# SRI & GREEN SUKUK: CHALLENGES & PROSPECTS

There has been a growing interest toward SRI sukuk or green sukuk lately, with a number of sukuk of this class being issued in the global market to finance environmentally friendly projects. This report looks at SRI & green sukuk's future as well as the challenges surrounding its growth.

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# SRI & Green Sukuk: Challenges & Prospects

**There has been a growing interest in the past few years towarads socially responsible invesment (SRI) sukuk or green sukuk. A number of sukuk in this class has been issued in the global market to finance environmental-friendly projects. The growing trend toward SRI sukuk or green sukuk is mainly due to the natural progression of sukuk market, the growing awareness of investors toward ethically and socially responsible investment and the stricter capital requirements for the bank to finance infrastructural projects.[1] This report looks at the future of SRI sukuk or green sukuk as well as the challenges surrounding its growth.**

**Growing Trends of SRI Sukuk or Green Sukuk**


Source: World Bank

## The New Era for SRI & Green Sukuk

There has been a growing interest in the global market toward SRI instruments. One of the areas that are normally associated with SRI is the environment and its preservation. Green bond therefore becomes a common instrument to serve this aspect of SRI in the global market. For example, in 2007 the European Investment Bank (EIB) launched a EUR 600mln climate awareness bond focusing on renewable energy and energy efficiency.[2] Subsequently in 2008, World Bank issued a total of USD440mln green bond to support climate-focused program for the Scandinavian pension.[3] In 2013, the African Development Bank issued a USD500mln green bond to finance climate change solution in Africa. As of June 2015, the World Bank has issued over 100 green bond papers valued at USD8.5bln.[4] To date, there is approximately USD65.9bln worth of green bonds available in the market.[5]

[1] World Bank, 2015
[2] www.eib.org
[3] World Bank, 2015
[4] World Bank, 2015; Sustainable and Resposible Investment: Trends and Prospects, 2015
[5] Bond and Climate Change Report, 2015

The similar trend towards SRI is also shared by the sukuk market, marked by a number of initiatives and government supports to promote the idea of SRI sukuk or green sukuk. In 2012, for example, the Climate Bonds Initiative (CBI) in cooperation with the Clean Energy Business Council of the Middle East and North Africa (MENA) and Dubai-based Gulf Bond & Association established the Green Sukuk Working Group to promote the idea of green sukuk which meets a low-carbon criterion.[6] In Malaysia, the Prime Minister of Malaysia in its Budget 2014 speech announced the aspiration of Malaysia to become a home for SRI.[7] In 2014, SC revised its sukuk guideline by incorporating the new requirements for the issuance of SRI sukuk. The new sukuk guideline explains that the proceeds of SRI sukuk can be used to preserve the environment and natural resources, conserve the use of energy, promote the use of renewable energy and reduce greenhouse gas emission.[8]

Furthermore, there are some plans to issue SRI sukuk or green sukuk in various jurisdictions and few of them have been materialised. For example, in late 2012, the Australian solar companies Solar Guys International and Mitabu managed to raise funds worth USD100mln for a 50MW photovoltaic project in Indonesia based on green sukuk which was structured in Malaysia and was fully funded under a Power Purchase Agreement.[9] In 2015, the UAE planned to issue green sukuk to finance renewable energy project.[10] The Dubai Clear Energy Business Council has discussed with the Dubai Supreme Council of Energy (DSCE) to issue green sukuk.[11] Likewise, the Islamic Development Bank (IDB) at the United Nations Global Warming Conference in Paris held in 2015 has indicated its interest to issue green sukuk to finance climate-related projects. Currently, IDB has USD180mln pilot projects to fund clear energy in its 56 member countries worldwide.[12] UK-based International Finance Facility for Immunisation (IFFIm) issued SRI sukuk murabahah worth USD500mln in 2014 for children's immunisation in the world's poorest countries via Gavi, the Vaccine Alliance to help protect tens of million of children against vaccine-preventable deceases.[13] This was regarded to be the first ever SRI sukuk with 3-year sukuk maturity coordinated by Standard Chartered Bank.[14] The sukuk received numerous awards such as the best innovation in Islamic finance from Euromoney and the best achievement in transformational finance from the Financial Times.[15] The second sukuk was issued in September 2015 raising another USD200mln with the same purpose.[16] The sukuk was 1.6 times oversubscribed with the investors from Middle East (65%), Asia (18%) and Europe (17%).[17]

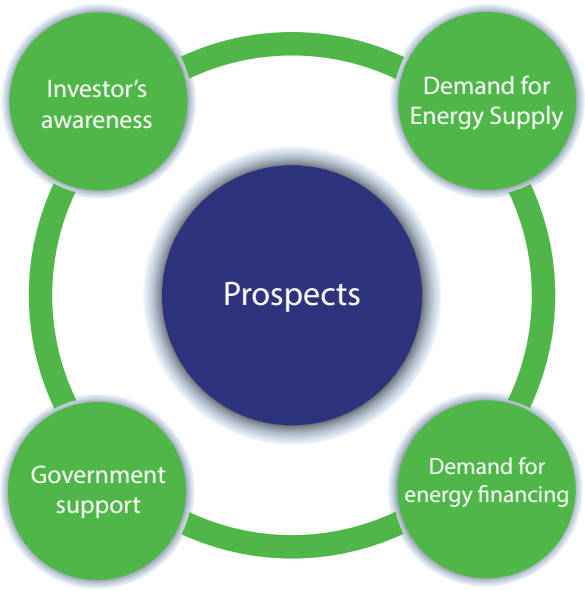
Malaysia has just recently launched SRI sukuk Ihasan by Khasanah Nasional Bhd. The sukuk is structured to offer a new method of fund "trust schools" through the capital market. An SPV, Ihsan Sukuk Bhd, was established by Khazanah Nasional Bhd. in the early 2015, to issue a ringgit denominated SRI sukuk programme worth RM1bln. This is the first SRI sukuk approved under SC's SRI Framework and was given AAA rating by RAM Rating Services Bhd.[18] The first issuance was on 18th June 2015 and managed to raise funds worth of RM100mln with a periodic distribution rate of 4.3% per annum and 7 year tenure.[19] The proceeds of sukuk are to be utilized for funding the roll-out of 20 School under Yayasan Amir's Trust School Programme, a non-profit organization established by Khazanah with the purpose to improve the quality of education in Malaysian public schools through Public-Private Partnership with the

[6] The Georgetown International Environmental Law review, 2014
[7] Ministry of Finance Malaysia, 2013
[8] Securities Commission, 2015
[9] Islamic Finance News
[10] http://www.arabianbusiness.com
[11] The National. March, 2015
[12] Bloomberg, 2015
[13] IFFIm, 2014
[14] IFFIm, 2014
[15] IFFIm, 2015
[16] IFFIm, 2015
[17] IFN, 2015
[18] RAM, 2015
[19] The Star Online, 2015

Malaysian Ministry of Education.[20] The trust school programme is a model that focuses on a school wide transformation throughout a five year period. Before the SRI sukuk was issued, there were already 20 schools under the programme, encompassing rural and urban schools, and impacting more than 20,000 schools nationwide.[21] Through the issuance of the SRI sukuk, it enables the programme to be further scaled up to include more schools and students. The strategic goals of the trust school programme focus on various stakeholders including: school leaders, teachers, students, parents and community.[22]

## Prospects

**Challenges of Green Sukuk**




Source: Adopted from various sources

The prospects of green sukuk in the future are encouraging driven by a number of factors, notably as follows:

1. The increase demand for energy supply - it is widely known that the need for clean energy and energy efficiency will increase in the future due to the growth of population. For example, the GCC population is projected to grow to over 53mln by 2020, a 30% increase over population in 2000. This makes the GCC one of the fastest growing region in the world thus the unprecedented rise in demand for energy, water, transport, urban development and infrastructure is unavoidable. Furthermore, the world's population is expected to grow from 6bln in 1999 to 9bln by 2044, recording an increase of 50%.[23]

2. The increase demand for energy financing – the significant increase of population will eventually increase the demand for energy funding and investment to finance the clean energy and energy efficiency projects to meet the needs of the future population. A number of ambitious initiatives and project plans have been made for this purpose. For example, in 2013, the King Abdullah City for Atomic and Renewable Energy (KA-CARE) released a white paper outlining its ambitious plan to produce and invite interest in 54,000MW of renewable energy by 2032.[24] Meanwhile, the Dubai Supreme Energy

[20] IFN, 2015
[21] Sustainable and Responsible Investment (SRI): Trends and Prospects, 2015
[22] CIMB, 2015
[23] https://www.census.gov
[24] Islamic Finance News, 2013

Council established the Dubai Integrated 2030 strategy plans for solar energy to account for 5% of Dubai's total energy-mix by 2030.[25] Furthermore, the Abu Dhabi Vision 2030 plans to increase the non-hydrocarbon related share of Abu Dhabi's Economy to between 40-60%, with a renewable energy capacity of 7% target by 2020.[26]

3. The growing awareness of investors toward SRI– in September 2014, the global investors who represented over USD2tln in asset under management issued an investor statement indicating their commitment to the growing of global market in the financing of climate change solutions. Barclays confirmed its plan to invest GBP1bln (USD1.48bln) in green bond by 2016 whilst Zurich plans to invest USD2bln in green bond.[27] Green sukuk will facilitate and increase the broader participations in the sukuk market by the conventional investor who are looking for ethical and socially responsible investment.

## Challenges

Notwithstanding the positive prospects for green sukuk, the future of green sukuk is hindered by a number of challenges and constrains. First, the secondary market for green sukuk is very small due to small number of investors holding sukuk funds and other institutional investors which traditionally require robust secondary market for meeting the investors' liquidity expectations. Second, the absence of the standard and verification system for performance measurement of green bonds/sukuk. Third, green sukuk may expose to higher risk profile. This is because many environmental friendly projects involve a sophisticated degree of new technology due to construction and operation of green technologies. Fourth, the difficulty to assure investors that sukuk proceeds will be used for projects with economic value, while meeting accepted and credible green standards.[28]

**Challenges of Green Sukuk**


Source: Islamic Finance News, 2014; Bielenberg 2011

[25] Islamic Finance News
[26] Islamic Finance News, 2013
[27] IFN, 2015
[28] IFN, 2015