

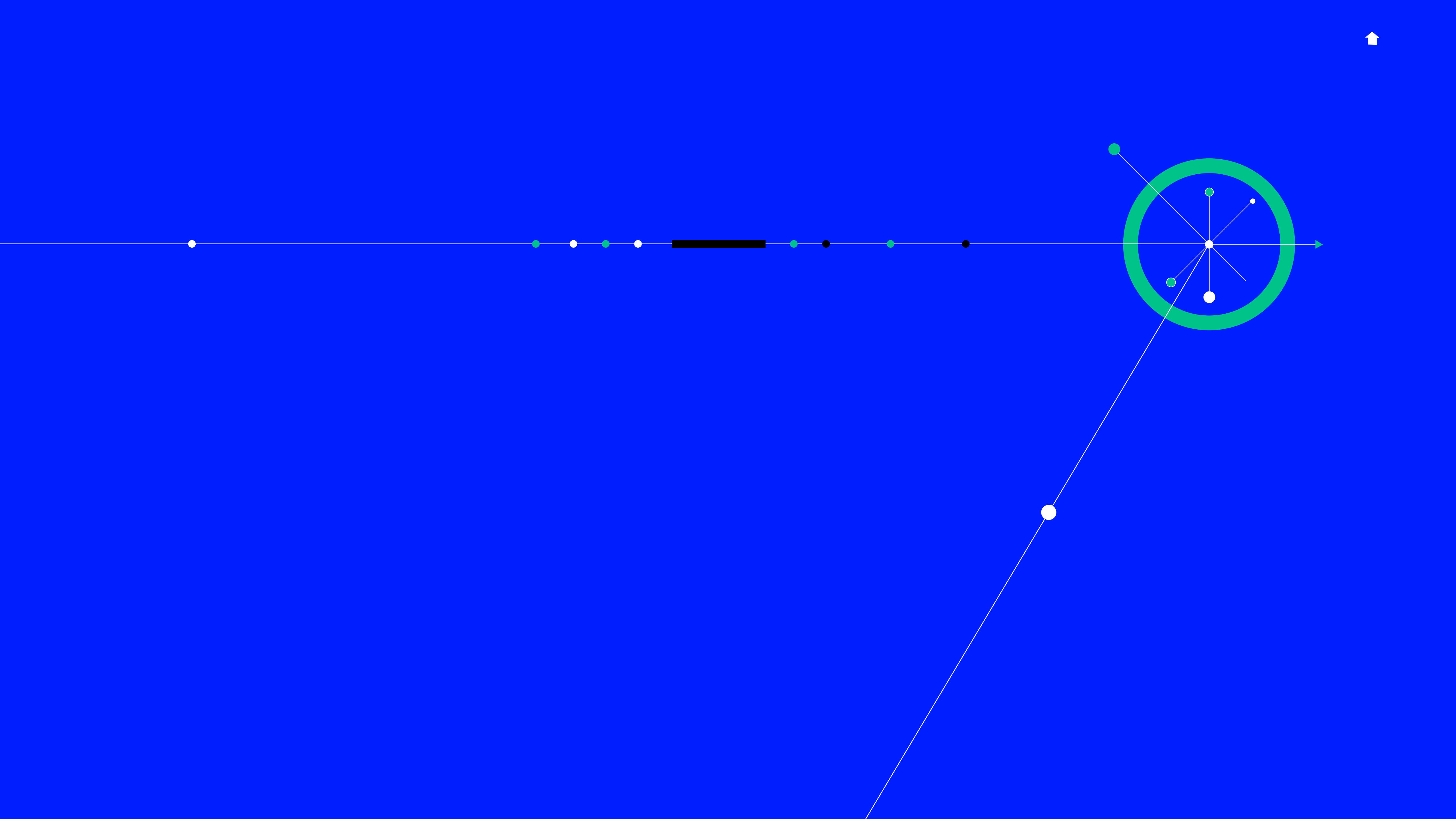
#GreenSukuk2022

## Green and sustainability sukuk report 2022

# FINANCING A SUSTAINABLE FUTURE

An LSEG Business





## London Stock Exchange

London Stock Exchange is a leader among international debt markets and the global sustainable finance ecosystem. It was the first exchange to set up a dedicated segment for green and sustainable bonds – the Sustainable Bond Market.

This segment included 340 active bonds worth \$142 billion, by the end of 2021. London Stock Exchange has hosted several high-profile debut green and sustainability bond issuances from China, India and the MENA region.

## UKIFC and GEFI

The Islamic Finance Council UK (UKIFC) is a leading not-for-profit body committed to promoting and enhancing the global Islamic and ethical finance industries. UKIFC continues to be a pioneer in advocating the role of Islamic finance in delivering positive social outcomes.

The Global Ethical Finance Initiative (GEFI) has become the hub at the centre of the ethical finance movement, organising and coordinating a series of programmes to promote finance for positive change.

## High-Level Working Group on Green and Sustainable Sukuk

During COP26, the UKIFC, GEFI, London Stock Exchange, HM Treasury, Indonesia’s Ministry of Finance and the Islamic Development Bank together launched the High-Level Working Group on Green and Sustainable Sukuk (HLWG).

The three-year initiative, under the Global Islamic Finance and UN SDGs Taskforce, aims to develop and promote green and sustainability sukuk to attract capital at scale to finance SDG projects.

## This report

Refinitiv is one of the leading independent sources of thought leadership and data on the global Islamic finance industry, including sukuk and sustainable Islamic finance.

The “Green and Sustainability Sukuk Report” report is a collaboration between Refinitiv, London Stock Exchange, UKIFC and GEFI. The report is a key outcome of the HLWG that will be informing and guiding the working group’s action plan for the coming two years.

The report provides insights on the green and sustainability sukuk market and broader ecosystem, in addition to outlining a roadmap to guide industry stakeholders across in building and enhancing this market for funding sustainable development plans.

We acknowledge the valuable contribution of the members of the HLWG to the drafting of the “Green and Sustainability Sukuk Report 2022”. The members of the HLWG, led by Shrey Kohli from the London Stock Exchange, supported us in providing valuable market insights and extensive advice on multiple drafts of the report.

## HLWG members

### Founding members

- UKIFC
- GEFI
- London Stock Exchange
- HM Treasury
- Islamic Development Bank
- Ministry of Finance, Indonesia

### Members

- Emirates NBD Capital
- DDCAP Group
- Dechert
- Etihad Aviation Group
- HSBC Amanah Malaysia Berhad
- Norton Rose Fulbright
- White & Case



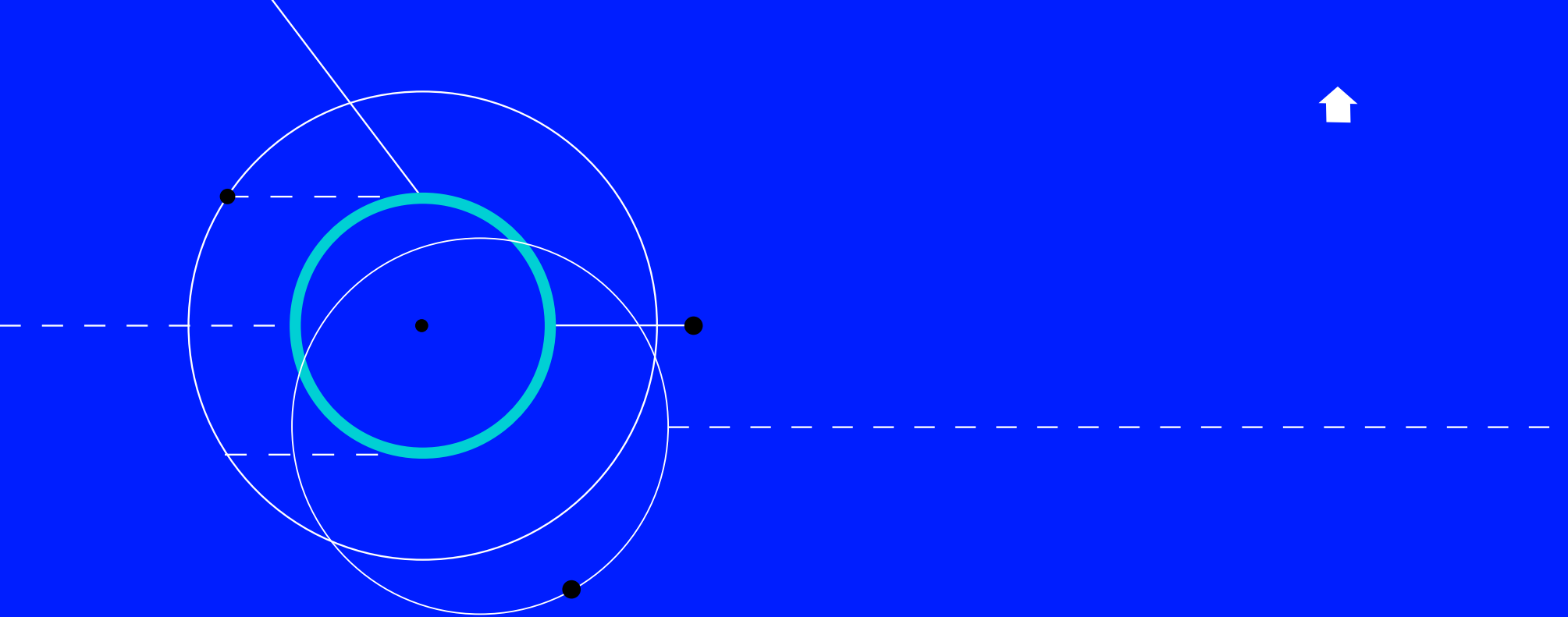
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# Foreword

This July marked five years since the first green sukuk was issued, raising a humble \$58 million. Green and sustainability sukuk have made great strides during this time, gaining traction across several Organisation of Islamic Cooperation (OIC) markets in Southeast Asia, the Gulf Cooperation Council (GCC) and Africa, with cumulative total issuance amounting to \$21 billion by the first half of 2022.

Even before the Covid pandemic, green and sustainability sukuk had seen huge growth momentum, more than doubling in 2019. During the pandemic, these sukuk issuances continued their growth trajectory, and set new records in 2020 and 2021. The pandemic also shifted the dynamics of the market as sustainability sukuk issuances surged in parallel with the wider Environmental, Social and Governance (ESG) bond market, led by the IsDB, which raised \$4 billion specifically ring-fenced to mitigate the health and economic impacts of the coronavirus outbreak and the recovery from the pandemic in its member states.

Still, demand for green and sustainability sukuk has been driven mainly by investors with ESG-centric investment mandates rather than Shariah compliance-focused investors, which has resulted in slower adoption of ESG principles across most OIC jurisdictions.

Last year, UKIFC, along with GEFI, IsDB, HM Treasury, Indonesia’s Ministry of Finance and London Stock

Exchange, launched the HLWG at COP26, a three-year initiative focused on co-ordinating international efforts to develop and position green and sustainability sukuk as a viable financial instrument and on directing investments into green and sustainable projects, with the aim of unlocking potential Islamic investments to facilitate the UN Sustainable Development Goals.

The “Green and Sustainability Sukuk Report” provides Islamic capital market stakeholders - including regulators, issuers and investors – with an overview of the primary market for green and sustainability sukuk, highlighting the impact of the pandemic and national development plans on supply and demand in domestic and international markets. The report also looks at the broader ecosystem for green and sustainability sukuk, focusing on governance and industry development efforts.

As we approach the 2022 United Nations Climate Change Conference (COP27), we hope that this report will encourage different countries to adopt green and sustainability sukuk as an innovative approach for financing their UN Sustainable Development Goals (SDGs) and sustainable development plans. The report features a roadmap outlining key recommendations - based on best practices and success stories - for governments, regulators and industry development bodies to facilitate the development of the green and sustainability sukuk ecosystem, expansion of the market, and broadening the investor base.



**Shrey Kohli**

*Director, Fixed Income and Funds  
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Chair, High-Level Working Group on Green and Sustainable Sukuk*



**Mustafa Adil**

*Head of Islamic Finance  
Refinitiv, an LSEG business*



**Omar Shaikh**

*Advisory Board Member & Director  
Islamic Finance Council UK (UKIFC)  
  
Secretariat, High-Level Working Group on Green and Sustainable Sukuk*



# Executive summary

## **\$30-50 billion opportunity for green and sustainability sukuk in delivering SDGs**

Delivering the SDG targets is estimated to require an annual \$5 trillion to \$7 trillion in funding from both the public and private sectors. However, lower-income developing countries are faced with a \$2.5 trillion annual funding gap that would need substantial increases in public funds to be filled.

Meanwhile, demand for ESG investments is on the rise as institutional investors progressively integrate ESG criteria in their investment mandates. The current supply of ESG debt issuance falls short of this demand, presenting a huge opportunity for green and sustainability sukuk to bridge the gap.

As Islamic finance and ESG investing share common principles and have complementary investment approaches, sukuk offer an alternative funding channel for sustainable development projects. The UKIFC estimates green and sustainability sukuk could raise \$30 billion to \$50 billion of capital to be allocated to the SDGs by 2025.

## **Green and sustainability sukuk reach new high as ESG bond issuance hits \$1 trillion mark**

Global ESG bond issuance broke through the \$1 trillion mark in 2021, having grown , on average, 70% annually since 2019 as sustainability bond issues surged, fuelled by Covid recovery measures. However, issuance slowed in 2022 amid economic uncertainty, amounting to \$429 billion during the first half.

On the other hand, green and sustainability sukuk totalled \$4.4 billion in H1 2022, following record issuance of \$6.1 billion in 2021. These sukuk represented only 1% of ESG bond issuance, however, and 4% of total sukuk issuance.

## **Funding Covid recovery pushes sustainability sukuk to the forefront**

Green sukuk made up 26% of the value of ESG sukuk issued in 2021, down from 91% in 2019, as a drop in green sukuk issuance was countered by a surge in sustainability and sustainability-linked sukuk following the Covid-19 outbreak in 2020.

On average, 82% of green and sustainability sukuk have been issued in international markets since 2018, reflecting strong demand from overseas investors. Considerable efforts are still required to spread awareness around ESG investing and the nuances of green and sustainability sukuk in traditional sukuk markets.

## **Indonesia and GCC account for more than half of ESG sukuk value**

Green and sustainability sukuk issuance has so far been led by Indonesia and the GCC, which have together provided 53% of the total.

The largest issuer of green sukuk has been the Indonesian government, which in 2018 became the first sovereign to issue such sukuk, and in 2019 issued the world's first retail green sukuk. This contributed \$50 billion in funding towards achieving the country's climate targets.

Green and sustainability sukuk have been the main driver of ESG debt issuance in the GCC, making up 80% of green and sustainability bonds sold by GCC-based issuers up to H1 2022. In comparison, sukuk made up 42% of cumulative non-ESG debt issuances from the GCC during the same period.

## Development of green and sustainability sukuk ecosystem pioneered by Southeast Asian markets

Several Islamic financial jurisdictions are developing action plans and regulations to support the sustainable development agenda, including green and sustainability investments.

Indonesia's Financial Services Authority (OJK) launched a Sustainable Finance Roadmap in 2014, set up a sustainable finance taskforce, and released its Sustainable Finance Umbrella Policy in 2017. Through these steps it began to develop a sustainable finance ecosystem while garnering the commitment of the financial industry to support the government's climate change agenda. The OJK also issued green bond regulations in 2017 aimed at encouraging the development of environmentally friendly capital market products.

The Malaysian government included enhancing green financing and incentives and driving investment in renewables in its 2021-2025 roadmap aimed at advancing sustainability and promoting the green economy. To support these priorities, Securities Commission Malaysia (SC Malaysia) in 2019 launched the Sustainable and Responsible Investment (SRI) Roadmap for the Malaysian Capital Market to create a facilitative SRI ecosystem and chart the role of the capital market in driving Malaysia's sustainable development. The regulator also introduced SRI and SRI-linked sukuk frameworks setting guidelines that would encourage asset owners to adopt ESG standards and aligning disclosure and reporting requirements with internationally accepted principles and best practices.

Most green and sustainability sukuk comply with one of the International Capital Market Association (ICMA) principles: the Green Bond Principles (GBP), Sustainability-Linked Bond Principles (SLBP) or Sustainability Bond Guidelines (SBG). Nearly 50% of GBP-compliant green sukuk are also labelled as 'ASEAN Green Bonds'. These green and sustainability bond principles recommend that

issuers seek external reviews, which would provide investors with the information they need to inform their decisions. Second Party Opinions (SPOs) are the most commonly used form of external review by green and sustainability sukuk issuers, covering 91% of issuances. They are also popular with sukuk investors, and rated as the most useful tool for assessing ESG credentials, according to 46% of survey respondents.

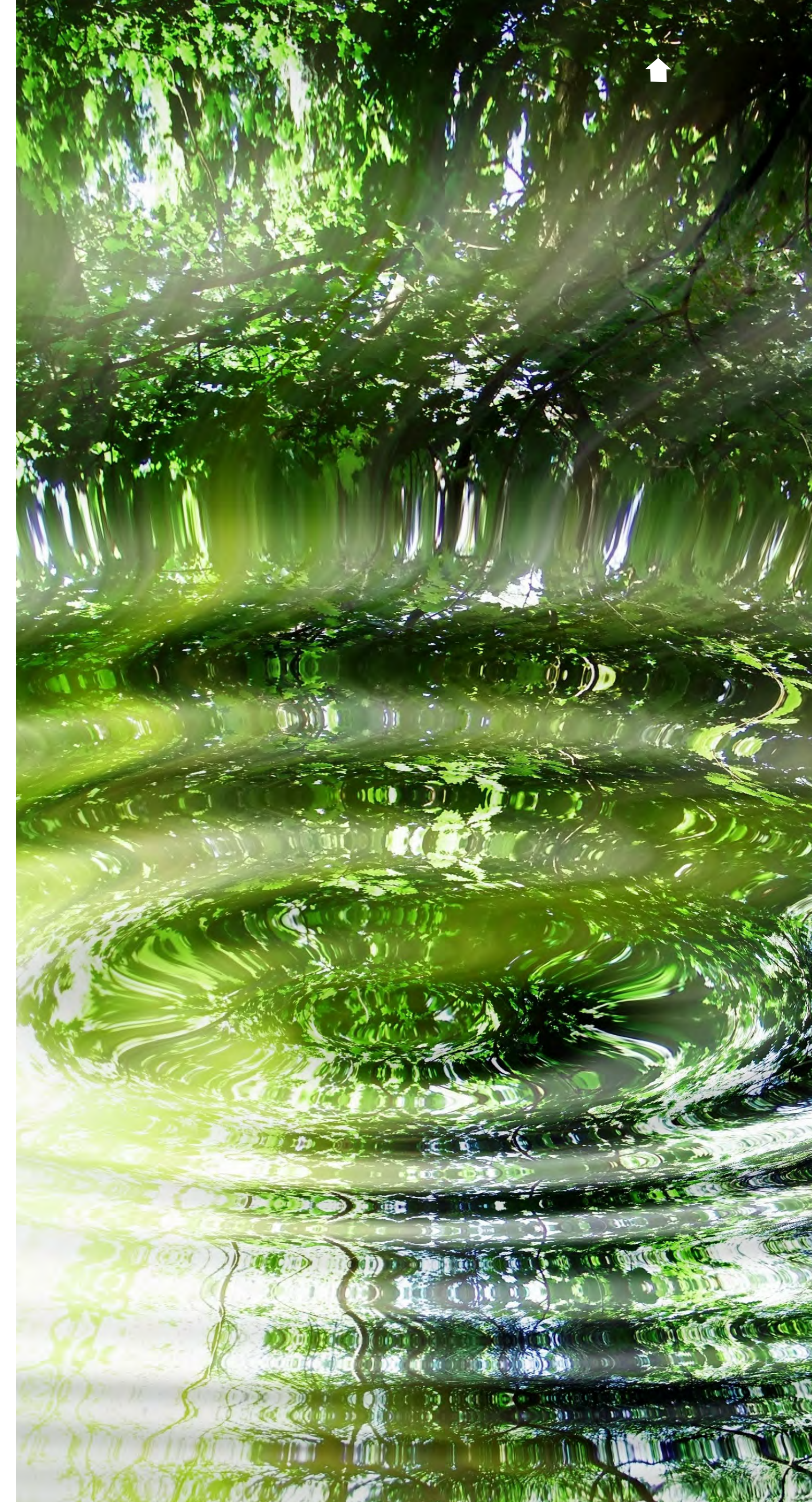
The development of the ESG sukuk ecosystem is also supported and facilitated by a number of bodies at a global level. Most notably, the HLWG, launched during COP26 in 2021, is a three-year initiative aimed at developing and promoting green and sustainability sukuk as a viable tool to attract the investments needed to support achieving SDG targets.

## Broadening horizons: a roadmap for green and sustainability sukuk

The green and sustainability sukuk market is at a nascent stage, with considerable growth opportunities in sight. To capitalise on rising demand and to keep pace with the wider ESG bond market, the roadmap for green and sustainability sukuk outlined in this report proposes a three-pronged approach for the further development of the market:

- **Promote common regional and international standards** to build a common understanding of the market
- **Build capacity** with issuers and enhance the wider ecosystem
- **Expand the investor base** beyond traditional sukuk investors

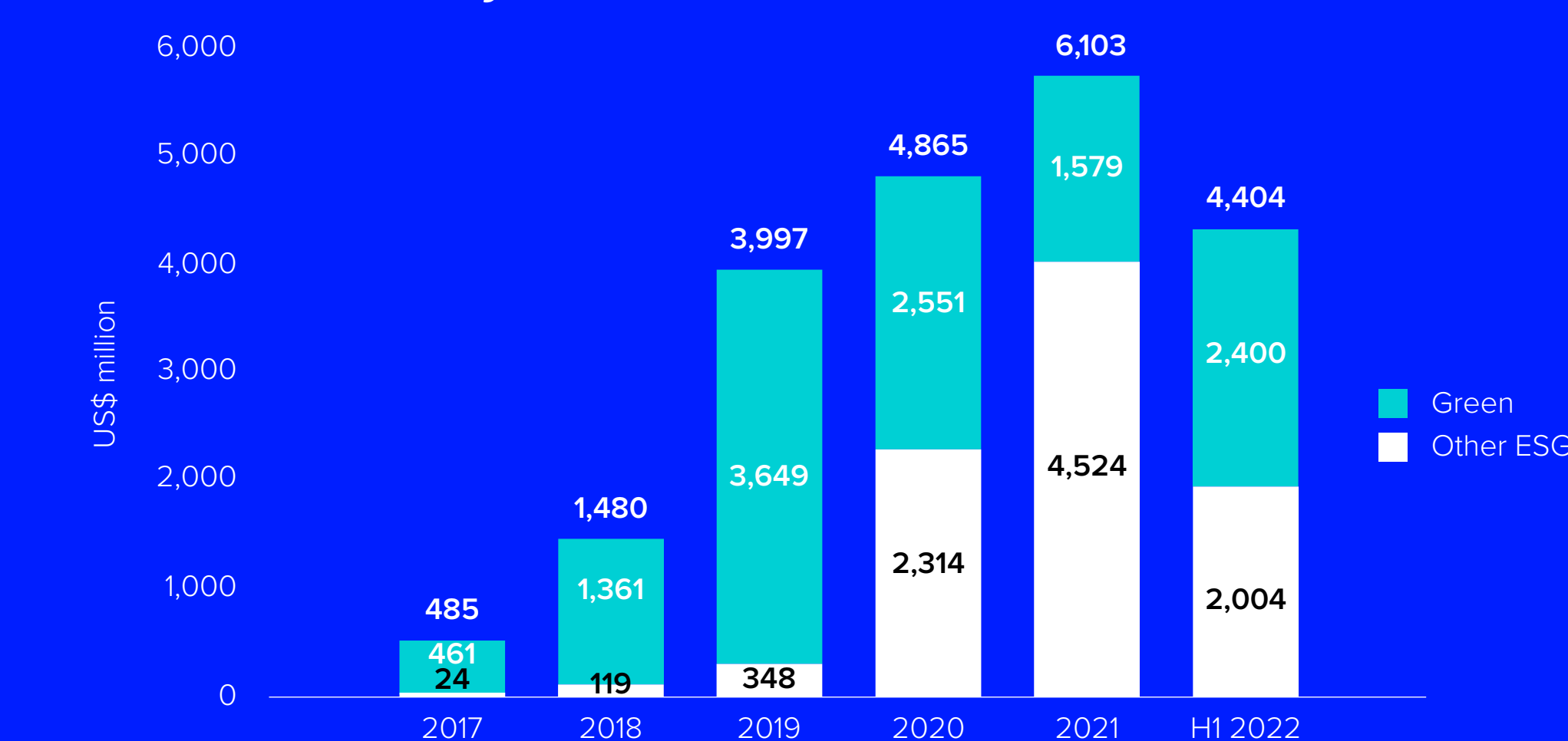
Key recommendations are outlined in the roadmap, based on best practices and experiences of established sukuk hubs. These are summarised in the next infographic.





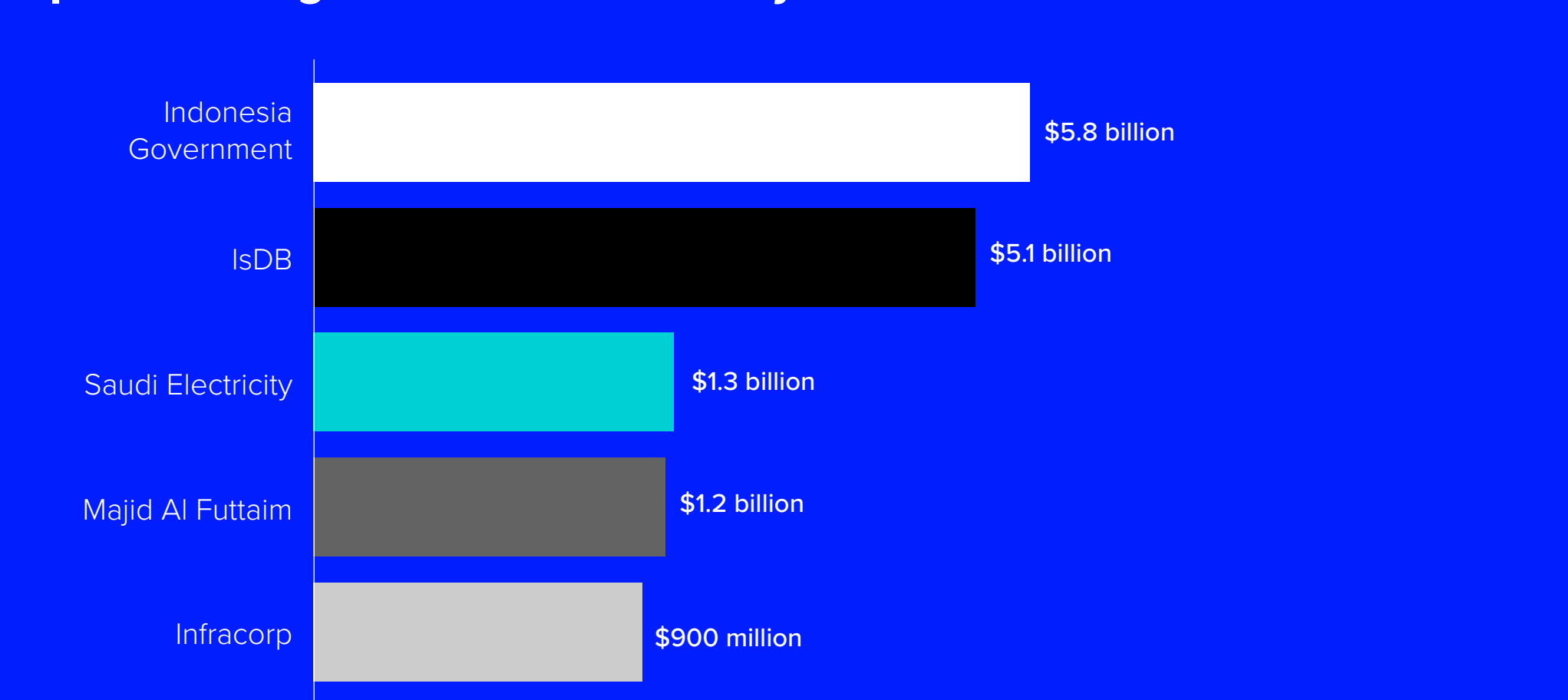
# Green and sustainability sukuk landscape

Green and sustainability sukuk issuance 2017 – H1 2022



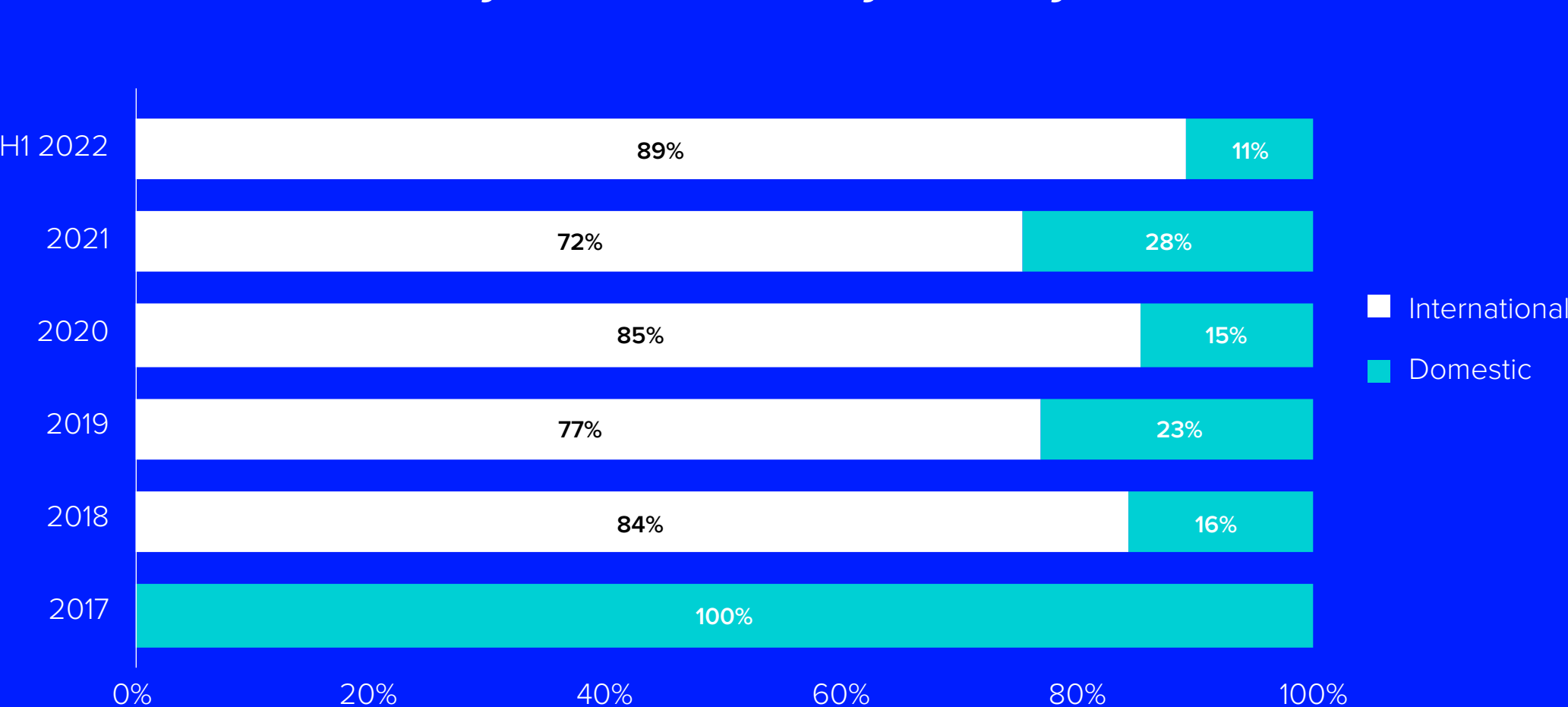
Source: Refinitiv, an LSEG business

Top issuers of green and sustainability sukuk 2017 – H1 2022



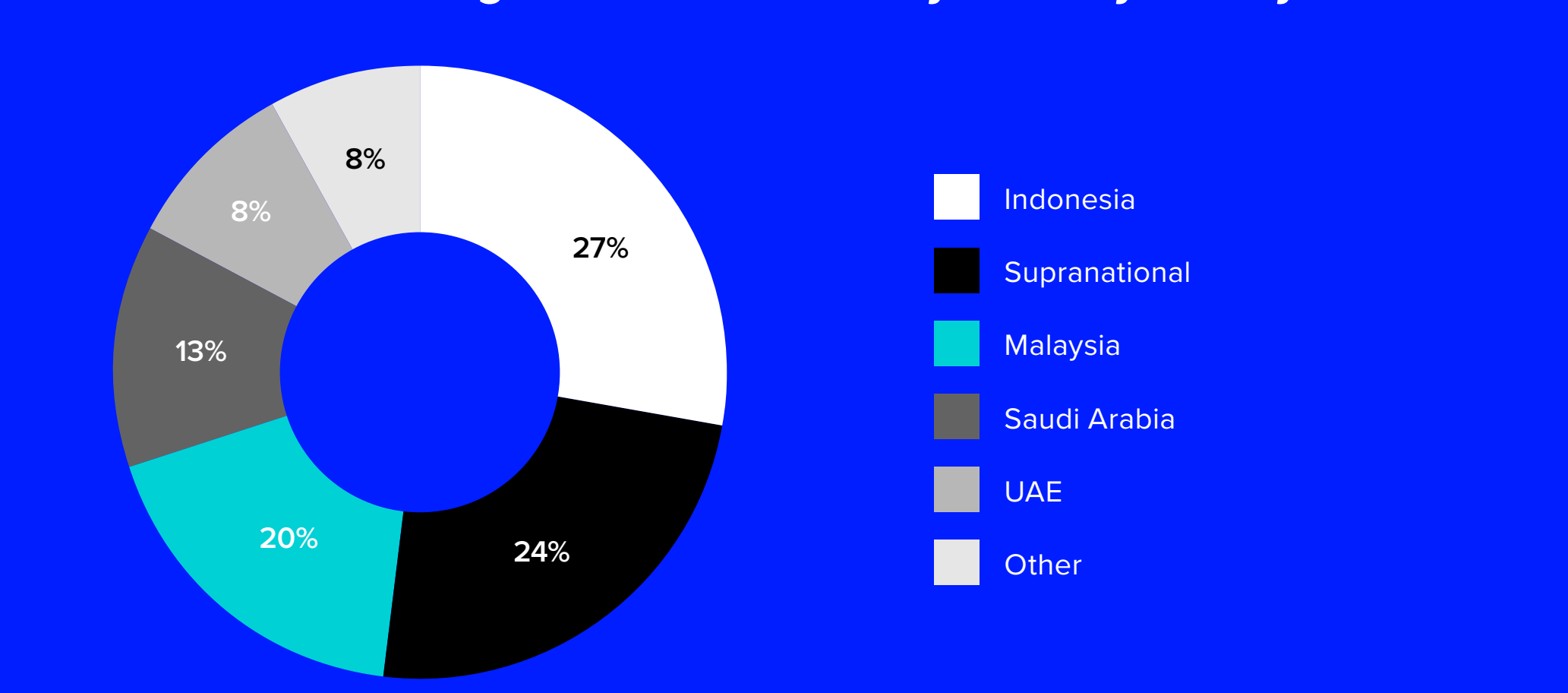
Source: Refinitiv, an LSEG business

Green and sustainability sukuk issuance by currency 2017 – H1 2022



Source: Refinitiv, an LSEG business

Cumulative issuance of green and sustainability sukuk by country 2017 – H1 2022



Source: Refinitiv, an LSEG business



# Green and sustainability sukuk ecosystem

## TAXONOMY

- Climate Bonds Initiative’s (CBI) Climate Bonds Taxonomy
- EU Taxonomy
- Indonesia Green Taxonomy 1.0
- Malaysia SRI Taxonomy

## INTERNATIONAL STANDARDS

- ICMA Principles
- Green Bond Principles
  - Sustainability-Linked Bond Principles
  - Sustainability Bond Guidelines
- ACMF ASEAN Green Bond Standards (GBS)

## INDUSTRY DEVELOPMENT

High-Level working Group on Green and Sustainable Sukuk (HLWG)

## KUWAIT

### Regulations

Amendments to Module 11 of Capital Markets Law to regulate green, sustainability and social-impact bonds and sukuk (2022)

## QATAR

### Regulations

QFC Sustainable Sukuk and Bonds Framework (2022)

## UAE

### Policies

UAE Sustainable Finance Framework 2021-2031

## PAKISTAN

### Regulations

SECP national guidelines for green bonds and sukuk (2021)

## BANGLADESH

### Regulations

Bangladesh Bank Policy on Green Bond Financing for Banks and FIs (2022)

## OMAN

### Regulations

Draft Bonds and Sukuk Regulation for SRI, Waqf, sustainability, green and blue bonds and sukuk (2021)

## INDONESIA

### Policies

- National Long-Term Development Plan of 2005-2025
- Sustainable Finance Roadmap 2021-2025
- Sustainable Finance Umbrella Policy (2017)

### Regulations

- Regulation on the Issuance and the Terms of Green Bonds (2017)

## MALAYSIA

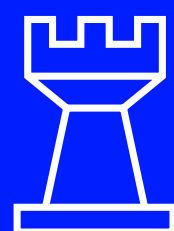
### Policies

- Twelfth Malaysia Plan 2021-2025
- SRI Roadmap for the Malaysian Capital Market

### Regulations

- SRI Sukuk Framework (2014)
- SRI-linked Sukuk Framework (2022)

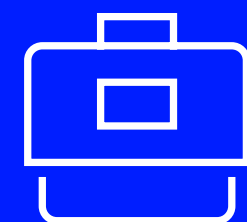
## Survey insights



### ESG mandates

are the primary motivation for investing in green and sustainability sukuk

54%



of investors have already integrated ESG criteria within their Shariah-compliant portfolios.

46%



of investors consider second party opinions the most useful tool for assessing sukuk green and sustainability credentials.

42%



of investors say ESG reporting and screening criteria were the main reason for not investing in green and sustainability sukuk.

## Green and sustainability sukuk roadmap

### Key recommendations

#### Promote common regional and international standards

- Develop ESG sukuk masterplans/ roadmaps
- Introduce specific ESG sukuk guidelines or regulations
- Harmonise taxonomy approaches
- Adapt internationally accepted green and sustainability standards for sukuk applications
- Standardise ESG disclosure and reporting requirements and mandate ESG assurance
- Build issuer awareness and a specialised ESG talent pool

#### Build capacity with issuers and enhancing the wider ecosystem

##### Increase issuance volume

- Incorporate green and sustainability sukuk within government funding mix
- Offer issuers cost-reduction incentives
- Establish ESG segments within stock exchanges

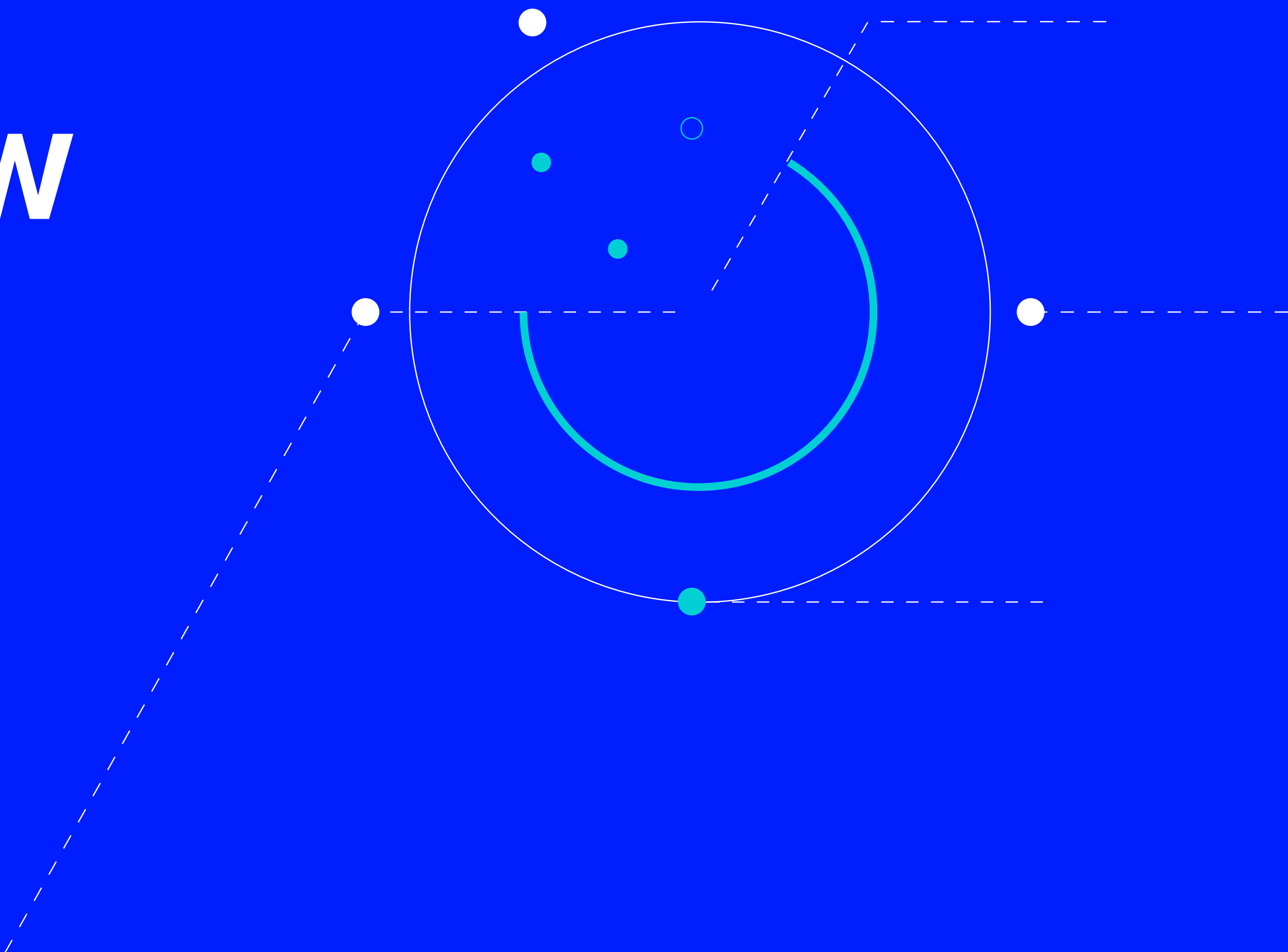
##### Innovation

- Support issuance of transition sukuk
- Introduce blue and nature sukuk
- Use Sukuk-Waqf to fund social finance projects

#### Expand the investor base beyond traditional sukuk investors

- Offer incentives for investors
- Promote investor awareness and capacity building
- Attract investors with no Shariah compliance mandate

# GREEN AND SUSTAINABILITY SUKUK OVERVIEW



# Role of Islamic finance and sukuk in delivering SDGs

The SDGs introduced in 2015 identify 17 specific targets for achieving sustainable development outcomes by 2030. Delivering these targets will require funding of \$5 trillion to \$7 trillion annually from both the public and private sectors, according to estimates from the UN.<sup>1</sup>

However, a major challenge for many countries is that public funding sources, especially in developing countries, are not sufficient to cover the funding requirements.<sup>2</sup> Developing countries are faced with a \$2.5 trillion annual funding gap, which particularly impacts lower-income economies. The latter will require larger public funding increases to meet the SDG funding requirements.

## Strong synergy between Islamic and ESG finance

Considering its social and moral ethos and asset-backed nature, Islamic finance offers an alternative channel to fulfil the substantial funding requirements for sustainable development activities and projects in developing countries. Islamic finance and ESG investing are generally based on common principles, thus complementing each other as both capital-raising and investment approaches.

Islamic finance promotes sustainable development and aligns with the SDGs through:

- Providing an additional layer of governance (Shariah) that ensures the ring-fencing of issuance proceeds and directs them towards projects that are aligned with both Shariah standards and ESG criteria

- Promoting financial inclusion (and thereby leaving no one behind) for those who might not engage with the financial sector for religious reasons or lack of access, which are major challenges to overcoming poverty
- Its ability to attract new sources of funding that remain untapped by conventional green and sustainable finance
- Its ability to maintain sustainability and stability during financial crises due to a core principle of avoidance of speculative and toxic financial instruments based on derivatives, generally full collateralisation due to its asset-backed nature, and close linkages to the real economy

The use of proceeds for green, sustainability and social bonds is intended to go towards eligible projects or assets that are aligned to specific objectives. Whilst these bonds are not always asset-backed or asset-based, the ESG bond framework creates a strong link between the capital raised and the issuer's underlying strategy and asset-mix, which aligns with the basic principles of Islamic finance.

Still, while ESG investing and Islamic finance share most of their principles, not all ESG bonds are Shariah-compliant. ESG sukuk must also comply with Shariah guidelines or standards, especially those concerning the use of proceeds, which cannot involve any interest-bearing activities, for example.

1. OECD Development Co-operation Directorate (DCD). "How Islamic finance contributes to achieving the sustainable development goals". (OECD Publishing, 2020)

2. Securities Commission Malaysia and the World Bank Group. "Islamic Green Finance: Development, Ecosystem And Prospects". 2019



# Why green and sustainability sukuk?

Many institutional investors are shifting towards responsible investing by incorporating ESG components within their investment strategies, which is helping to drive demand for ESG financial products. However, there remains a shortage in the global supply of ESG investments, and green and sustainability sukuk have the potential to fill some of this gap, particularly for investors seeking Shariah compliance as well. These sukuk also offer investors exposure to debt in emerging markets, which include the most active sukuk jurisdictions such as Malaysia, Indonesia and the GCC states.

There is also a need for large-scale investments in developing economies to fund sustainable development, which can leverage green and sustainability sukuk to reach a wider investor base, including Shariah-compliant investors.

Green and sustainability sukuk are still at a nascent phase, most likely due to a shortage of certifiable green projects, particularly in oil-reliant GCC economies. Yet as these countries transition to running more sustainable economies, there will be more growth potential for these types of sukuk.

On the other hand, there is growing demand for green and sustainability sukuk from investors in Western markets such as the US and Europe, where ESG priorities are becoming increasingly widespread. Combined with regular demand from Shariah-compliant investors, this will broaden the investor base for green and sustainability sukuk.

## ESG sukuk classifications



### Green sukuk

Issued to specifically fund projects that have a positive environmental impact. Examples include renewable energy, clean transportation, carbon neutrality, sustainable water, and waste-water management.



### Social sukuk

Issued to specifically fund projects that have a positive social impact. Examples include affordable basic infrastructure, affordable housing, employment generation, and workforce diversity.



### Sustainability sukuk

Issued where proceeds are exclusively applied to a combination of green and social projects.



### Sustainability- or SDG-linked sukuk

Issued based on the issuer's commitment to meeting ESG objectives. Issuers can use the proceeds for general purposes but are required to achieve the stated targets. If the issuer does not meet the target, these sukuk have coupon step-ups in place as a penalty to the issuer.



### Transition sukuk

Issued to fund a firm's transition towards a reduced environmental impact or to reduce their carbon emissions.



### Blue sukuk

Issued to fund marine-related projects such as sewage treatment or ocean conservation.



# Survey

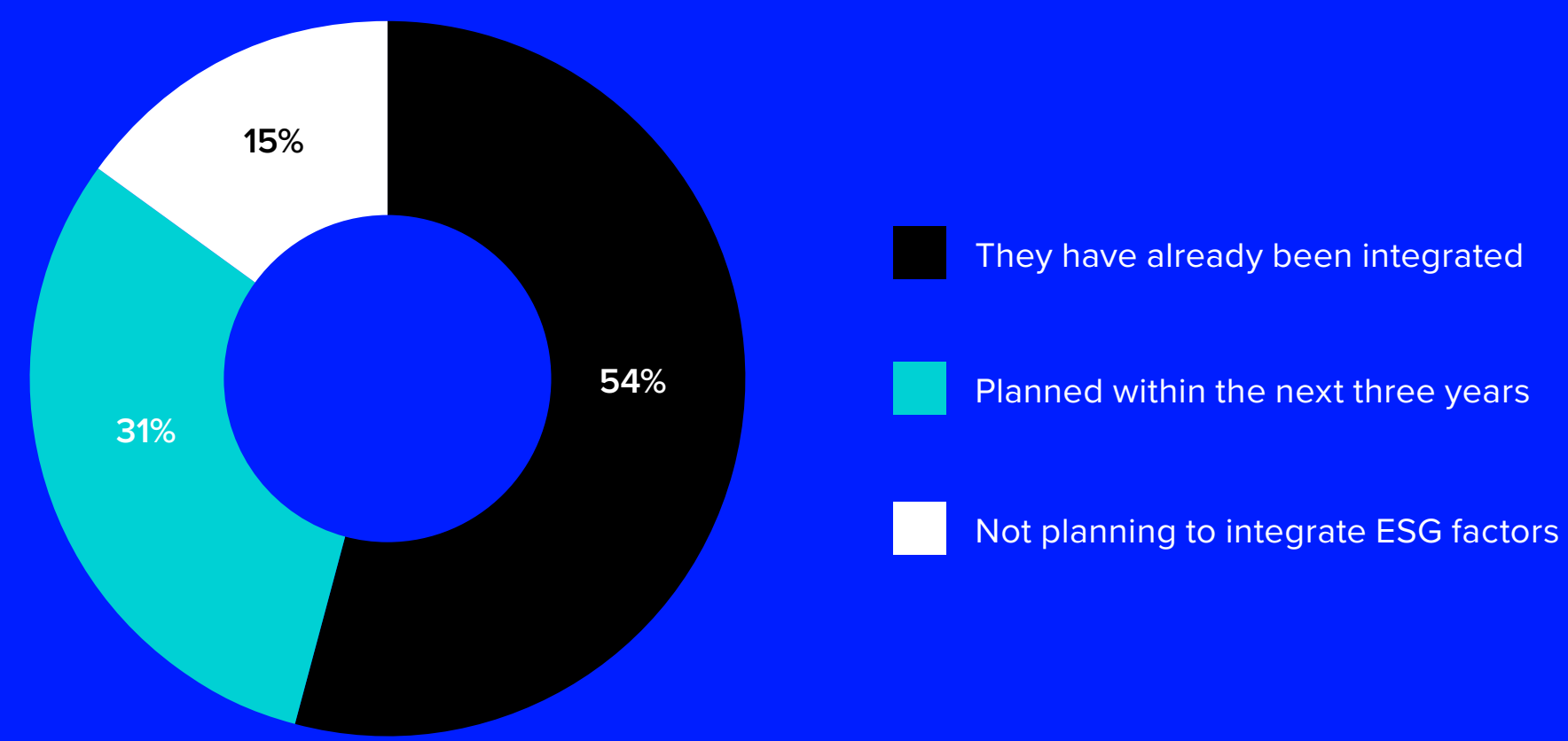


## Demand for Shariah-compliant ESG investments

Demand for ESG investments is growing as they enter the mainstream in global markets and investors increasingly incorporate ESG criteria in their mandates. Investors with Shariah-compliant mandates have also been increasingly incorporating ESG investments into their portfolios, sparking greater demand for Shariah-compliant ESG investments.

According to the 2022 Refinitiv Sukuk Survey, more than half of respondents have already integrated ESG criteria in their Shariah-compliant portfolios, suggesting there is already a strong base for demand for Shariah-compliant ESG investments such as green and sustainability sukuk. Meanwhile, 31% of respondents are considering including ESG investments in their Shariah-compliant portfolios, suggesting further growth in demand from Shariah-sensitive investors over the medium term.

### Are you considering integrating ESG criteria into your Shariah-compliant investment mandate?

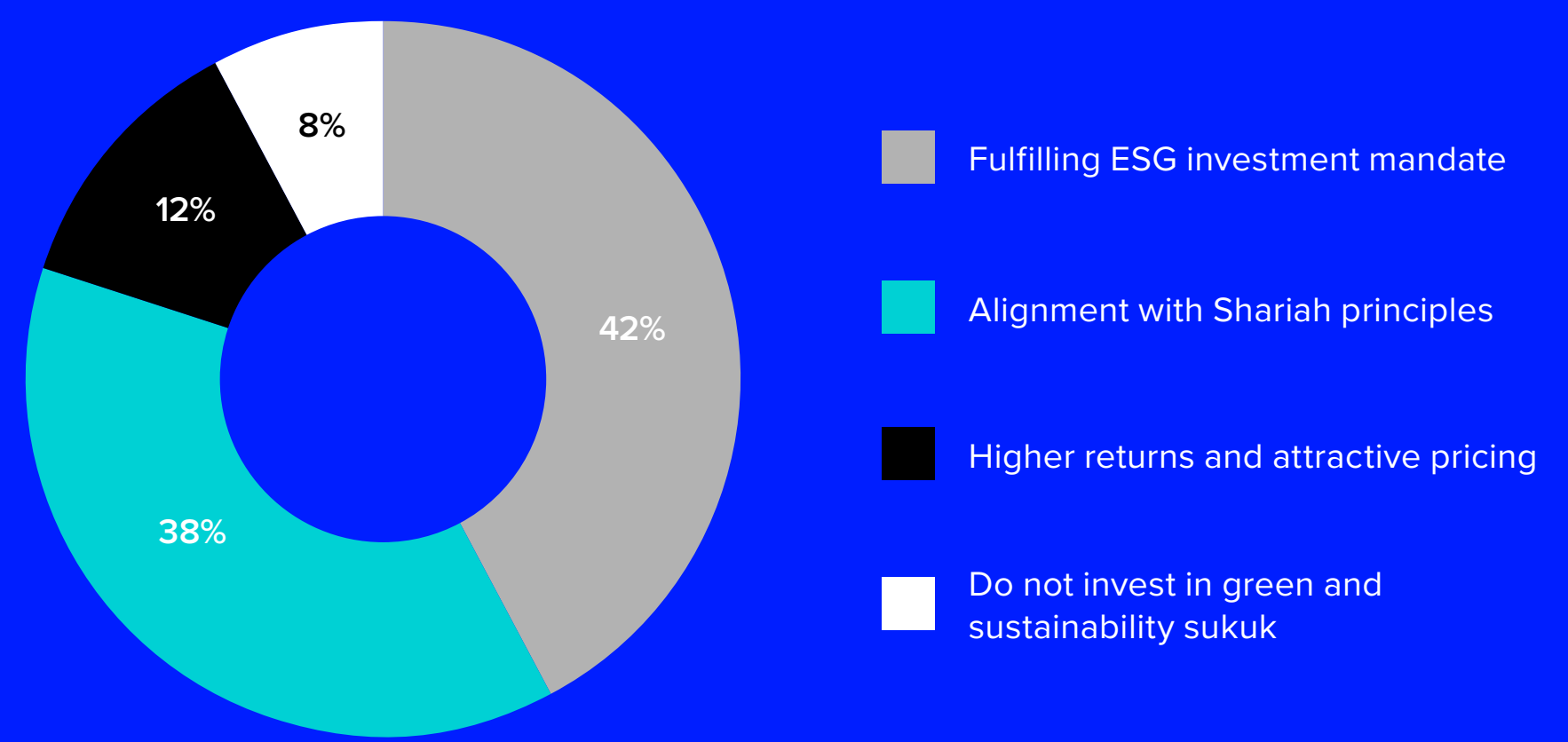


Source: Refinitiv Sukuk Survey 2022

Investor demand for green and sustainability sukuk has been higher than for traditional sukuk. Based on a sample of reported subscription results, green and sustainability sukuk were 4.4 times oversubscribed on average, compared with 3.3 times for comparably sampled traditional sukuk.

According to the survey, the primary motivation for investing in green and sustainability sukuk is to fulfil ESG investment mandates. This indicates that the higher demand for these sukuk is not stemming from a shortage of Shariah-compliant investments. Rather, it is being driven by non-traditional sukuk investors who are not restricted by Shariah-compliance mandates.

### What is the main reason for investing in green and sustainability sukuk?



Source: Refinitiv Sukuk Survey 2022

# Green and sustainability sukuk landscape

The ESG bond primary market had a slow start to the year, amid an environment marked by escalating geopolitical tensions, rallying oil prices, inflationary pressures and the Fed's hawkish policy stance. Global ESG bond issuance reached \$429 billion during the first half of 2022, after having broken through the \$1 trillion mark in 2021.

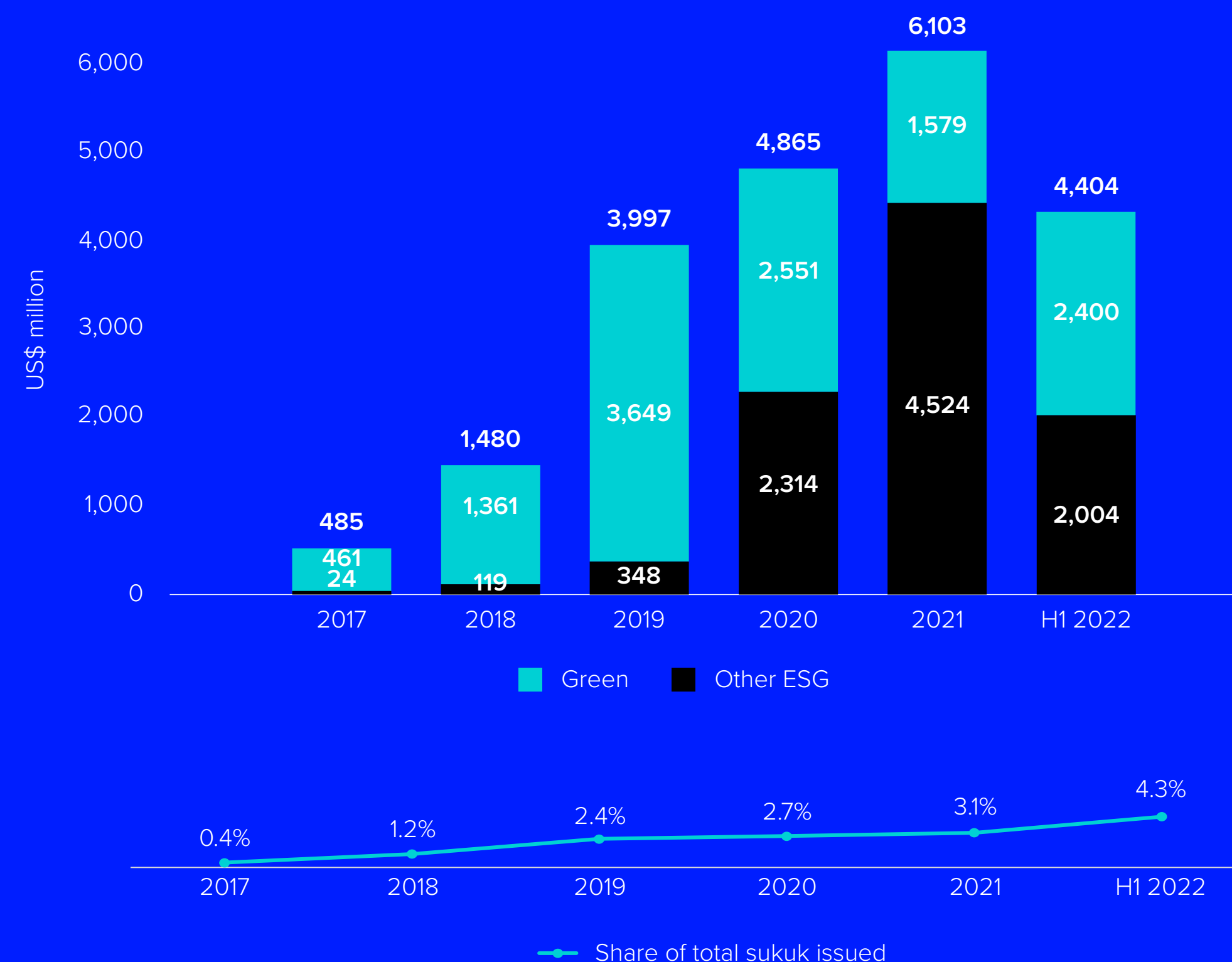
Meanwhile, green and sustainability or ESG sukuk issuance reached \$4.4 billion in H1 2022, making up 1% of total ESG bond issuance and 4% of sukuk issuance.

In 2021 overall, ESG sukuk issuance reached a new high of \$6.1 billion as these sukuk gained prominence in both existing and new markets in the wake of the Covid pandemic.

Green sukuk made up 26% of the value of ESG sukuk issued in 2021, down from 52% in 2020 and 91% in 2019, as other forms of ESG sukuk - mainly sustainability or sustainability-linked - gained more traction during the pandemic. While a greater number of green sukuk (36 of 53 ESG sukuk) were issued during 2021, the average issuance size was relatively small at \$44 million. The average issuance size of sustainability and sustainability-linked sukuk was significantly larger at \$266 million.

Cumulative green and sustainability sukuk issuance has so far been led by Indonesia and the GCC, which have together provided 53% of the total. Turkey, Bangladesh, Sudan and Nigeria joined the ranks of ESG issuers in 2021, when they made their debut issuances.

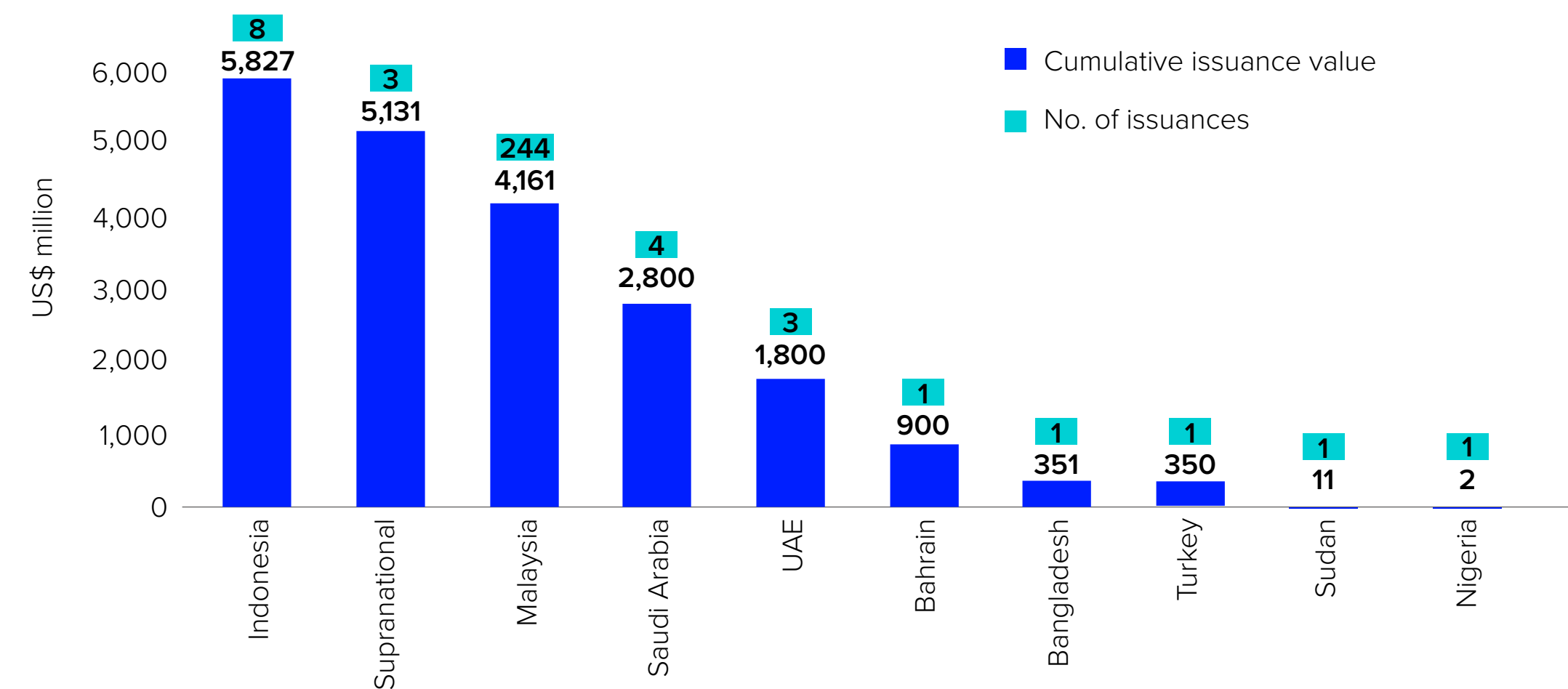
## Green and sustainability sukuk issuance 2017 – H1 2022



Source: Refinitiv, an LSEG business



Green and sustainability sukuk cumulative issuance by country as of H1 2022

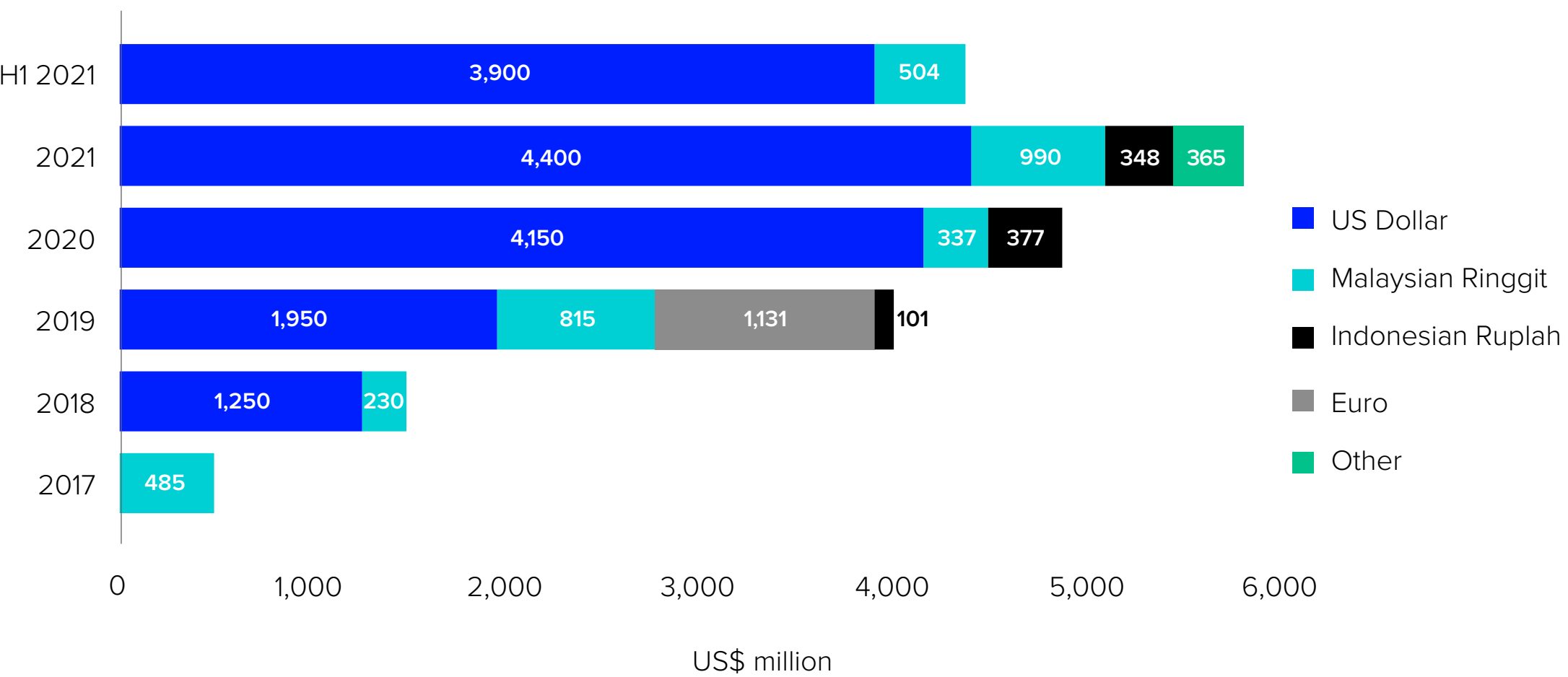


Source: Refinitiv, an LSEG business

Green and sustainability sukuk have been mostly issued in international markets, with an annual average of 82% issued in foreign currencies since 2018. By comparison, international issuances of traditional sukuk made up 32% of annual issuance, on average.

This is likely an indication of stronger demand for green and sustainability sukuk in international bond markets. More than half of sukuk investors (54%) have already incorporated ESG factors within their investment mandates, according to the 2022 Refinitiv Sukuk Survey. Considerable efforts are still required to spread awareness around ESG investing and the nuances of green and sustainability sukuk in these markets.

Green and sustainability sukuk issuance by currency 2017 – H1 2022



Source: Refinitiv, an LSEG business

Corporate issuers have been more active in the green and sustainability sukuk market, accounting for 91% of all issuances but just 37% of total value. Meanwhile, corporate issuance has accounted for 10% of the cumulative value of traditional sukuk issuance during the same period. The Indonesian and Malaysian governments are the only sovereigns to have issued green and sustainability sukuk to date, raising \$6.6 billion, or 31% of the total.



Top issuers of green and sustainability sukuk as of H1 2022

Country	Issuer	Total amount issued (US\$ million)
Indonesia	Indonesian Government	5,827
Supranational	Islamic Development Bank (IsDB)	5,131
Saudi Arabia	Saudi Electricity Co.	1,300
UAE	Majid Al Futtaim	1,200
Bahrain	Infracorp	900
Malaysia	Malaysian Government	800
Saudi Arabia	Riyad Bank	750
Saudi Arabia	Saudi National Bank	750
UAE	Etihad Airways	600
Malaysia	PNB Merdeka Ventures	475
	Others	3,840
	Total	21,333

Source: Refinitiv, an LSEG business

As of H1 2022, the Indonesian government was the biggest issuer of ESG sukuk, particularly green sukuk. The sovereign is regarded as a pioneer in green sukuk, having issued the world’s first sovereign green sukuk in 2018 in order to contribute to the \$50 billion in financing needed to meet the country’s climate commitments and to achieve its national emissions-reduction goals by 2030.

The Indonesian government has issued two green sukuk each year since - one domestically and the other in the Eurobond market. This includes the world’s first retail green sukuk, issued in 2019. In total, Indonesia has raised \$5.8 billion from sovereign green sukuk. The proceeds have helped to finance projects in renewable energy, energy efficiency, sustainable transportation, waste-to-energy, and waste management, as well as climate resilience in vulnerable areas.



## Executive insights



**Dr Zamir Iqbal**  
Vice President (Finance) and CFO  
Islamic Development Bank

### **Tell us about your experience as an issuer developing a sustainability sukuk framework, and what are the areas for development?**

Our Sustainable Finance Framework (SFF) was developed specifically to enable IsDB to issue Green, Social and Sustainability (GSS) sukuk and was crafted by a cross-complex team of finance and operations. This included treasury, infrastructure, energy, transport, climate change, project portfolio, among others.

The discussions mostly centred on the potential eligible project categories that can be included in the GSS sukuk asset pool. This required a balancing act between securing the strongest Second Party Opinion (SPO) from an external provider and the immediate needs of our member countries, who are still dealing with mitigation, adaptation and transition at varied levels.

Placing our member countries' needs at the forefront was indeed important, so as not to exclude them from the potential funding that would be raised by issuing GSS sukuk.

Ultimately, we obtained a strong Medium Green Shading, which was in line with other peer multilateral development banks such as the International Finance Corporation (IFC), Kreditanstalt für Wiederaufbau KfW<sup>3</sup> and African Development Bank (AfDB), who had similar considerations. IsDB also secured a very strong (low) ESG-risk rating of 11.5 out of 100, which demonstrated strong internal governance and mainstreaming of climate change policy and its considerations in our operations.

Another important highlight of this exercise was the reaffirmation of the strong alignment of IsDB's operations as well as sector policies with global industry standards set out by the ICMA. As IsDB operates under Islamic finance principles and has best-in-class governance structures, the Framework exercise only reaffirmed the fact that IsDB already had climate change action and sustainability at its heart, which gave us a good head-start for our member countries.

3. Credit Institute for Reconstruction



In addition, the comprehensive data-capturing process by our operations teams was critical in ensuring that reliable and detailed project-level information was easily accessible for us to prepare annual impact reports for the use-of-proceeds of each of our GSS sukuk, which are available on our website for investors and other stakeholders. These reports are validated by external reviewers, whose validation reports are also published on our website.

With respect to areas for development, regional standards and taxonomies are very much needed in order to support a ‘just transition’, which IsDB supports for its member countries who are seeking to transition towards low-carbon energy solutions. This requires improved and customized standards that would facilitate, rather than restrict, this progress, so that no-one is left behind.

**What was the basis for determining your preference between green and sustainability-linked sukuk?**

Sukuk issuance, in general, requires an underlying asset pool whose collective worth is equivalent to the issuance amount. Therefore, a green sukuk issuance requires that a sufficient number amount of green- or climate-related projects are available to be securitized for the issuance. Sustainability sukuk, on the other hand, cover a much broader range and require a mix of green- and climate-related and social sector-related projects.

We undertook a comprehensive project data assessment to identify the quantum of green and social projects available, in line with the eligibility criteria set out in the ICMA Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines.

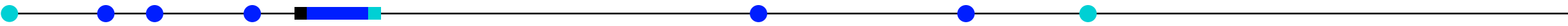
Determining whether to issue a green or a sustainability sukuk depends on the availability of eligible projects as well as the potential pipeline of similarly eligible projects. The potential pipeline is shaped by IsDB’s overall operations plan, which is informed by high-level objectives from its climate change policy, climate action plan, energy policy, health policy, etc.

**What benefit did you gain from issuing the first ESG sukuk in your jurisdiction?**

With its debut green sukuk issuance of €1 billion in November 2019, IsDB was able to secure the confidence of environmentally conscious investors from previously untapped markets such as Europe and Japan. Their participation was especially notable given that they invested in an IsDB sukuk issuance for the first time, demonstrating their comfort with the sukuk format when it is labelled ‘green’ or ‘sustainability’. Not only did this help in expanding our investor base, it also opened up new avenues of investor engagement, especially with those focused on ESG and SRI investments.

The proceeds of the green sukuk were fully allocated to 11 green projects across our member countries, in alignment with the Climate Change Mitigation and Climate Change Adaptation objectives. These included projects in renewable energy, clean transportation, energy efficiency, pollution prevention and control, environmentally sustainable management of natural living resources, and land use and sustainable water and wastewater management.

Detailed impact reporting of the proceeds and external validation was critical in providing additional comfort to the sukuk investors.



# Recent developments

## Covid-19 catalyst for ESG sukuk paradigm shift

ESG sukuk issued before 2020 were almost entirely green, closely following the trend in the wider ESG bond market. The only non-green sukuk issued up to that point was a single SDG sukuk from HSBC Amanah Malaysia in 2018. However, this trend shifted after the Covid-19 outbreak in 2020, when a drop in green sukuk issuance was countered by a surge in sustainability and sustainability-linked sukuk, driven by a new urgency for financing inclusive, health-related and poverty-alleviating projects and for meeting the SDGs.

The socioeconomic crisis brought on by the pandemic shed light on the need for sustainable economic recoveries, particularly in developing countries. This raised the importance of ESG bonds and sukuk as a fundraising tool for green and sustainable recovery programmes and projects. The infrastructure investment gap - the difference between investment needs and current investment levels - has worsened since Covid-19 as governments reallocated their infrastructure investment budgets towards funding relief efforts. This has increased the need to mobilize private funds, particularly through capital markets, i.e. bonds and sukuk. These instruments have the ability to attract pools of institutional funds that are projected to be worth between \$45 trillion and \$60 trillion globally, including pension and insurance funds. These investors have increasingly been integrating ESG factors into their mandates.

In June 2020, the Indonesian government and the Islamic Development Bank (IsDB) ended a six-month Covid-induced hiatus in ESG sukuk issuance. The Indonesian sovereign sold a \$750 million green sukuk and IsDB issued a \$1.5 billion sustainability

sukuk in the Eurobond market. In October that year, Etihad Airways issued its first transition (sustainability-linked) sukuk, raising \$600 million from international markets. Together, these two non-green issuances made up 43% of the value of ESG sukuk issued in 2020.

In 2021, IsDB returned with a \$2.5 billion sustainability sukuk – its largest issuance ever and the largest sustainability and ESG sukuk to date. The oversubscribed issuance - with an order book of more than \$2.65 billion - will be partly used to finance or refinance green and social projects under IsDB's Sustainable Finance Framework.

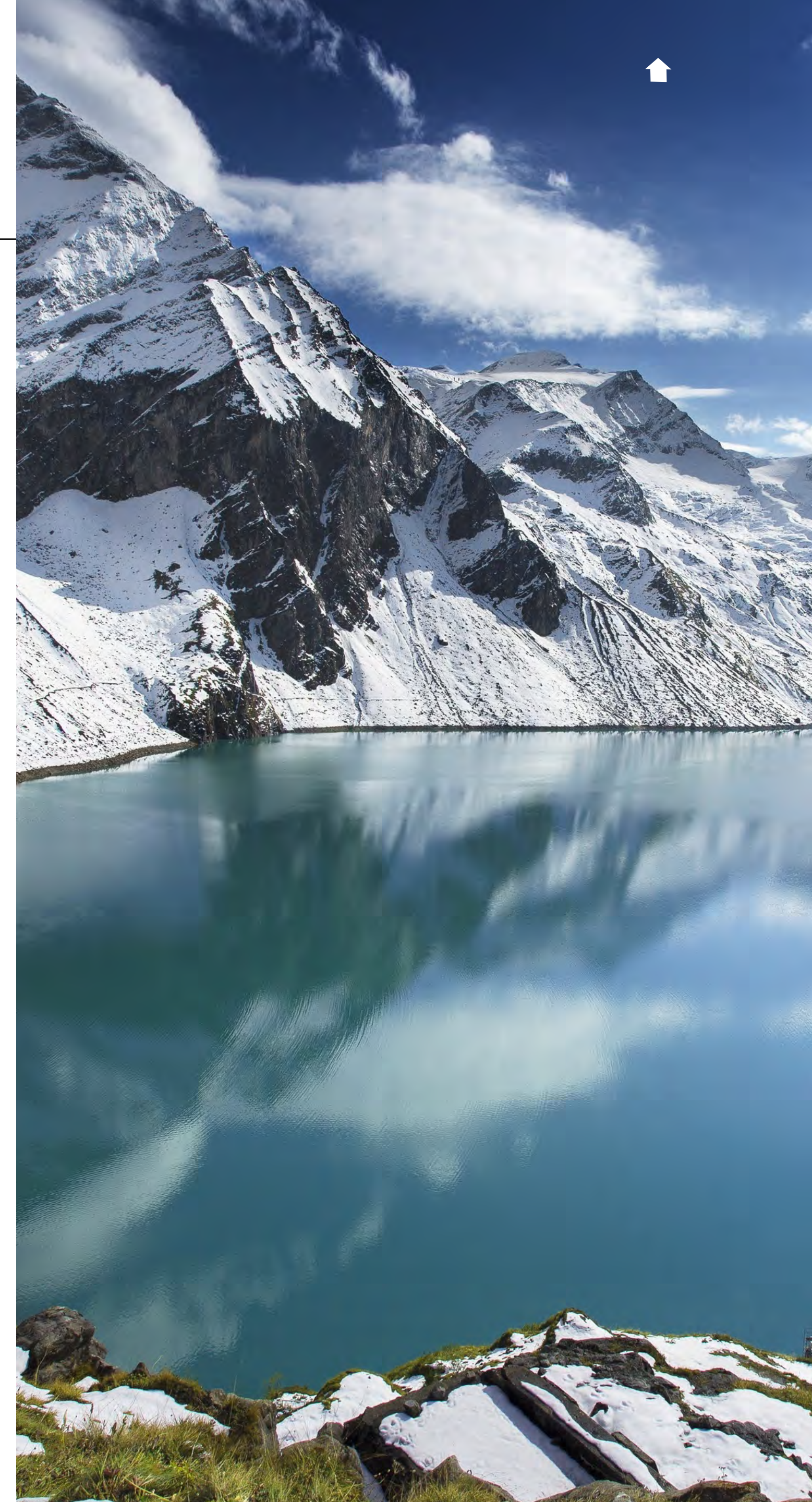
Also that year, the Malaysian government issued its first sustainability sukuk - the first sovereign to do so – which raised \$800 million. The proceeds were earmarked to finance SDG-aligned social and green projects. Two more issuances came from Kuveyt Türk Bank and Malaysia's SME Bank, bringing global sustainability sukuk issuance in 2021 to \$4.5 billion, or 74% of total ESG sukuk value.

Interest in ESG debt instruments will continue to grow. The need for sustainable infrastructure and to address environmental and social issues remains, as national priorities shift back from the focus on emergency Covid-19 responses. As sovereigns reopen their economies, opportunities to rebuild more sustainably are available, and a number of governments have shown their intent to pursue these opportunities.

The UAE and Saudi Arabia are aiming to be the main drivers of change within the GCC region. The UAE was the first GCC country to join the 'Race to Zero', committing to Net Zero by 2050 and an estimated \$165 billion investment in clean energy. Saudi Arabia has

4. Mehta, Anouj, et al. "Green, Sustainability, and Social Bonds For COVID-19 Recovery: A Thematic Bonds Primer". Asian Development Bank, 2021.

5. To 'go net zero' is to reduce greenhouse gas emissions and/or to ensure that any ongoing emissions are balanced by removals.





set its Net Zero target for 2060, aiming to completely eradicate the burning of gas and to raise its share of natural gas and renewable energy sources to around 50% by 2030.

Regional momentum on how to bridge Islamic and sustainable finance practices is set to continue at the upcoming UN Climate Change Conferences, both of which will be held the Middle East: COP27 in Egypt and COP28 in Dubai. Green and sustainability sukuk will be a key theme at both conferences: an agenda led by the HLWG that was established during COP26.

This could be a catalyst for growth in sustainability projects and ESG sukuk issuances across developing countries, particularly in the Middle East and Africa. Still, market growth will need to be supported initially by education and promoting awareness of green and sustainability sukuk issuance processes and benefits in order to attract new issuers to the market.

### Green and sustainability sukuk gaining traction in GCC

Industry analysts expect greater amounts of ESG debt, both bonds and sukuk, to be issued in GCC markets in order to fund green, sustainability and transition projects. This will be facilitated by governments' plans to tap into the rising global demand for ESG investments.

The green and sustainability sukuk market expanded into GCC jurisdictions in 2019, with two green sukuk issued by UAE-based Majid Al Futtaim raising a total of \$1.2 billion. These sukuk, while few in number, made up 30% of total ESG sukuk issuance by value in 2019.

ESG investment opportunities are rapidly emerging in GCC markets as governments plan substantial investments in the renewables sector and social development as part of their economic development and diversification plans, most of which are due for completion within the next decade. Corporates are also integrating ESG principles in their operations and financing.

Issuers in the region have also come under pressure from foreign investors, mainly from developed economies, to cater to the increasing demand for ESG-linked products, which could eventually become a point of access for tapping international capital markets.

Green and sustainability sukuk have been the main driver of ESG debt issuance in the GCC, making up 80% of green and sustainability bonds sold by GCC-based issuers<sup>6</sup> up to H1 2022. In comparison, sukuk made up 44% of cumulative non-ESG debt issuances from the GCC during the same period.

The prominence of green and sustainability sukuk in the GCC is most likely the result of ESG and Shariah principles being largely aligned, which increases the potential of such sukuk to be designated ESG-compliant and a more efficient base for structuring ESG debt. Also, by adding an ESG aspect to sukuk, issuers are able to appeal to a broader investor base.

## Riyad Bank issues the first AT-1 sustainability sukuk

Riyad Bank issued the world's first sustainability-linked Additional Tier 1 (AT-1) sukuk in February 2022. The bank committed to using an amount equivalent to the net proceeds of the issuance to provide Shariah-compliant financing and refinancing for certain green or social projects and companies, which derive over 90% of their revenue from eligible ESG categories specified in the bank's Sustainable Finance Framework.

The bank will use exclusionary criteria in its selection and approval processes for the eligible projects and companies, with a three-year lookback period for refinancing.

Saudi Arabia is currently the only Organisation of Islamic Cooperation (OIC) jurisdiction, and one of just a handful in Asia, where an ESG AT-1 bond has been issued.

6. Excludes IsDB, whose issuances are classified as supranational.



### ESG sukuk from GCC-based issuers 2019 - H1 2022

Issuer	Number of Issuances	Total amount issued (US\$ million)
Saudi Electricity Co	2	1,300
Majid Al Futtaim	2	1,200
Infracorp Sukuk Ltd	1	900
Saudi National Bank	1	750
Riyad Bank	1	750
Etihad Airways	1	600
Total	8	5,500

Source: Refinitiv, an LSEG business

All ESG sukuk issued from the GCC in the first half of 2022 were debut issuances, from three different. All three sukuk were listed on the London Stock Exchange<sup>7</sup>.

The largest was a green sukuk that raised \$900 million for Infracorp - the newly established infrastructure investment arm of Gulf Finance House (GFH). This was also the first ESG sukuk issued from Bahrain.

There were also two Saudi issuances. Saudi National Bank and Riyad Bank each issued \$750 million in sustainability-linked sukuk. Saudi Arabia has now become the largest issuance base for ESG sukuk in the region, with a total of \$2.8 billion in cumulative issuance.

Looking ahead, GCC sovereigns such as Qatar and Saudi Arabia have noted their intention to issue bonds in the ESG debt market when market conditions are more conducive for issuing sukuk.

7. See appendix.



# Executive insights



**Raja Amir Shah Raja Azwa**  
Chief Executive Officer  
  
HSBC Amanah Malaysia Berhad

## How would you describe investor appetite for ESG sukuk? What types of investors are driving this demand?

Within the realm of the global sukuk market, we have seen a rapid rise in ESG sukuk issuance, with a widely reported \$4.4 billion issued in H1 2022, bringing total outstanding ESG sukuk to \$21.3 billion, according to Refinitiv data. Demand for ESG sukuk is growing substantially as more investors begin to integrate sustainability and impact investing criteria into their investment decision-making processes. This growth also stems from a strong push by the investor community to promote sustainability-related investments through collaborative, investor-led organisations such as the UN-supported PRI or Net Zero Asset Managers initiative.

It is also interesting to note that we are seeing investors pushing boundaries by investing across multiple tenors. As an example, the Indonesian government issued the world’s first sovereign green sukuk in 2018, with a 5-year tenor. It then extended the maturity curve with a 30-year green sukuk in 2021 and a 10-year tranche in June 2022.

The green sukuk tranche has consistently provided investor profile diversification for the Indonesian government, with 35.6% of the green tranche for the 2022 sukuk issuance allocated to green or SRI investors.

In the case of the Malaysian government’s sustainability sukuk issuance in 2021 – the world’s first sovereign sustainability sukuk – the transaction was able to attract a new set of investors (i.e. investors with ESG mandates) to participate in the 10-year tranche.

Against the backdrop of robust demand coming from high-quality, real-money accounts with ESG mandates, we see not only sovereign issuers capturing these pockets of demand, but corporate issuers are also seizing this opportunity. Saudi National Bank’s ‘sustainability’ sukuk issued in January 2022 saw around 19% of the final issue size allocated to accounts with an ESG mandate.



In terms of the type of investors driving demand for ESG sukuk, traditional Islamic investors still play a key role with anchor orders, although a large portion of these investors may not currently have an ESG investment mandate. Their interest has been more focused on the Shariah compliance of the instrument, rather than focusing on the sukuk’s ESG credentials. Having said that, the sukuk market has witnessed a new pool of liquidity driven by investors with dedicated ESG desks, based largely out of Europe, who may not have previously showed interest in traditional sukuk issuances.

However, with the increased awareness of ESG, we can expect investors to be more informed on the importance of ESG-linked investments and the impact they will have in moving towards a better economy.

**How does the structuring process for ESG sukuk differ from traditional sukuk? What are the areas for improvement in this process?**

There are four broad categories of ESG sukuk in the market: green, social, sustainability (a combination of green and social objectives), and sustainability-linked. Across all categories, the structuring process would entail an additional layer of workstreams involving the issuer’s commitment to sustainable finance.

The first step is to develop a sustainability sukuk framework that is aligned with international standards such as the ICMA Green Bond Principles.

In establishing the framework, it is important to ensure alignment with the following four core components:

- Utilisation of proceeds: sukuk proceeds must be used exclusively to finance or refinance expenditures related to eligible green or sustainability projects
- Project evaluation and selection: a clear tagging process to identify expenditures related to eligible green projects
- Management of proceeds: identify whether there are any designated accounts to capture such proceeds and the processes for allocation of the proceeds
- Reporting: publish an annual report on the progress of the identified eligible projects, the amount of proceeds allocated and an impact analysis where an independent third party would be appointed to provide assurance

Issuers would then be encouraged to appoint an SPO provider for an independent assessment of the accuracy and integrity of the sustainability framework, which adds credibility.

For sustainability-linked instruments, profit payments are linked to an issuer’s performance against company-wide ESG KPIs. There is a need to identify the relevant ESG metrics as KPIs, which should be relevant, core and material to the issuer’s overall business, measurable or quantifiable on a consistent methodological basis, and externally verifiable.



As an example, Yinson Holdings issued the world’s first sustainability-linked sukuk with a profit step-up in 2021. This was an innovative structure with a tiered profit step-up against three sustainability performance targets.

Market players must work together on encouraging greater transparency in order to address concerns around greenwashing. All sukuk transactions must be asset-based to be Shariah-compliant. In the current ESG sukuk market, issuers tend to have two separate sets of assets: underlying assets to be used under the sukuk structure; and ESG assets identified as eligible projects.

Although the underlying assets under the sukuk structure are not limited to ESG assets, issuers may want to work towards utilising the ESG assets as the underlying assets for the sukuk structure for efficiency purposes.

In reality, it can be challenging to find assets that meet both criteria. However, the Malaysian government’s sustainability sukuk in 2021 successfully identified such assets by employing vouchers under public infrastructure projects as its tangible assets under the sukuk structure, and it utilised the same public infrastructure projects as the ESG government assets identified under eligible projects as per the framework.

With sustainability-linked sukuk, the biggest challenge lies in defining an ambitious KPI (e.g., emissions-reduction targets). A one-size-fits-all approach does not work, in our view. We need to recognise that each sector’s pathway to Net Zero will be different, depending on technological constraints and the

starting carbon footprint. Hence, a sector-specific approach is needed, where companies ought to be assessed against a sector-specific benchmark.

**Is the pricing of ESG sukuk in the primary market more favourable compared to traditional sukuk? Could we observe ‘greeniums’ for these sukuk?**

The greenium measures the spread of ESG-labelled sukuk to non-ESG-labelled sukuk from the same issuer of the same seniority and maturity.

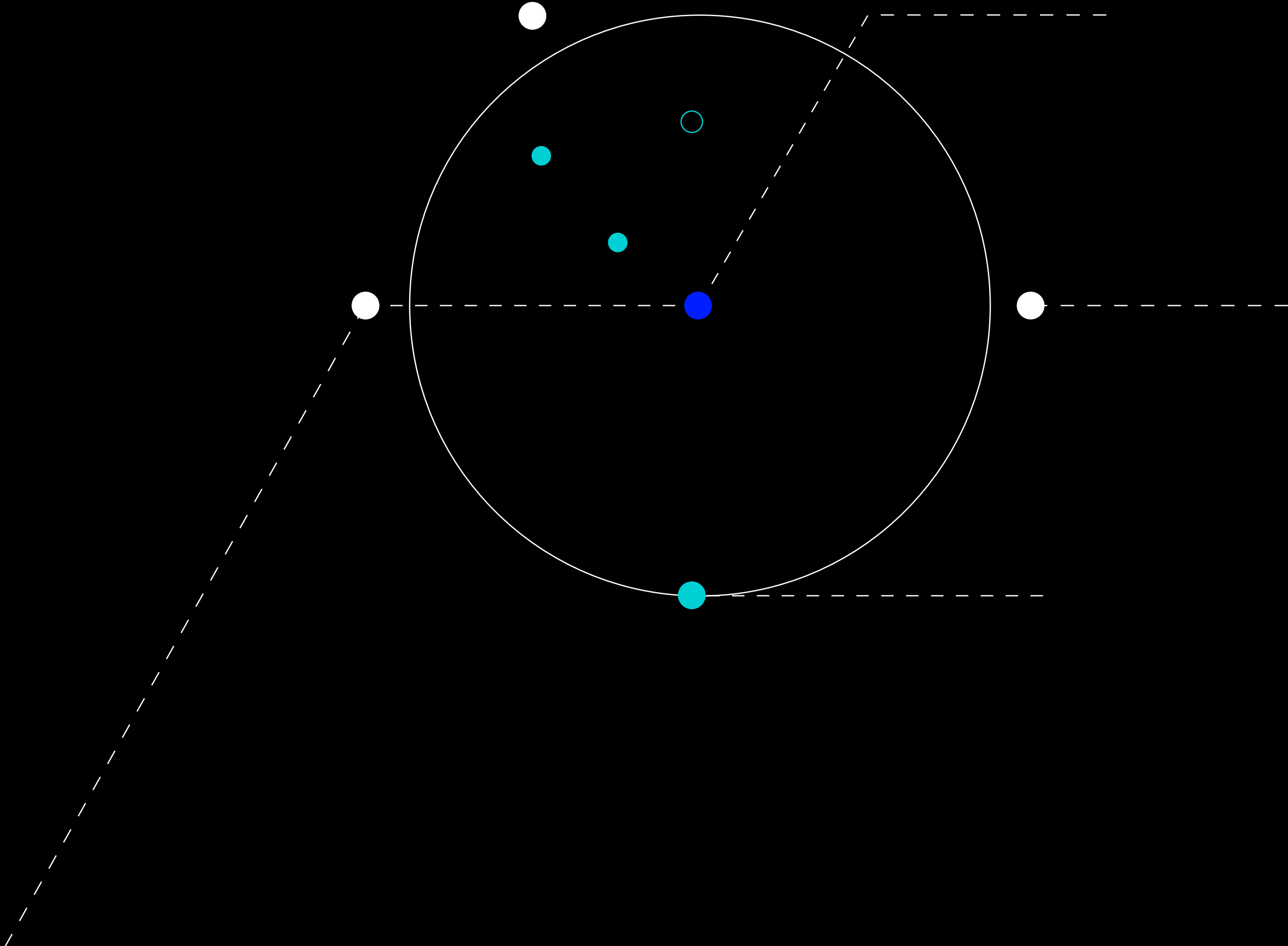
In 2020, Cagamas, the National Mortgage Corporation of Malaysia, priced a 3-year ASEAN sustainability SRI sukuk (SRI sukuk) and a plain-vanilla Islamic Medium-Term Note (IMTN) in the local market on the same day. There was a lower yield recorded (2 basis points) on the SRI Sukuk compared to the IMTN. However, it is worth highlighting that ESG sukuk transactions may be able to garner a larger order book, driven by the wider pool of ESG-focused investors.

As such, issuers can achieve a higher price compression during the book-building process, subject to market conditions. Although the pricing advantage is uncertain at this juncture due to the limited comparables in the sukuk market, we can view greeniums as the ‘price’ of cutting financed emissions.





# ECOSYSTEM FOR GREEN AND SUSTAINABILITY SUKUK



# Policies and regulatory landscape

*Policymakers and regulators across a number of Islamic financial jurisdictions are developing policies and action plans towards achieving sustainable development agendas, including green and sustainability investments, by 2030.*

## National policies

**Indonesia** – The country's National Long-Term Development Plan of 2005-2025 sets out green and sustainable development plans for the Indonesian economy, which are estimated to require annual investment of between \$300 billion and \$530 billion. The majority of these investments will be directed towards critical infrastructure, agriculture, forestry, energy, mining and waste. Sustainable finance is part of the long-term strategic plan to move from a consumption-based economy to a productive economy focused on key sectors.

In 2014, Indonesia's Financial Services Authority (OJK) launched its Sustainable Finance Roadmap, which calls upon the financial sector, including capital markets, to contribute to the national commitment to address climate change.

The second phase of the roadmap, covering 2021-2025, provides a further blueprint for the sustainable transformation of the financial sector, aimed at strengthening the resilience and competitiveness of financial services. The OJK also set up a sustainable finance task force as a platform to coordinate the financial industry in developing a sustainable finance ecosystem under the five-year roadmap.

In 2017, the OJK released its Sustainable Finance Umbrella Policy, which outlined an action plan for banking, capital markets, and non-banking sectors. Under this policy, financial institutions were required to submit an annual plan to the OJK on their implementation of sustainable finance, covering the development of green financing offerings and expanding green portfolios, in addition to incorporating sustainability within organisation, risk management, and governance structures.

**Malaysia** – The Malaysian government, in its Twelfth Malaysia Plan roadmap for 2021-2025, stated that the country's development is aimed at advancing sustainability and promoting the green economy. The highlighted priorities include enhancing green financing and incentives, driving investment in renewable energy, and promoting the circular economy.

Securities Commission (SC) Malaysia launched the Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market (SRI Roadmap) in 2019. This was aimed at creating a facilitative SRI ecosystem and charting the role of the capital market in driving Malaysia's sustainable development.

**UAE** – In 2021, the UAE Ministry of Climate Change and Environment published the UAE Sustainable Finance Framework 2021-2031, which presented a set of recommendations including incentivising sustainable finance products and initiatives, and prioritising improvement in the supply and demand of sustainable finance products and climate and green investment projects. The framework also looked into capacity building of existing and future sustainable finance professionals.





# Executive insights



**Nana Riana**  
Deputy Director Regulation and Legal Analysis of  
Islamic Finance, Directorate of Islamic Finance  
  
DG of Budget Financing and Risk Management  
  
Indonesia Ministry of Finance

## Do you view the development of a dedicated regulatory framework as integral to the growth and success of the ESG sukuk market in your jurisdiction?

A dedicated regulatory framework is a key building block for the growth and success of Islamic green finance as well as the ESG sukuk market. The framework would also be a key driver in bridging Islamic finance and the green industry.

Developing a regulatory framework would be beneficial as it would improve standardisation in both the issuance and reporting processes. This would ensure consistency across issuances, proper standards being met, and ease of comparability for investors as well as other stakeholders in the transaction.

A green bond/sukuk framework emphasizes the use and management of proceeds, reporting processes, and external party review, which are among the processes that support the transparency and accountability of ESG sukuk issuance. For investors, disclosure is among the areas of major concern, and may include investment screening and reporting.

At the regulatory level, it is important to encourage more green and sustainability sukuk issuances by means of incentives. In Indonesia, for example, the OJK released its Board of Commissioners Decree in 2018, which provided a 25% discount for first-time issuers who registered their green bond transactions in the capital market. Similarly, the Indonesia Stock Exchange’s (IDX) Board of Directors Decree of 2020 provided a 50% discount on the listing fee for green bonds.



**What is your approach to streamlining the issuance process and standardization of the taxonomy for ESG sukuk?**

The OJK, as a regulator, has released the Indonesia Green Taxonomy, which can be used as a reference for not only onshore capital markets but also wider stakeholders.

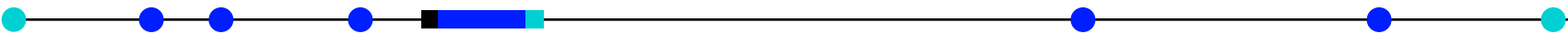
Intensive consultation and discussion with the OJK and green advisers would be necessary for corporates issuing green bonds/sukuk to ensure that the whole process complies with the standard.

The Ministry of Finance is also open for discussion with corporates who would like to hear the experience and knowledge of how the government sets the green framework and issues green instruments.

**What types of incentives would make issuing ESG sukuk more conducive for issuers?**

The OJK has several initiatives on incentives for issuers of green financial instruments as per Regulation No. 60/POJK.04/2017. This regulation states that incentive types may include capacity-building, sustainable finance awards, and other incentives.

Technical assistance and/or financial incentives in preparing green or ESG instruments would further promote green or ESG issuance, such as the 25% discount offered to first-time issuers who registered their green bond transactions in the capital market under the OJK’s Board of Commissioners Decree of 2018.



## Regulatory frameworks

**Malaysia** – SC Malaysia introduced its SRI Sukuk Framework in 2014, setting guidelines that would encourage asset owners to adopt the UN Global Compact Principles, SDGs or other ESG standards. In 2019, the framework was revised to enhance disclosure standards and reporting requirements, and to clarify the role of external reviewers, further aligning the requirements with internationally accepted principles and best practices.

More recently, SC Malaysia launched the SRI-linked Sukuk Framework in July 2022, expanding on the SRI Sukuk Framework. This new set of rules allows for the use of proceeds to be for general purposes, contingent on the issuer committing to pre-specified sustainability outcomes within a predefined timeline, monitored by key performance indicators.

**Indonesia** – The OJK issued its Regulation on the Issuance and the Terms of Green Bonds in 2017, aimed at encouraging the development of environmentally friendly capital market products. The regulation set standards for green bond issuance, covering 11 categories for eligible projects, including energy efficiency, pollution prevention and control, natural resource management, and biodiversity conservation. A minimum of 70% of green bond proceeds must be used to finance green projects.

**Pakistan** – In 2021, the Securities and Exchange Commission of Pakistan (SECP) approved national guidelines for green bonds and sukuk. According to these guidelines, green sukuk can only be issued based on globally accepted standards such as ICMA's Green Bond Principles. Eligible projects are expected to be mapped to the SDGs.

**Kuwait** – In February 2022, Kuwait's Capital Markets Authority made comprehensive amendments to Module 11 of its Capital Markets Law executive bylaws to regulate the processes for issuance, listing and subscription of instruments including green, sustainability and social-impact bonds and sukuk.

**Qatar** – The Qatar Financial Centre (QFC) launched the GCC's first dedicated sustainable sukuk and bonds framework in March 2022 to further develop the local debt market. The framework is based on ICMA's Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines. It is focused on promoting appropriate disclosures and the flow of relevant information, reporting and transparency to ensure that ESG objectives are met, and greenwashing risks are minimized.

**Bangladesh** – Bank Bangladesh, issued its Policy on Green Bond Financing for Banks and FIs in September 2022, outlining guidelines on issuing green bonds for banks and non-banking financial institutions (NBFIs). These guidelines allow financial institutions to issue green bonds across eight sectors, only when their non-performing loans (NPL) are less than 10% of the total loans, with more relaxed rules for state-owned banks.

The policy specifies that these green bonds must also comply with the Bangladesh Securities and Exchange Commission (Investment Sukuk) Rules and relevant Islamic Shariah principles.

**Oman** – Oman's Capital Market Authority issued Draft Bonds and Sukuk Regulation in 2021, which also covers SRI, including but not limited to social (Waqf), sustainable, green and, for the first time, blue sukuk.



## International standards

The majority of ESG sukuk so far issued have complied with one of the ICMA principles – the Green Bond Principles (GBP), Sustainability-Linked Bond Principles (SBP) and Sustainability Bond Guidelines (SBG) - which have collectively become the world's leading frameworks for the issuance of thematic bonds. These principles are voluntary frameworks outlining best practices when issuing bonds serving social and/or environmental purposes. They provide guidelines and recommendations that promote transparency and disclosure, thereby enhancing the integrity of the market.

The Principles also raise awareness of the importance of environmental and social impact among financial market participants, which is ultimately aimed at attracting more capital to support sustainable development

Nearly 50% of green sukuk that are GBP-compliant are also compliant with the ASEAN Capital Markets Forum's ASEAN Green Bond Standards (ACMF ASEAN GBS). These green sukuk have been issued by Malaysian corporates as well as the Indonesian government.

The standards were developed based on ICMA's GBP but provide more specific guidance on how the GBP are to be applied across ASEAN in order for bonds to be labelled as ASEAN Green Bonds. Being based on GBP makes them internationally accepted and widely used for the development of national green bond guidelines.

The ASEAN GBS are intended to enhance transparency, consistency and uniformity of ASEAN green bonds, which will also contribute to the development of a new asset class, reduce due diligence costs, and help investors to make more informed investment decisions.





## Executive insights



**Dr. Mohamad Akram Laldin**  
Executive Director

Islamic Shari'ah Research Academy (ISRA)

### What separates ESG bonds from also becoming Shariah-compliant?

ESG principles are largely aligned with Shariah principles. The general principles of Shariah related to fairness, transparency, equal rights and other related principles are also the guiding principles for ESG bonds. However not all ESG bonds can also be considered Shariah-compliant. For example, ESG bonds that use their proceeds to finance projects involving interest-bearing activities do not qualify as Shariah-compliant. This would also apply to the institutions involved in facilitating the bond transactions. In addition, the contract used to issue the bond must also be Shariah-compliant. Generally speaking, ESG bonds are Shariah-compliant in term of the purpose of the bonds and will be easier to be issued to comply with the Shariah requirements.

### What are the current Shariah standards that are applicable to green and sustainability sukuk? Are they sufficient?

Currently there are no specific Shariah standards applicable to green and sustainability sukuk. However, the existing Shariah standards for sukuk would still apply to ensure the Shariah compliance of a green or sustainability bond, even though general ESG principles overlap with Shariah standards.

Having said that, some scholars have developed the Maqasid matrix for the purpose of ensuring that financial products are in line with the general purpose and objectives of Shariah or Maqasid al-Shariah. This matrix can be used for guiding principles in the issuance of ESG sukuk because it covers a broader range of values or principles, including ESG, SRI, VBI and other principles. Still, the challenge here is to ensure that all the values are validated to ensure they comply with the general and specific principles of Maqasid al-Shariah.

**Are there any plans to develop more specific standards for green and sustainability sukuk?**

It is important to develop more specific standards for green and sustainability sukuk. At the moment, we at the International Shari’ah Research Academy for Islamic Finance (ISRA) and the International Centre for Education in Islamic Finance (INCEIF) are working on a number of initiatives with industry players related to ESG principles. We are also open to further collaborations to develop more specific standards for green and sustainability sukuk.

In addition, we are also working on a framework to integrate aspects of Maqasid al-Shariah that overlap with ESG, SRI and VBI principles into fatwa issued by Shariah scholars. This will add an ESG perspective to the fatwa, in addition to the Fiqh (Islamic legal) point of view, taking into consideration the social and environmental impacts of the sukuk or Islamic product as well.





## Taxonomy

Taxonomies have been developed as classification systems for green and sustainable finance to identify activities, assets and/or project categories that deliver on key climate, green, social or sustainability objectives with reference to identified thresholds and/or targets. These taxonomies may be based on lists and descriptions of eligible projects, assets and activities, or may be based on quantitative or qualitative process-based criteria.

### **Climate Bonds Initiative's (CBI) Climate Bonds Taxonomy** –

Nearly all green sukuk issued to date align with the CBI's taxonomy. First released in 2013, this globally recognised taxonomy framework outlines a 'traffic light' system to determine eligibility. Assets are attributed 'green' when they are considered automatically eligible, which is generally coherent with the Green Bond Principles.

**EU Taxonomy** – The EU's Taxonomy Regulation, which came into force in 2020, is a classification system that defines and sets rules that determine which economic activities are environmentally sustainable. More recently, the EU introduced Taxonomy-linked disclosure obligations on companies and financial market participants. The EU Taxonomy involves Technical Screening Criteria (TSC), which define the specific requirements and thresholds for an activity to be considered as significantly contributing to a sustainability objective.

**Indonesia Green Taxonomy 1.0** – The OJK launched its Green Taxonomy framework in 2022 as a guideline for supporting the Sustainable Finance Program. The taxonomy builds on the government's efforts to attract more capital to sustainable finance in Indonesia. The framework is aimed at classifying sustainable financing and investment activities and is intended to be the basis for all stakeholders carrying out sustainable economic activities. It further classifies activities that support environmental protection and management, as well as climate change mitigation and adaptation in line with the government's Nationally Determined Contributions, with the goal of encouraging innovation and investments in sustainable economic activities.

## Malaysia's SRI Taxonomy

SC Malaysia announced that it will release its SRI Taxonomy by the end of 2022 as part of the next phase of capital market development under its Capital Market Masterplan 3.

The voluntary framework aims to:

- Accelerate the development of the SRI asset class and promote greater awareness and adoption of sustainability practices
- Set out principles and guidance that capital market participants can adopt in order to undertake sustainable economic activities
- Enable capital market participants to identify economic activities that are aligned with environmental, social and sustainability objectives
- Provide guiding principles for financing a credible transition, in order to enable more companies to leverage market-based instruments in meeting their transition financing needs

# Industry development

## High-Level Working Group on Green and Sustainable Sukuk (HLWG)

The HLWG was launched in November 2021, during the COP26 programme, by founding partners the UKIFC, GEFI, London Stock Exchange, the UK Treasury, Indonesia's Ministry of Finance and IsDB.

The three-year initiative group is the fourth working group under the Global Islamic Finance and the SDGs Taskforce. It aims to develop and promote green and sustainability sukuk as a viable financial instrument that can attract capital at scale to finance projects for achieving the SDGs.

The HLWG will focus on the following objectives:

- Ensuring green and sustainability sukuk are featured at annual COP summits up to and including 2023, which will increase awareness of the ESG sukuk and encourage their issuance as a key Islamic financing tool
- Assisting and enhancing established global standard-setting bodies and regulatory initiatives to encourage better alignment of the Islamic finance industry with the global green and sustainability financial movement
- Identifying and addressing specific existing challenges for green and sustainability sukuk on the supply and demand sides



# Second Party Opinion (SPO) providers

Green and sustainability bond principles generally recommend the use of external reviews, assessments, or verification of the bonds or associated frameworks, which plays a critical role in providing investors with the information on the green or sustainability credentials of sukuk they need in order to make their initial investment decision.

SPOs are the most common form of external reviews used by green and sustainability sukuk issuers, so far covering 91% of such sukuk. They are pre-issuance assessments of green and sustainability bonds or, more specifically, their associated frameworks, conducted upon the issuer’s request by external consultants with environmental and climate expertise.

## Breakdown of SPOs provided for green and sustainability sukuk as of H1 2022

Second opinion provider	Markets	% of SPOs provided
CICERO Shades of Green	International	44.9%
RAM Sustainability	Malaysia	38.8%
MARC	Malaysia	11.5%
Others: Sustainalytics, Vigeo Eiris, S&P Global, Tuva	International	4.8%

Source | Refinitiv, an LSEG business

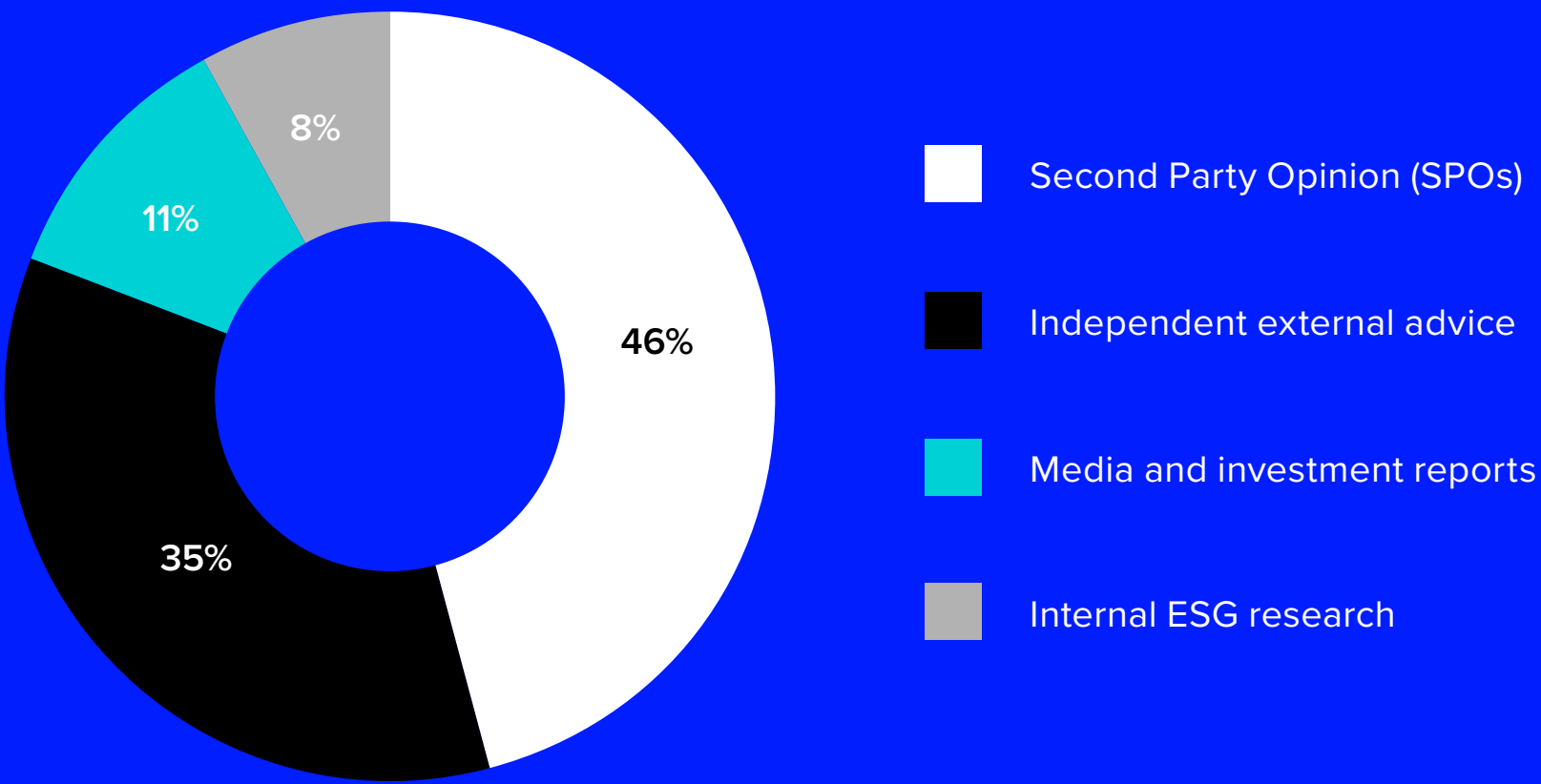
The most prominent SPO providers for ESG sukuk include CICERO, which has provided SPOs supporting over 100 domestic and international green and sustainability sukuk issuances. Local rating agencies RAM Sustainability and MARC are prominent SPO providers in the Malaysian market, supporting more than half of domestic green and sustainability sukuk. Other SPO providers active in the international green and sustainability sukuk space include Sustainalytics, S&P Global, Vigeo Eiris and Tuva.

# Survey

## Assessment tools for ESG credentials

In addition to their popularity among issuers, investors also regard SPOs as the most useful tool for assessing the green and sustainability credentials of sukuk, according to 46% of survey respondents.

### What is the most useful tool when analysing green and sustainability sukuk credentials?

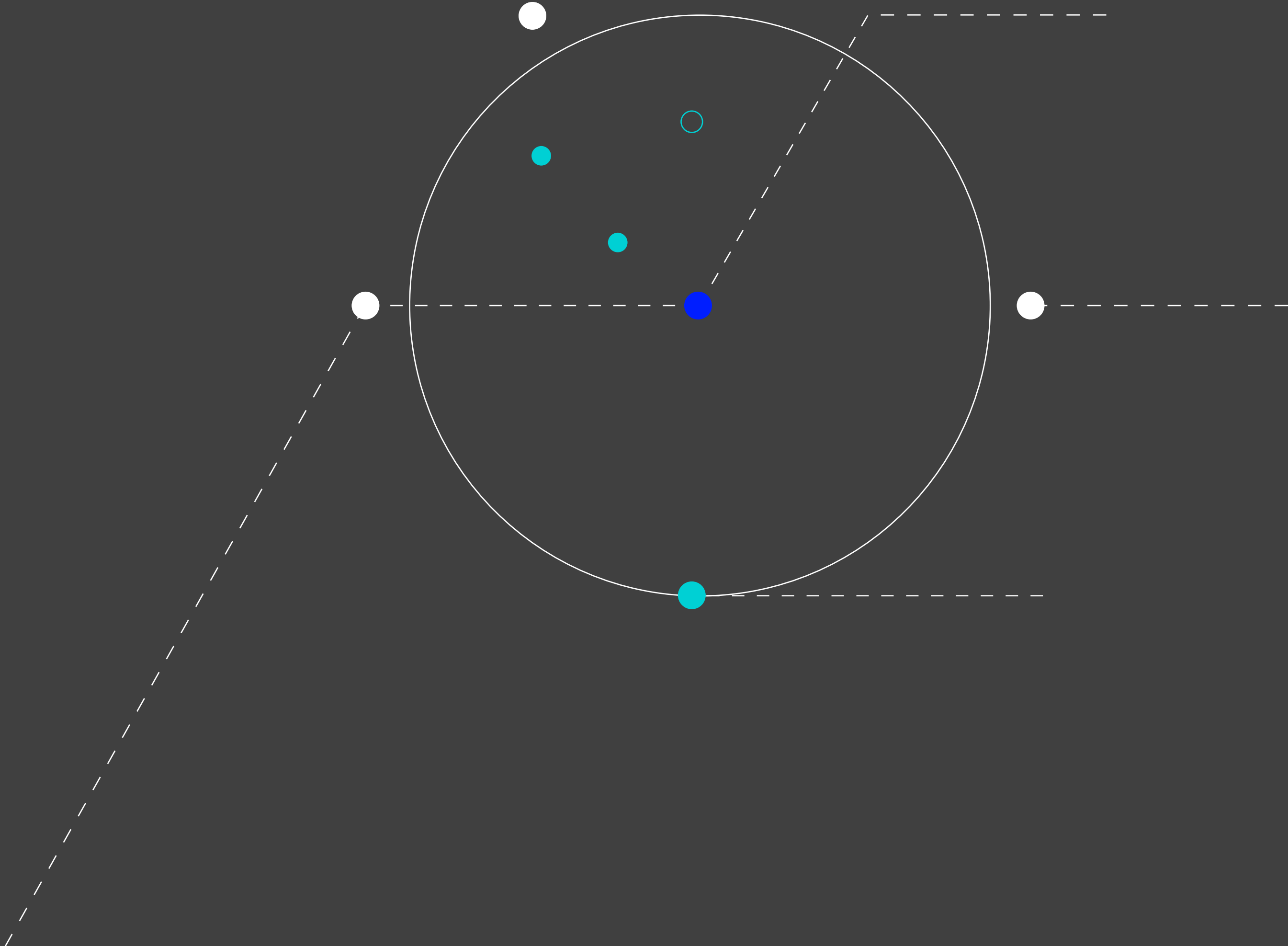


Source: Refinitiv Sukuk Survey 2022

Independent external advisories also seem to be a common tool for verifying sukuk’s ESG credentials, used by 35% of respondents. A small proportion of investors prefer to rely on internal resources.



# ROADMAP FOR GREEN AND SUSTAINABILITY SUKUK



As mentioned earlier in this report, the funding gap for fulfilling SDG requirements in developing countries, including OIC countries, amounts to \$2.5 trillion annually by 2030. This funding need is equivalent to 3.5 times the current size of the sukuk market, presenting a huge opportunity for ESG sukuk. It is estimated that \$30 billion to \$50 billion of capital dedicated to the SDGs could be raised through green and sustainability sukuk by 2025, according to UKIFC.

Burgeoning global demand for ESG investments presents further opportunities for growing the ESG sukuk market. More than \$600 billion flowed into ESG-focused funds in 2021, according to data from Refinitiv Lipper. Demand will continue to increase as ESG investment growth extends into developing economies, which will prompt even higher flows into ESG-focused fixed income funds. Naturally, this will increase demand for ESG sukuk as a tool for diversification and a source of higher yields.

However, the ESG sukuk market is still in an early development phase. In order to keep pace with the growth of the wider ESG bond market and leverage increasing investor demand and growth opportunities from SDG funding needs, a considerable development journey lies ahead.

This section outlines key recommendations under the following three pillars, based on best practices and experiences of established sukuk jurisdictions in capital market development:

- 1. Promote common regional and international standards**, to build a common understanding of the market
- 2. Build capacity** with issuers and enhance the wider ecosystem
- 3. Expand the investor base** beyond traditional sukuk investors

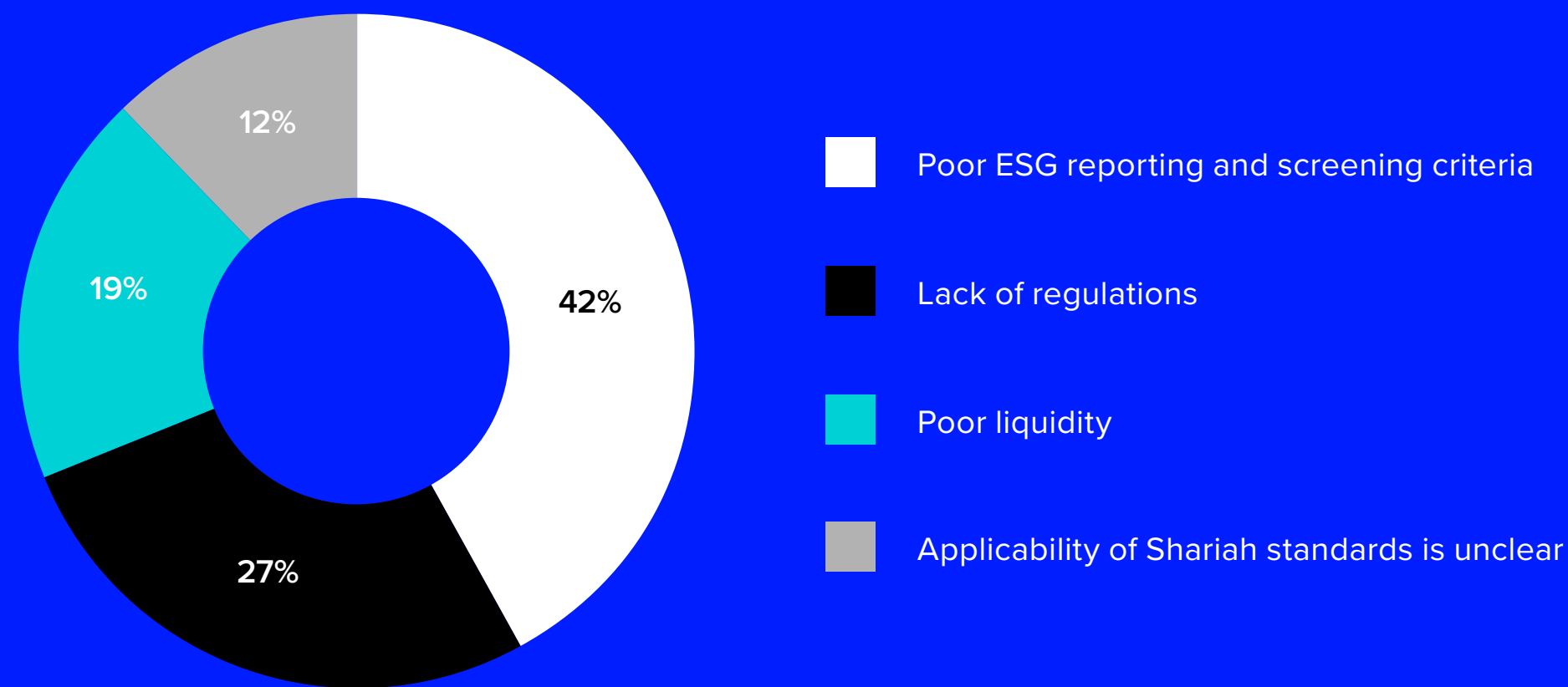


# Survey



## Areas for further development of green and sustainability sukuk

What is the main reason holding investors back from investing in green and sustainability sukuk?



Source: Refinitiv Sukuk Survey 2022

The majority of respondents in the Refinitiv Sukuk Survey said that ESG reporting and screening criteria were the main reason keeping investors from investing in green and sustainability sukuk.

Concerns over ESG governance appear to be taking precedence over clarity of Shariah standards’ applicability for prospective investors in green and sustainability sukuk. This supports the observation that fulfilling ESG investment mandates is the main driver for ESG sukuk investments. Meanwhile, 27% of respondents believe more regulation around these sukuk is required to attract new investors.





# Executive insights



**Omar Shaikh**  
Advisory Board Member & Director  
  
Islamic Finance Council UK (UKIFC)

## What do you perceive to be the main challenges to the development of the ESG Sukuk market?

There are current inherent challenges within the sukuk market, applicable to ESG and non-ESG sukuk, relating to the current AAOIFI legislation being a significant issue. In particular, AAOIFI standard 59 prohibits certain types of sukuk from being issued and this has impacted the market.

Two specific challenges we see in relation to the development of the ESG Sukuk market are:

- Awareness, understanding and technical knowledge: to issue a green or sustainability sukuk, issuers must develop a framework, using global best practice approaches (such as the Green Bond Principles). This will enable issuers to measure, report and authenticate issuance. The skill sets and processes required to do this are new to sukuk issuers and are additional to the existing Shariah compliance requirements.
- Strategic will: if all other factors (cost, etc.) remain neutral, do issuers genuinely want to do this? Structuring sukuk is more resource-intensive than structuring conventional bonds, so going a step further to structure a green or sustainability sukuk is perhaps, for many, a step too far. Governments and regulators therefore have an important role to stimulate the market and engage stakeholders.

## How do you evaluate the current state of market awareness of ESG sukuk?

At present there is limited understanding of ESG sukuk in the market. The work being led by the UKIFC, such as the Global Islamic Finance & SDGs Taskforce, is playing an important role in mobilising stakeholders to raise awareness and inspire practical action. The HLWG launched by the Taskforce at COP26 and showcased during the UN General Assembly has shone an important light on the role ESG sukuk can play in helping countries meet their Nationally Determined Contributions by attracting a wider investor base as the demand for environmentally conscious investments grow. For the first time, this is giving Islamic finance a formal and consistent voice at the global COP platform.



Market pioneers such as IsDB, the Indonesian government and Majid Al Futtaim are playing an important role by issuing benchmark-size, global green and sustainable sukuk. Such issuances offer best-practical examples, at scale, that can help to promote green and sustainability sukuk as viable options for other issuers. In Malaysia, the SC has been issuing useful SRI market frameworks, and from the GCC, CIBAFI have been actively promoting SDG-alignment and sustainability amongst member Islamic banks.

**How are you facilitating the policy development and standardisation of streamlining ESG sukuk globally?**

In 2021, UNDP Indonesia commissioned the UKIFC to put together a report showcasing Indonesia’s pioneering sovereign green sukuk. The report acts as a toolkit for helping others globally who are considering the issuance of an ESG sukuk.

After COP26, the HLWG, chaired by London Stock Exchange, is facilitating policy development and the standardisation and streamlining of ESG sukuk issuance globally. The working group is bringing together key stakeholders to identify challenges for ESG sukuk and to present practical solutions.

In addition, the Taskforce has already issued a guidance note to assist Islamic banks in reporting under the UN Principles for Responsible Banking, presented ESG sukuk at multiple global events, conducted a global retail survey exploring consumer awareness and appetite for sustainable products, issued a Pakistan country-level sustainability report, and designed a comprehensive structured ESG capacity-building programme.

**In which markets do you see expansion and growth opportunities for ESG sukuk? Which sectors do you expect will drive issuance growth?**

Based on our aforementioned work, the UKIFC estimate an additional \$30 billion to \$50 billion of capital towards the SDGs can be raised by 2025 through green and sustainability sukuk. There is considerable opportunity for ESG sukuk across the OIC countries, as well as the UK. Indonesia, Pakistan and Malaysia will continue to be important markets and Central Asian markets could become more active in coming years.

Additionally, with COP27 taking place in Egypt this year and COP28 hosted in the UAE in 2023, it is likely some of the large GCC energy, construction and aviation companies will tap into the ESG sukuk market, which can help facilitate their transition to Net Zero and their development work within the clean green energy space.



# Key recommendations for green and sustainability sukuk development

## PROMOTE COMMON REGIONAL AND INTERNATIONAL STANDARDS

- Develop ESG sukuk masterplans or roadmaps
- Introduce specific ESG sukuk guidelines or regulations
- Harmonise taxonomy approaches
- Adapt internationally accepted green and sustainability standards for sukuk applications
- Standardise ESG disclosure and reporting requirements and mandate ESG assurance
- Build issuer awareness and a specialised ESG talent pool

## BUILD CAPACITY WITH ISSUERS AND ENHANCING THE WIDER ECOSYSTEM

- Increase issuance volume**
- Incorporate green and sustainability sukuk within the government funding mix
  - Offer issuers cost-reduction incentives
  - Establish ESG segments within stock exchanges
- Innovation**
- Support issuance of transition sukuk
  - Introduce blue and nature sukuk
  - Use Sukuk-Waqf to fund social finance projects

## EXPAND THE INVESTOR BASE BEYOND TRADITIONAL SUKUK INVESTORS

- Offer incentives for investors
- Promote investor awareness and capacity building
- Attract investors with no Shariah compliance mandate

# Pillar 1: Promote common regional and international standards, to build a common understanding of the market

## Develop ESG Sukuk masterplans or roadmaps

*Impacted stakeholders: ecosystem*

The development and success of green and sustainability sukuk markets depends initially on government support. Some OIC countries' national economic and financial sector development plans have set out objectives that address certain aspects of sustainable finance. However, establishing a dedicated, comprehensive masterplan or roadmap focused on developing domestic ESG capital markets, or more specifically green and sustainability sukuk, would further underline governments' commitment.

Malaysia, for example, hosts the most developed ecosystem and market for green and sustainability sukuk. Demonstrating the government's commitment to developing this market, SC Malaysia launched its five-year SRI Roadmap, which identified 20 strategic recommendations to drive the development of a robust SRI ecosystem and position Malaysia as a regional SRI centre. These include broadening the range of SRI instruments, increasing the SRI investor base, building a strong SRI issuer base, instilling a strong internal governance culture, and designing an information architecture within the SRI ecosystem.

Other Islamic financial jurisdictions could develop similar national-level plans taking local context into account. A masterplan for green and sustainability sukuk should identify specific initiatives to encourage more primary market issuance, facilitate liquidity, establish a wider investment pool, and promote foreign investment through the development of the appropriate regulatory frameworks, market infrastructure, capacity-building, and incentivisation programmes.

## Introduce specific ESG sukuk guidelines or regulations

*Impacted stakeholders: ecosystem*

Regulatory support is also integral to the development and growth of the green and sustainability sukuk market. Regulatory guidelines or frameworks specific to these sukuk should serve as an extension to existing bond or sukuk regulations. The green and sustainability sukuk guidelines would address more specific areas of the issuance process, including the use of proceeds, eligible ESG projects, disclosure and reporting requirements, and external reviews. They would also be beneficial for distinguishing between use of proceeds and the sukuk's underlying assets, in order to address any ambiguities while identifying eligible ESG projects.

It is proposed that regulators develop these guidelines based on international standards and best practices for green and sustainability bonds and sukuk. However, it is crucial to periodically revise the regulations in order to remain aligned with international standards and to ensure that procedural bottlenecks do not impede market development.

Both ICMA and CBI have made updates to their green bond standards, in 2021 and 2022, respectively. These updates reflect recent developments in the market and regulatory frameworks and emphasise that regulations and standards must keep pace with the evolving market landscape. While the ESG sukuk market may still be in its early stages, it would be prudent for regulators to align with developments and regulations in the wider ESG debt market as a priority, in order to avoid missing new risks that could emerge as green and sustainability sukuk enter the mainstream.





As an example, SC Malaysia’s SRI Sukuk Framework was introduced as an extension to its previously established Sukuk Guidelines, with core components including the use of proceeds, processes for project evaluation and selection, management of proceeds, and disclosure and reporting. The revised SRI Sukuk Framework later expanded the list of eligible SRI projects, enhanced disclosure and reporting requirements, and clarified the role of external reviewers.

It is also proposed that ESG sukuk regulations identify and clarify which Shariah standards apply to the sukuk and mandate their compliance. Clarifying the stage of the issuance process at which a Shariah review should take place would benefit issuers. It is suggested that it takes place prior to the ESG external review or SPO.

### **Harmonise taxonomy approaches**

*Impacted stakeholders: regulators, issuers, investors*

Although taxonomies offer investors security and clarity, their multiplicity across national, regional and international levels may fragment the market and cause some confusion for investors. Developing a global green and sustainability taxonomy that can serve as a ‘gold standard’ would reduce information and data inconsistency as well as difficulty of comparison, which in turn would mitigate greenwashing and social-washing risks.

While Indonesia and Malaysia have already developed national green and SRI taxonomies, an international green and sustainability sukuk taxonomy could be developed in alignment with internationally accepted taxonomies such as the CBI Taxonomy for green bonds.

Regulators, investors and other stakeholders have become increasingly concerned about greenwashing and mislabelling of ESG investments resulting from loopholes in taxonomy frameworks. It is imperative that the taxonomy be comprehensive, recognising differences between national contexts and priorities. This would ensure inclusive coverage of projects or sectors that would otherwise be excluded because they do not fit the remit of taxonomies developed in other jurisdictions.

It is also important for the taxonomy to follow a multi-tier approach, similar to the CBI and ASEAN taxonomies, to ensure clearer labelling of green and sustainability investments. The binary approach of the EU taxonomy sparked debate in July 2022, following the inclusion of nuclear power and natural gas as environmentally sustainable economic activities from 2023. While private investments in gas and nuclear energy are needed for energy transition, a general ‘green’ label would not be suitable in this case. Green investments fall into varying degrees of ‘green’, and a multi-tier approach would help issue a more specific green label that ensures an investment such as in natural gas would not be labelled exactly the same as an investment in solar energy, for example.

### **Adapt internationally accepted green and sustainability standards for sukuk applications**

*Impacted stakeholders: regulators, issuers, investors*

As with taxonomies, multiple green and sustainability compliance standards could raise concerns over compliance risk in the long run with various regulators impose differing local, regional and international standards.

It is proposed that the HLWG undertakes the objective of adapting internationally accepted green and sustainability standards for sukuk applications. Existing green and sustainability standards can be expanded to include sukuk-specific provisions that take into consideration the nuances of various Islamic financing structures, following the concept of the ASEAN GBS. It is also suggested to supplement these standards with guidance notes on their application to green and sustainability sukuk. Ideally, this would be a joint initiative with an international green and sustainability standards-setting body such as ICMA.

### **Standardise ESG disclosure and reporting requirements and mandate ESG assurance**

*Impacted stakeholders: regulators, issuers, investors, data providers*

With greater disclosure comes greater transparency, which benefits regulators and investors. The Taskforce on Climate-Related Financial Disclosures (TCFD) framework is increasingly becoming the foundation for standards and requirements needed to chart the transition to a low-carbon economy.



The framework is overarching and its implementation warrants consideration by banks and other financial institutions, as well as capital markets.

However, the adoption of the framework in core sukuk markets remains at a nascent stage, with Malaysia only recently issuing draft guidelines for its adoption while other jurisdictions are still exploring the option.

TCFD recommendations provide guidance to all market participants on the disclosure of information on the financial implications of climate-related risks and opportunities so that they can be integrated into business and investment decisions.

It is suggested that the TCFD framework be incorporated in green sukuk guidelines among the disclosure and reporting requirements. The framework's wide international adoption and acceptability will make compliant green sukuk more attractive to international investors.

The standardisation of disclosure and reporting requirements can also help address the challenge of fragmented and inconsistent ESG data and ratings faced by investors. This is mainly the result of using varying ESG definitions and performance assessment methodologies across each of the three pillars (E, S and G), which reduces their comparability.

Multiple reviews of available ESG data, metrics and ratings have revealed a low correlation between ESG data and ratings providers. The considerable disparities between ESG ratings providers have led to investors demanding information that is consistent, comparable and reliable.

ESG assurance can restore investors' trust in the ESG information ecosystem. It is proposed that regulators require ESG issuers and ratings providers, in addition to entities publishing their ESG data, to seek third-party ESG assurance in order to ensure alignment with TCFD standards. This could take the form of third-party certification or reports supplementing annual ESG reports.

A report by EY estimates that half of the world's largest businesses have already achieved assurance

over their sustainability disclosures, with most having their disclosures deemed "limited". However, ESG assurance is expected to become a mandatory requirement in developed ESG markets such as the EU and US, mainly driven by policy intervention.

### **Build issuer awareness and a specialised ESG talent pool**

*Impacted stakeholders: regulators, issuers*

Issuer awareness and capacity-building are two of the main challenges facing the development of ESG bond and sukuk markets. Knowledge gaps still exist around the differences between ESG and traditional sukuk, as well as their advantages and challenges.

There is a need to develop a talent pool that has in-depth knowledge and expertise of ESG investment and fixed income markets across the entire ecosystem, including regulators, issuers, investors and verifiers.

For regulators and issuers, in particular, awareness, education and training on green and sustainability sukuk structuring and issuance, taxonomy, compliance, external reviews, and reporting are necessary.

It is proposed that capital market regulators set up training programmes and sponsor ESG certifications and qualifications for their staff. Secondments of these staff to regulators in Europe, Southeast Asia and the US that have more experience with ESG bonds would facilitate much-needed experience sharing and skills transfer in the ESG space and facilitate better global consistency.

It is also proposed that regulators and industry development bodies conduct awareness campaigns on ESG investment career development options for market professionals, and offer training programmes for various stakeholders. Such programmes could be explored by multilateral organisations such as IsDB in collaboration with relevant international bodies.

## Pillar 2: Build capacity with issuers and enhance the wider ecosystem

### Increase issuance volume (market depth)

#### Incorporate green and sustainability sukuk within the government funding mix

*Impacted stakeholders: governments, issuers*

As part of incorporating sustainable finance within national development plans, it is proposed to strongly promote the use of green and sustainability sukuk for financing environmental transition and sustainability projects led by governments or semi-government/state-owned entities. The resulting green and sustainability sukuk issuances would be the main driver of market growth, increasing market activity and liquidity and prompting similar issuances from the private sector.

The Indonesian government was the first sovereign to issue green sukuk, in 2018, and has since then been an active issuer. By the end of H1 2022, it had successfully issued \$5.8 billion in green sukuk to finance renewable energy and other climate-related projects, making it the world's largest green sukuk issuer. State-owned Saudi Electricity Company also issued \$1.3 billion in green sukuk to finance its green projects portfolio in September 2020.

OIC governments should consider including green and sustainability sukuk as an additional source of funding. GCC countries, in particular, are large producers of carbon emissions due to their sizeable oil industries, which is prompting multi-billion-dollar investments in energy-transition projects that can be financed through green and sustainability sukuk.

An added benefit to increasing sovereign ESG sukuk is the creation of a yield curve for green and sustainability sukuk, which would help guide the pricing of corporate issuances. This in turn would encourage more corporates to issue ESG sukuk.

### Offer issuers cost-reduction incentives

*Impacted stakeholders: issuers*

Compared to conventional bonds, green and sustainability sukuk involve two additional cost layers: the cost of a Shariah-compliance review and the cost of a green or sustainability SPO. This leaves potential issuers reluctant to venture into the green or sustainability sukuk issuance process.

Cost-reduction incentives have proven to be an effective tool for encouraging corporates to issue sukuk, as evidenced by the Malaysian capital market development model. Such incentives include tax deductions, fee waivers, discounts and grants.

SC Malaysia offers issuers two types of incentives:

- Tax Deduction on SRI Sukuk issuances for the expenditure incurred on the issuance or offering of SRI sukuk approved or authorized by, or lodged with, the SC during the years of assessment 2016-2023. The tax deduction is applicable to SRI sukuk of which 90% of the proceeds are used solely for the purpose of funding SRI projects as specified in SC guidelines
- SRI Sukuk and Bond Grant Scheme, where eligible issuers of SRI and SRI-linked can claim the grant to offset up to 90% of the external review costs incurred, subject to a maximum of RM300,000 per issuance.

Other incentives that could be offered to issuers include subsidising listing fees for new issuers or waiving regulatory approval fees for returning issuers.





**Establish ESG segments within stock exchanges**

*Impacted stakeholders: stock exchanges, issuers*

It is also suggested that stock exchanges that are popular with sukuk issuers - such as Bursa Malaysia, Nasdaq Dubai or Tadawul – establish green, sustainability or ESG segments, either as parallel markets or within their main markets. Dedicated green or ESG segments of stock exchanges offer a win-win opportunity for issuers and investors alike.

Such platforms offer issuers the access to substantial liquidity derived from institutional investor capital. They also vet potential listings based on robust ESG standards, disclosures and sustainability reporting, which enhances issuers’ profiles and boosts their visibility to investors. This vetting process also offers investors greater transparency and assurance of ESG compliance at both the issuer and sukuk levels.

London Stock Exchange and the Luxembourg Stock Exchange, where international sukuk are commonly listed, have each established such segments. London Stock Exchange became the first exchange to set up a dedicated segment for green bonds in 2015, supported by ICMA. The segment evolved into the Sustainable Bond Market (SBM), launched in 2019, which raises capital for green, social, sustainability and sustainability-linked purposes. In 2021, the exchange launched a world-first transition bond segment on the SBM, There were over 340 active bonds listed on the SBM, which raised \$142 billion by the end of 2021. This included 100 ESG bonds issued in 2021 alone.

Luxembourg Stock Exchange launched the Luxembourg Green Exchange (LGX), a dedicated platform for green, social and sustainable securities. LGX hosts over 1,300 sustainable debt securities in more than 40 currencies, valued at \$771.4 billion, making it the world’s leading platform for ESG bonds.

**Innovation (market breadth)**

**Support issuance of transition sukuk**

*Impacted stakeholders: issuers*

While issuance and demand for sustainability bonds and sukuk have risen substantially since the Covid pandemic emerged, transition bonds and sukuk are yet to gain traction.

Transition bonds and sukuk help corporates to transition from carbon-intensive to climate-neutral operations, underpinned by sustainable corporate strategies. To date, there has been only one transition sukuk issuance, from Etihad Airways, which raised \$600 million in 2020.

Investors have so far been cautious over transition bonds, avoiding commitments to currently high-carbon-emitting activities. Another challenge is that they are not so clearly defined and do not follow an agreed set of standards in the same way as green, sustainability and social bonds.

Still, the bonds can play an important role in facilitating the transition of corporates in fields that would not normally qualify for green bonds, such as large carbon-emitting industries including oil and gas, iron and steel, chemicals, aviation, or shipping. Core sukuk markets, particularly GCC states, would greatly benefit from transition bonds and sukuk to achieve their Net Zero targets.

There is room for growth in transition sukuk and bonds, but this will require more transparency on the use of proceeds and dedicated standards to gain greater acceptance by investors. Failure to do so could result in more greenwashing cases, where issuances by heavy-carbon-emitting corporates could be labelled ‘green’ because ‘transition’ is not clearly defined.

The London Stock Exchange’s Transition Bond Segment is a step in this direction, where issuances and issuers undergo a robust screening process before listing, which helps ease investor concerns and makes transition bonds and sukuk more appealing.



Collaborative efforts between market stakeholders to clearly define transition bonds and sukuk and introduce specific disclosure and reporting requirements at an international level would greatly boost investor confidence in these bonds.

**Introduce blue and nature sukuk**

*Impacted stakeholders: issuers*

The increased focus on ecosystem restoration and preservation has resulted in the development of two niche segments in the ESG bond market: blue bonds and nature bonds.

Blue bond proceeds can be allocated to sustainability projects that are directly operating in or by the ocean, seas and freshwater, including marine conservation and restoration, water-related infrastructure, shipping, offshore renewable energy, and projects that have a direct impact on the ocean, seas and freshwater. By H1 2022, total blue bond issuance has amounted to \$1.4 billion.

Sukuk issuers, particularly sovereigns that have set national priorities for marine conservation and restoration, could emulate and leverage such instruments to expand the green and sustainability sukuk offering, and perhaps reduce borrowing costs in the process.

Oman’s Capital Market Authority has included blue bonds and sukuk in the regulatory framework it is currently developing for green and other ESG sukuk. Also, in June 2022, the Indonesian government announced plans to issue blue bonds, under the Blue Principles, to finance ocean-related initiatives in Indonesia.

Over half of the world’s economic output, or around \$44 trillion, is dependent on nature to some extent. Nature and environmental risks, including biodiversity loss and degradation of ecosystems, are becoming a rising concern for governments, corporates and individuals. Biodiversity loss was ranked within the top five global risks by likelihood and by impact in the World Economic Forum’s (WEF) Global Risks Report 2021. In the 2022 edition, it was identified as the third most severe risk over the next decade.<sup>8,9</sup>

8. Granados Franco, Emilio, et al. “The Global Risks Report 2021”. World Economic Forum, Geneva, 2021.  
9. Granados Franco, Emilio, et al. “The Global Risks Report 2022”. World Economic Forum, Geneva, 2022.

To help address nature risks, the Taskforce on Nature-Related Financial Disclosures (TNFD), which builds on the TCFD model, was announced in July 2020. This international initiative aims to develop a framework for organisations to address environmental risks and opportunities, enabling the channelling of capital flows into positive action.

Nature bonds, a concept still under development, have been proposed to link issuances to biodiversity targets and carbon emissions, whereby borrowers can reduce their borrowing costs (profit payments) if quantified biodiversity and emissions-reductions targets are met. Issuers might also be able to pay back debt using carbon credits.

Pakistan’s government, a long-time sukuk issuer, could be the first issuer of nature bonds, potentially raising up to \$1 billion this year. Other OIC jurisdictions in Southeast Asia, such as Indonesia and Malaysia, could also leverage nature sukuk to finance biodiversity initiatives if dedicated guidelines or frameworks are developed.

**Use Sukuk-Waqf to fund social finance projects**

*Impacted stakeholders: governments, issuers*

Green and sustainability sukuk have the potential to fund Islamic social finance initiatives, and Waqf projects aligned with the SDGs in particular. This can be achieved using the ‘Sukuk-Waqf’ model, whereby sukuk proceeds are used to finance pre-screened Waqf projects complying with green, sustainability or social bond principles.

The main difference between these and other ESG sukuk lies in investors’ objectives. In theory, investors would not be driven by profit, rather by serving the public interest. On this basis, it is suggested this type of sukuk mimics the structure of a social impact bond, where investor pay-off is contingent on the performance of the underlying project against pre-defined KPIs.

Thus it is proposed to open subscription for this type of sukuk to retail investors as well, marketing them as products through retail Islamic banks. An example is the Sukuk Al Waqf programme launched in April 2022 by the Mohammed bin Rashid Global Centre for Endowment Consultancy in partnership with the Awqaf and Minors Affairs Foundation in Dubai and the National Bonds Corporation. The sukuk will raise funds from institutional and retail investors that will be diverted towards humanitarian and social development Waqf projects. The instruments will have one-, three- and five-year tenors, in addition to perpetual issuances. While these sukuk are marketed and offered as savings bonds, the proposed sukuk-Waqf can also be issued in primary sukuk markets by local Waqf authorities, multilateral institutions, and Waqf fund managers.

An issue that may arise with this type of sukuk is the guarantee of repayment, which would be due on the Waqf fund as the issuer. This can be addressed by acquiring a takaful product for additional insurance of the underlying project’s viability.

12. Oubdi, Lahsen, and Abdessamad Raghbi. “Sukuk-Waqf: The Islamic Solution For Public Finance Deficits”. European Journal Of Islamic Finance - IJEF, 2018..





# Executive insights



**Sam Dodd**  
Manager, Fixed Income, Primary Capital Markets  
  
London Stock Exchange

## What is the added benefit of listing on a dedicated exchange or market such as London Stock Exchange’s Sustainable Bond Market, compared to listing on the Main Market or International Securities Market?

London Stock Exchange’s dedicated Sustainable Bond Market (SBM) champions innovative issuers in sustainable finance and improves access, flexibility and transparency for investors. Sustainable finance debt instruments are an ideal way for business to tap into a \$100 trillion pool of private capital managed by global institutional fixed-income investors.

Issuing a sustainable finance bond or sukuk provides a signal that the issuer has a meaningful sustainability strategy and has identified material environmental risks and opportunities that the business faces and is investing to deliver on them.

The additional disclosure required to issue a sustainable bond or sukuk creates greater levels of dialogue between issuers and investors.

Sukuk issuers can also display their issuance alongside high-profile international issuances on SBM from supranationals, local governments and municipalities, as well as corporates. Many bonds on SBM have been world firsts in terms of currency, geography and structure, including the first certified green bonds out of China, India, the Middle East and North Africa, and the first sovereign bonds from Asia Pacific and the Americas.



**What are the different classifications of securities available for listing on the SBM?**

Distinct segments further enable investors to distinguish between different types of sustainable bonds, based on independently verified frameworks and use of proceeds.

There are three main categories: use of proceeds certified (green, social or sustainability); issuer-level classified (green revenues or sustainability-linked instruments); and transition.

Green bond proceeds are used exclusively to finance green projects, or projects with clear environmental benefits, whilst social bond proceeds are used exclusively to finance eligible social projects as defined by the relevant international standards used. Sustainability bonds, however, are a blend of the two, with proceeds used exclusively to finance any combination of eligible green and social projects as defined by the relevant international standards used.

As more issuers choose to make sustainability central to their operations, we have seen an increase in companies deciding to issue all funding products within a single green or sustainable format. To reflect this, issuers can utilise a new issuer-level classified segment for bonds by issuers whose core business activity is aligned with the green economy or where the sustainable nature of the instrument is not based on distinct and predefined use of proceeds.

The two sub-segments are for issuers demonstrating they have greater than or equal to 90% of revenues derived from green revenues, and sustainability-linked bonds, which are forward-looking, performance-based bond instruments where the issuer is committing to future improvements in sustainability outcomes within a predefined timeline.

Transition bonds are a subset of sustainability bonds, whereby the issuer is raising funds in debt markets for climate and/or just transition-related purposes. These bonds are a financing tool available to issuers that are crucial if the ambitious global carbon-emission-reduction targets are to be realised, as activities in higher-emitting sectors require significant financing in order to move towards less carbon-intensive operating models. The concept of climate transition focuses principally on the credibility of an issuer’s climate change-related commitments and practices.

**What is the screening or verification process that issuers must undergo to access the Sustainable Bond Market? What is the significance of third-party review or opinion in this process?**

To list on the SBM, issuers must list or be admitted on one of the fixed income primary markets operated by London Stock Exchange and must submit a completed SBM Declaration and Application Form.

The form will ask issuers the classification of the securities (green, social, sustainable, etc.), for acknowledgement and commitment to post-issuance reporting obligations, and for the disclosure of mandatory sustainability-related documents as applicable, such as an Independent External Review.

The Exchange requires issuers to provide proof of an external review of the securities from an independent third-party reviewer at the time of application before any green, social or sustainable securities can be admitted to SBM.

The external review increases the confidence of investors in the robustness of market standards and provides additional visibility for those issuers admitting securities on SBM.



## Pillar 3: Expand the investor base beyond traditional sukuk investors

### Offer incentives for investors

*Impacted stakeholders: investors*

As with issuers, investors can be encouraged to invest in green and sustainability sukuk through cost-reduction incentives. While these may not be necessary in light of the surging demand for ESG investments, they may be influential in jurisdictions where ESG criteria have not yet been incorporated in investment mandates.

Following the Malaysian and Saudi models for investor incentives, regulators could offer investors tax or Zakat exemptions on income from profit payments, where applicable. Alternatively, exemption from, or discounts on, stamp duty, trading commissions or transaction fees could facilitate greater activity and liquidity for listed green and sustainability sukuk.

### Promote investor awareness and capacity-building

*Impacted stakeholders: investors*

The high demand for ESG investments is mainly driven by institutional investors from developed markets such as the US and Europe, where most investment mandates have incorporated ESG guidelines. However, in most sukuk markets, ESG investing is still at an early phase, partly due to a lack of awareness among traditional investors.

It is proposed that regulators and industry development bodies launch investor education and awareness programmes providing educational materials and workshops, and support market-led initiatives for ESG sukuk investor engagement and training.

Engaging investors earlier in the investment process by involving them in the development of green and sustainable infrastructure investment pipelines can facilitate more ESG sukuk investment.

It is also proposed to encourage institutional investors to pursue ESG capacity-building within their investment teams, and to build their knowledge of ESG investments, particularly fixed-income instruments, as well as best practices for ESG investment processes. A number of ESG certifications and qualifications are now available to investment professionals worldwide, which can help them develop knowledge and insights into ESG asset classes, investment strategies, and risk management.

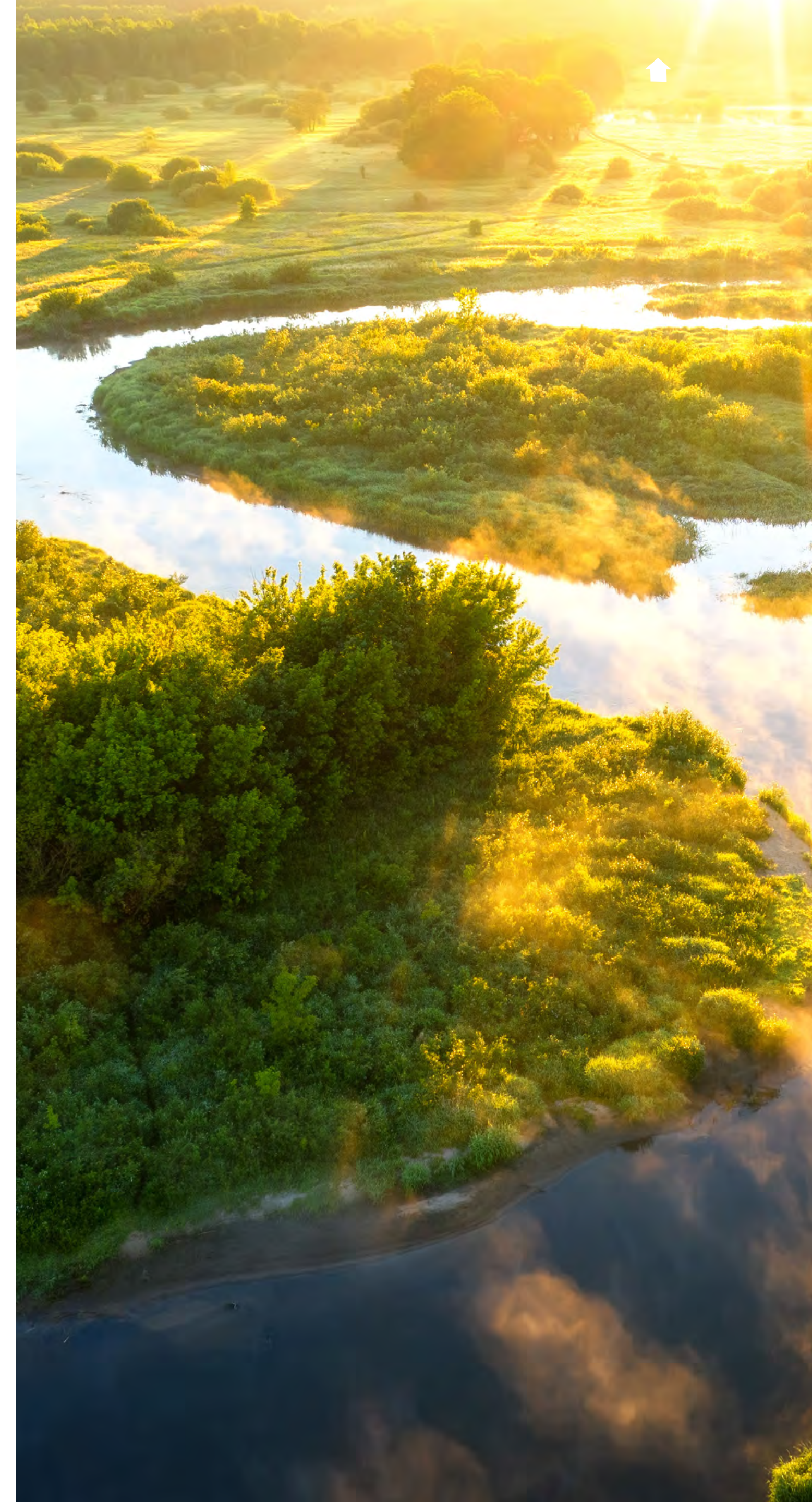
### Attract investors with no Shariah compliance mandate

*Impacted stakeholders: issuers, lead arrangers*

While demand for ESG investments in domestic OIC markets has not gathered pace, investors in developed markets are still seeking higher yields and diversification in emerging markets. Many of these investors follow mandates that include ESG elements and they are putting pressure on issuers in emerging markets to offer more ESG instruments.

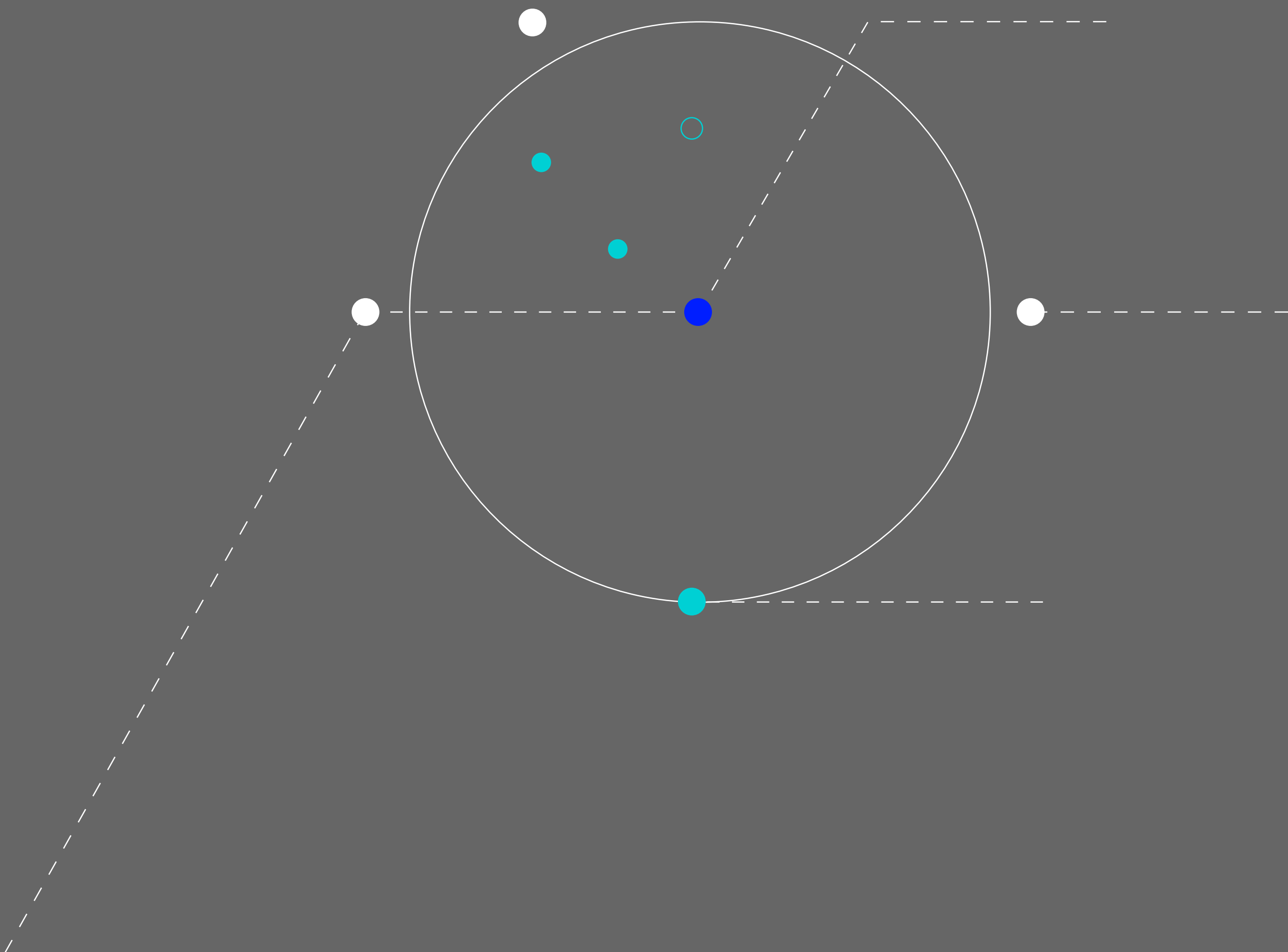
Tapping this demand can contribute to the growth of green and sustainability sukuk issuances, as well as attract more foreign capital flows into domestic markets that can fund environmental and sustainable projects and initiatives.

It is proposed to place greater emphasis on the ESG characteristics of the sukuk when promoting them to investors from non-OIC jurisdictions. These investors are predominantly institutional investors with no explicit requirement or commitment to invest in Shariah-compliant products or instruments.





# APPENDIX (CASE STUDIES)



# Infracorp

Issues Bahrain’s first-ever green sukuk

Issuance Details	
Company	Infracorp
Rating (Fitch)	B
Sector	Financial
Market	ISM

## Infracorp completes issuance of \$900 million sukuk

- Infracorp is the infrastructure and sustainability arm of GFH Financial Group. It manages nearly \$3 billion of infrastructure assets, including a 250 million-square-foot land bank earmarked for sustainable economic and social infrastructure
- In March 2022, Infracorp sold \$900 million in sustainable sukuk, the first-ever green sukuk issued by a Bahraini entity
- The perpetual Islamic bond was issued on London’s International Securities Market (ISM) at a semiannual yield of 7.5%
- Proceeds from Infracorp’s debt sale will be used to accelerate the growth of sustainable infrastructure across the Middle East and South Asia
- GFH Financial Group BSC underwrote the deal

Source: London Stock Exchange, Refinitiv, May 2022



# Saudi National Bank

Issues debut sustainable sukuk



Issuance Details	
Company	Saudi National Bank
Rating (M/S&P/F)	A1 / A- / A-
Sector	Financial
Market	ISM

Transaction Details	
Issue Date	19 January 2022
Issue Size	\$750 million
Coupon	2.34%
Maturity	5 years

## Saudi National Bank completes issuance of \$750 million sukuk

- Saudi National Bank (SNB) is the largest financial institution in Saudi Arabia. It plays a vital role in supporting the economic renewal of Saudi Arabia through transformation of the banking sector and facilitating the delivery of Saudi Arabia’s Vision 2030
- In January 2022, SNB sold \$750 million of its debut sustainable sukuk, with demand topping \$3.2 billion
- The five-year Islamic bond was issued on London’s International Securities Market (ISM) at an annual yield of 2.34%.
- Proceeds from the sale will be used for projects eligible under the bank’s Sustainable Finance Framework such as funding renewable energy facilities, including loans to develop such projects and loans related to tree-planting
- HSBC was the sole ESG structuring agent on SNB’s sukuk sale and was joined on the deal by Citi, Emirates NBD Capital, Goldman Sachs, Mizuho Securities and SNB Capital

Source: London Stock Exchange, Global Capital, January 2022



# Riyad Bank

Sells world’s first sustainability-linked AT1 Islamic bond



Issuance Details	
Company	Riyad Bank
Rating (M/S&P/F)	N/A
Sector	Financial
Market	ISM

Transaction Details	
Issue Date	17 January 2022
Issue Size	\$750 million
Coupon	0.00%
Maturity	-

## Riyad Bank sells \$750 million in perpetual sustainability sukuk

- Riyadh Bank is one of the largest financial institutions in Saudi Arabia and the Middle East
- In January 2022, Riyadh Bank sold \$750 million in Additional Tier 1 (AT1) Islamic bonds linked to sustainability on London’s International Securities Market (ISM)
- The world’s first sustainability-linked AT1 Islamic bond will be non-callable for five-and-a-half years and is marked as the world’s first sustainability linked AT1 Islamic bond.
- Its yield was tightened from initial price guidance of around 4.375% after demand exceeded \$3 billion
- The deal was arranged by BofA Securities, HSBC, Riyadh Capital and Standard Chartered

Source: London Stock Exchange, Global Capital, February 2022





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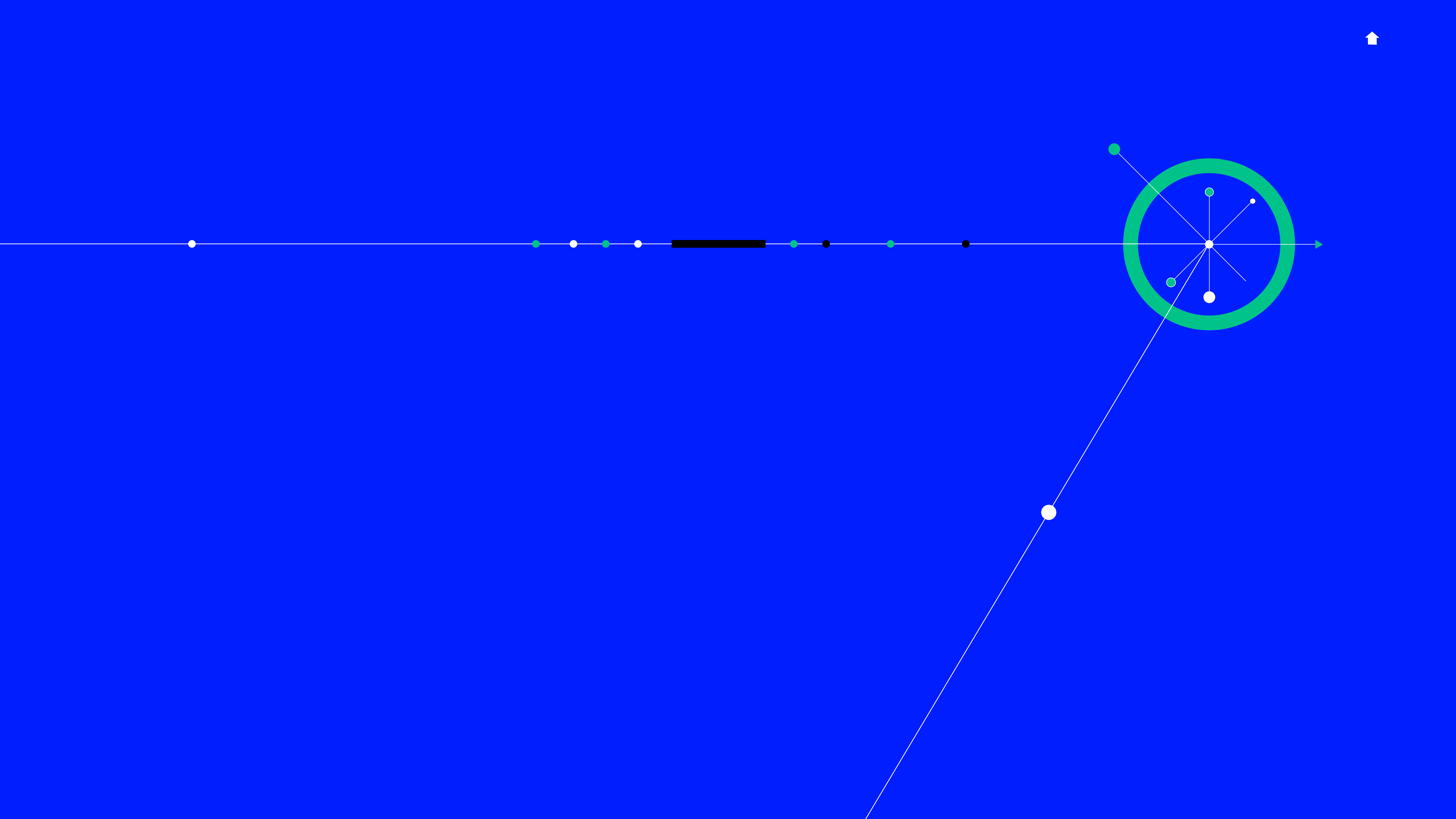
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