind, we will continually endeavor to provide a range of products and services catered to SRI. We also plan to expand our efforts to identify emerging sustainability-driven opportunities in our range of products and services to steer the capital market toward sustainable solutions and assets in the coming years.

BURSA MALAYSIA