



Islamic Finance

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Deloitte Islamic Finance Insights Series
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Foreword from Deloitte



Dr. Hatim El Tahir, FCISI
Director, Islamic Finance Group
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Deloitte & Touche (M.E.)

Dear colleagues,

It is a pleasure to share with you this whitepaper, which brings together the collective views of an industry forum organized by Deloitte Middle East (ME) and supported by Deloitte UK, held last November in London. The event was generously hosted by the Chartered Institute of Securities and Investment (CISI) and supported by the Islamic Research and Training Institute (IRTI). The three-session industry talk looked at the role and potential of Islamic finance as a responsible source of investment in funding social infrastructure projects. Guest speakers and practitioners have deliberated on the regulatory, market practices and supporting initiatives and institutions. The consensus views and practical insights gained from this discussion are the subject of this whitepaper.

In defining the key enablers and influencers of building an effective Islamic finance investment structure as a source of social infrastructure financing, we invited a select group of the guest speakers of our event to sum up the main challenges and opportunities, and identify policy and practice steps required to effect this proposition, that is, to validate and make use of Islamic finance resources. In this exercise, our contributors have addressed key regulatory, practice and capability building requirements.

The whitepaper discussion has benefited from the invaluable contributions of these practitioners and presents harmonized viewpoints on the prospects of an alternative source of financing social projects.

Last but not least, Deloitte Middle East is grateful for the support of several industry organizations and institutions, who have for a number of years supported our Islamic finance thought leadership program and publications which aimed at embracing professional excellence and promoting best practices.

This whitepaper is produced under the Deloitte Islamic finance series, "Leading by Engaging", produced by the Deloitte ME Islamic Finance Knowledge Center (IFKC). We hope that you enjoy reading this whitepaper and gain useful insights from it.

Foreword from CISI



George Littlejohn
Senior Advisor
Chartered Institute for Securities &
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In March 2018, the Islamic Development Bank, London Stock Exchange Group, and the UK Government brought together a stellar group of speakers in a special “Sukuk Summit”, titled “Driving change – funding the future”. Introducing the event, which was run at the stock exchange’s London headquarters and live webcast round the world, HE Dr Bandar MH Hajjar, President of the Islamic Development Bank Group, said: “Islamic finance has gone from strength to strength in recent years. Since 2014, when the UK became the first non-Muslim country to issue a Sukuk, more investors have looked to the Sukuk market due to high liquidity and the need to diversify their portfolios. “Furthermore,” he added, “we have seen the development of the Sukuk as applied to genuinely innovative growth areas, such as green investment, social impact and Fintech.”

All these exciting trends were explored during the summit and in this excellent report, with which we, the Chartered Institute for Securities & Investment (CISI), are honored to be involved. We commend Dr Hatim El-Tahir, one of our distinguished Fellows, and his colleagues on their leadership in ensuring that our industry knowledge remains current and forward looking.

The CISI’s members, in “mainstream” investment banking, wealth management, and corporate finance, as well as the many specialists in Islamic finance who have joined our 45,000-strong global membership since the launch of our Islamic Finance qualification a decade ago, see sustainable finance as one of the hottest topics in global investment right now.

Acknowledgments

Deloitte Middle East wishes to acknowledge the support of a number of individuals and institutions for their contributions toward the making of this whitepaper and its points of view. We salute their courage and spirit to work with us in addressing industry issues, which we hope will benefit fellow industry practitioners and professionals worldwide.

While the whitepaper has benefited greatly from their contributions, the views expressed herein are solely of the authors and do not necessarily reflect the views of Deloitte.

Report contributors:

- Stella Cox, CBE, Managing Director, DDCAP Group
- Tallat Hussain, Environmental Counsel, White & Case
- Nyra Mahmood, Managing Director, SSHC Limited
- Peter Casey, Advisor, IFSB and ESCA
- George Littlejohn, Senior Adviser, CISI, UK
- Dr. Osman Ahmed, Lead Economist, IRTI-IDB Group
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Industry supporters



Executive summary

Policy makers, the private sector and governments continue to find ways to bridge gaps in infrastructure funding, with the social infrastructure landscape having come to the top agenda in importance.

A recent Deloitte analysis shows that governments are attempting to use increased infrastructure funding as a tactic for economic stimulus, tightened credit markets are posing an obstacle to raise debt finance, and lastly, governments' budgets are constrained. These challenges, coupled with increased geopolitical risks and social pressures, have all created a compelling need for funding options for the social projects worldwide.

This whitepaper discusses these trends and the value proposition of an alternative Sharia'-complaint funding model which resembles sustainable finance, and shares guidelines and principles of responsible investment and sound governance practices. The whitepaper's contributors have analyzed the impact of this model in light of regulatory, market practice and governance requirements.

Stella Cox CBE, Managing Director, DDCAP Group, looks at the changing dynamic in investor demand and analyzes the disruptive global financial practices as she presents a panoramic account of the key emerging sources of responsible finance and their impact on social infrastructure. In addition, she asserts that the Islamic capital markets appear to have embraced the trend towards sustainable investing, particularly in South East Asia, highlighting

the growing demand for green assets from conventional market investors.

George Littlejohn, Senior Advisor, CISI, UK, continues the discussion on corporate sustainability and sheds some light on the new generation of finance industry leaders and market trends in areas of Fintech, big data and the impact of financial inclusion.

Governments are attempting to use increased infrastructure funding as a tactic for economic stimulus, tightened credit markets are posing an obstacle to raise debt finance, and lastly, governments' budgets are constrained.

Peter Casey, Advisor, IFSB and ESCA, shares his perspectives on the connection between Islamic finance and social infrastructure and argues, from a regulatory point of view, that the market for Sukuk, as for bonds, is predominantly one of institutional or professional investors. He believes that Sukuk allows investors to choose specific investments which fit their values, and notes that many Sukuk have in fact supported infrastructure projects. He concludes his take on this by suggesting three regulatory points.

In the outset of her article, Tallat Hussain, Environmental Counsel, White & Case, believes that for environmentally and socially sustainable finance to flourish there must be an alignment of investor interests (and appetite for risk) with issuer goals (and commitments). In this case study, Hussain argues that "taking environmental and social sustainability finance onto the global stage means consideration of cultural imperatives around the world as well as regulatory differences".

Nyra Mahmood, Managing Director, SSHC Limited, looks at the governance of human capital and prescribes the steps to nurture human capital and talent in Islamic finance through investing in people. She also argues that the Islamic finance talent pool must reflect diversity and inclusion. Women are an untapped resource, especially across Muslim-majority countries, which house the biggest Islamic finance institutions.

Finally, Dr. Osman Ahmed, Lead Economist, IRTI-IDB Group, showcases the role of the IDB as a Multilateral Development Bank (MDB) and presents a detailed analysis of the impact of recent initiatives to eradicate poverty in our world. He asserts that different Islamic financial instruments can provide flexible tailored-funding for specific small-sized or mega projects. Examples of modes for financing are Sukuk, Ijarah (leasing), installment sale, Istisnaa (order to make) and equity.

Sustainability and investment opportunities

Creating financial systems that are more responsive to the real economy

By Stella Cox, CBE, Managing Director, DDCAP Group

Islamic financial market practitioners have long argued that forms of Sharia'-compliant finance bring impact beyond conventional market alternatives. Their supporting logic is that funds are raised and invested in asset-backed and asset-based transactions through equitable, contractual arrangements that promote partnership and the sharing of profit and loss for the benefit of the wider economy.

Following the global financial crisis, debate about culture and practice within global financial services, as well as their prospective impacts on global social welfare and environment, became a core agenda item for both private and public sectors. Environmental, social and governance (ESG) focused determinants became increasingly numerous, with social (S) including crisis and conflict management, and community infrastructure services such as healthcare and education, employment and diversity. These determinants resonated further when asset owners, investors and institutions set objectives beyond risk and return to prioritize global social welfare within investment criteria.

The descriptors applied to the various groups and focuses, within the responsible investment subset, are seemingly ever-evolving, encompassing not just considerations of social impact but those pertaining to the environment (E), including green financing and sustainable investing, and also to governance (G). Frequently grouped together, whilst responsible investment practices incorporate environmental, sustainability and social welfare considerations and therefore have similarities, investors and beneficiaries who also adopt Socially Responsible Investment (SRI) values endeavor to combine financial return with moral or ethical return with the purpose of satisfying measurable social impact objectives.

There is now a growing consensus that the objectives of generating profit and doing well (in whatever form, be it tackling environmental concerns, poverty alleviation, humanitarian crisis management or resourcing healthcare or education) are not mutually exclusive and, in fact, can be achieved in tandem. On

September 25, 2015, the General Assembly of the United Nations adopted a set of 17 Sustainable Development Goals ("SDGs"), with specific targets to be achieved by 2030, as a universal call to action to end poverty, protect the planet and ensure peace and prosperity for all. With an inclusive agenda, the goals are interconnected and provide clear guidelines for adoption, as well as targets for all countries to unite them and address the root causes of poverty. Subsequently, an acceleration of themed funds and investment products targeting socially impacting assets have taken place.

The Islamic capital markets appear to have embraced the trend towards sustainable investing, particularly in South East Asia. Mirroring growing demand for green assets from conventional market investors, there is a similar trend developing in the Sharia'-compliant space. This is small to date but undoubtedly growing, in parallel with investments that are made with reference to social considerations. The Malaysian sovereign wealth fund, Kazanah Nasional, launched the US\$ 282 million Sukuk Ihsan program



in 2015. Ihsan's inaugural issuance became the world's first social impact bond to be rated globally, with issuance proceeds disbursed to improve the accessibility of quality education in Malaysian government schools.

In 2016 the IDB and its development partners launched the US\$ 2.5 billion Life and Living Fund (LLF), the largest development initiative of its kind in the Middle East. In a period extending from launch to 2021 the LLF will provide up to US\$ 2.5 billion of concessional financing aimed at saving and improving lives.

At a supranational level, a noteworthy, global Islamic capital market transaction was the successful US\$500 million Sukuk issuance in November 2014 by the International Finance Facility for Immunization Company (IFFIm). An AA rated obligor, IFFIm raises funds within the international capital markets to accelerate the availability of funds for immunization programs and health system enhancement by Gavi, the Vaccine Alliance. IFFIm's unique public-private partnership presents a compelling case study for financing with social impact. 79% of Gavi's funding is from government with the balance from the private sector. Its financial base consists of legally binding grant payments (approximately US\$ 6.3 billion) from its nine sovereign donors, of which the UK is the largest in terms of funding amount and tenor of commitment, whilst the World Bank is IFFIm's treasury manager. Prior to the

2014 Sukuk, IFFIm had raised some US\$ 5 billion equivalent from the conventional capital markets in support of Gavi over an eight-year period. Proceeds of the Sukuk funded children's immunization programs in the world's poorest countries. The landmark transaction was the first socially responsible Sukuk, and was the largest Sukuk al-Murabaha in the public markets at the time of issuance, as well as being the largest inaugural Sukuk offering by a supranational.

In May 2016, the United Nations Development Program (UNDP) entered into a memorandum of understanding (MoU) with the IDB to strengthen their bi-lateral relationship with the purpose of supporting the effective implementation and achievement of the SDGs. UNDP and IDB's initial MoU was executed as long ago as 1986. Since then, the IDB has extended more than US\$ 240 million over a ten-year period for projects relating to agriculture, electricity and housing under the UNDP's Program of Assistance to the Palestinian People. Under the 2016 MoU concentration will be on upscaling ongoing initiatives and exploring new opportunities.

The Life and Living Fund (LLF) is blending a US\$ 500 million grant of funding with US\$ 2 billion of the IDB's own capital to enable the IDB to accelerate its concessional financing of health, agriculture and basic infrastructure for the IDB's lower income member countries. Major LLF donors include the IDB's own Islamic Solidarity Fund for Development, the Bill & Melinda Gates Foundation, the Qatar Fund for Development, the King Salman Humanitarian Aid and Relief Foundation and the Abu Dhabi Fund for Development. Most recently, the IDB, through a statement made at the IMF/World Bank meeting in Washington DC in October 2017, affirmed its intention to extend its Sukuk issuance program in

support of financing medium- to long-term projects that are principally focused on the SDGs objectives.

These are just a few illustrations of the impact that multilateral accords and high profile public/private sector undertakings can deliver. They are of critical importance. The SDGs will not be achieved without effective social infrastructure for delivery. Sources of conventional, institutional funding do not have sufficient capacity to meet demand and the position is further challenged in emerging economies or those where financial markets remain underdeveloped. Examples of benchmark transactions like IFFIm's have been very limited to date but, over the years, financing and investment templates have evolved in response to investment requirements across a diverse set of infrastructure projects in numerous geographies and sectors. They have shown that most asset-backed or asset-based infrastructure is generally eligible for Islamic funding, that sources of Sharia' and conventional finance can co-exist successfully and that funding can be delivered through public and private sector collaboration. In most instances of private and public sector funding being deployed, multilateral development banks and institutions have been pathfinders, but precedents have been created for commercial lenders to follow.

In the next few years, millennials will inherit the largest transfer of generational wealth to date and are potentially set to control US\$ 24 trillion by 2020.

A changing dynamic in investor demand and stipulation is also now playing its part in shaping the funding of social infrastructure whilst diversifying sources

of investment and prospectively adding capacity and scale. The scope and extent of that demand is not just apparent within the wholesale markets, either. In the next few years, millennials will inherit the largest transfer of generational wealth to date and are potentially set to control US\$ 24 trillion by 2020, according to Deloitte. Millennials tend to be better educated, better informed and socially minded, and they are proactive investors in the SRI environment. More affluent Muslim countries each have significant millennial populations that are also proportionally greater than those of non-Muslim countries.

Technology plays a role

Technology is increasingly a major contributor to evolving this investor group's access to and engagement with funding of social infrastructure development, and that opportunity is resonating with entrepreneurs as well as investors. Crowdfunding platforms focused on building funding capacity to foster sustainable and inclusive growth through aggregation of small scale investments are growing in number in recent years.

Creating an environment conducive to the financing, creation, implementation and ongoing development success of these innovative, privately owned technology businesses and concepts is, however, a subject of Islamic financial industry debate, as the extent of public sector provision and commitment varies between geographies and start-up businesses are challenged by the lack of access to capital or institutional funding.

Challenge and awards initiatives such as the Ethical Finance Innovation and Challenge Awards (EFICA), sponsored by Abu Dhabi Islamic Bank and Thomson Reuters, which will enter its fifth year in 2018, and the RFI Foundation's Support Disruption for Good Challenge acknowledge the current disconnection between smaller, impact-focused businesses and the unsatisfied requirement to mobilize capital to meet the 2030 targets of the SDGs. These challenges provide a platform for small and innovative business to present and highlight to a broader audience, giving the opportunity to generate awareness, extend outreach, attract expert mentorship or even raise capital. In 2018, the RFI Support Disruption for Good Challenge will focus on identifying technology companies whose products and services are gaining market traction

and whose technology helps the financial sector to increase the scale of its financing and investment in the priority sectors of agriculture, healthcare and development of sustainable cities.

The Islamic Development Bank (IDB) is also launching a fund which will provide seed capital to innovative start-ups and SMEs, helping them implement development projects related to certain of the SDGs. IDB's Transform Fund, which has a target capital of \$500 million, will run in tandem with a new online hub called Engage, designed to connect innovators to one another and assist them in developing their ideas. Both the hub platform and the Transform Fund will focus on projects related to six of the SDGs, being greater food security, healthier lives, inclusive and equitable education, sustainable management of water, access to affordable and clean energy, and sustainable industrialization across the developing world. The Fund will ensure that innovators, start-ups and SMEs with the best ideas get access to financing for those projects. It will provide up to US\$50,000 to US\$100,000 for individual projects, as well as funding partnerships between researchers and entrepreneurs that will tackle the world's most pressing development challenges.

In conclusion

There are many principles of Islamic financing and investment that are complementary in the way they influence investment decisions. Both focus on creating financial systems that are more responsive to the real economy and that provide a more holistic approach for all stakeholders. Undoubtedly, the stewardship embraced by Islamic financial practitioners promotes social impact and governance but, as a financial industry subsector that has evolved from a commercial banking model within emerging markets, there

has been a timeline to ensuring that the industry, its capabilities in terms of both product and technology and the mind-set of its stakeholders are suitably developed, aligned and appropriately placed to deliver. Given the enormous global requirement for investment in social infrastructure development to satisfy welfare needs, public sector policy and multilateral accord must provide for delivery of financing and investment solutions to achieve goals and meet objectives. However, the opportunity is there for private sector participation of varying scale. Other subsets of the SRI community are clearly enthusiastic to

explore opportunities to collaborate with Sharia'-compliant partners and, within the Islamic financial marketplace, we are establishing our own industry organizations to foster a more evolved understanding of where our respective responsible focuses and values might complement one another. This is taking place with the objective of originating practical and compelling financial solutions with measurable social and environmental impact, further supported by an investor base that is more socially conscious and committed to working towards the objectives of a fairer society.

Corporate sustainability and the new generation of finance industry leaders

By George Littlejohn, Senior Adviser, CISI, UK.

Sustainable issues have always been part of both sell- and buy-side research analysis and valuations, even if these were not explicitly labelled as ESG (environmental, social, and governance) or SRI (socially responsible investment) outputs. However, as a January 2018 report from AFME, the Association for Financial Markets in Europe, points out, firms have more recently created some material factors into an ESG or SRI research framework. "Many firms have ESG- or climate change-specific analyst teams," it says. "Building on years of experience of specific sectors (10-15 years for some members), the research analysts are well placed to assess the materiality of ESG-related risks to a sector or a specific security. Sector analysts are best placed to assess which factors, ESG or not, can materially impact a sector and its underlying stocks' financial and valuation performance."

The systematic inclusion of ESG factors into the usual risk metrics and cash flow analysis depends on various factors, typically the type of security, geography, the format of the research and the industry, the level of investor demand and the availability of ESG-related information from corporates. That means an awful lot of data, and from an analytical point of view that can feel like drinking water from a fire hydrant.

Georg Kell, vice chair of asset management firm Arabesque and former United Nations (UN) Global Compact

head, is typical of industry leaders at the cutting edge of bringing big data to bear on financial decisions. "The dawn of the Internet was a revolution in how it restructured the landscape of the economy and society around a network structure," he says. "It became a new medium for commerce, finance, power and culture, and changed our perception of time and space.

"We now live in a globalized and connected world where information flows at the speed of light, an age where data shapes almost every aspect of our lives. Through new technology, big data has disrupted entire industries. It has influenced how we work, how we consume, and how we view the world. Increasingly, it also holds the promise of shifting global markets towards greater environmental stewardship, better social impact, and increased respect for universal human rights."

Arabesque is typical of the new generation of finance industry leaders, building partnerships between finance, mathematics and business themes. Five years old, it grew from a buyout from Barclays – whose last CEO Antony Jenkins has himself gone on to build a new career in Fintech – and has been built in cooperation with academics from universities including Cambridge, Harvard, Maastricht, Oxford and Stanford. It aims "to bring a new dimension to investing using self-learning quant models and big data to assess the performance and

sustainability of globally listed companies." Its rules-based approach to stock selection integrates ESG information on some 7,000 companies with financial and momentum analysis, processing over 100 billion data points via 250,000 lines of code to build its strategies.

Arabesque is primarily a fund management firm, but makes all that data available free to anyone online. Commercial madness? No. The free data has a three-month time lag; professionals subscribe to buy up-to-the minute information. The free data is there to grow interest and confidence in the field. Arabesque typifies the mantra-de-jour in the tech world – "do less, then obsess."

This touches on all of our lives, not just those of the one in five of the world's population covered by Dr Hajjar and his colleagues. As he explained at the Sukuk Summit, "The Islamic banking industry has grown at a double-digit rate for the last decade and reached \$2.1 trillion last year alone. Moreover, Islamic finance has a strong track record in promoting financial, social, and economic stability, as well as financial inclusion and shared prosperity, in line with the UN's Sustainable Development Goals.

"We have seen therefore that financial success and responsible investment need to not be mutually exclusive," Dr Hajjar concluded.

Creating an enabling regulatory environment

Islamic finance and social infrastructure: A regulator's perspective

By Peter Casey, Advisor, IFSB and ESCA

The connection between Islamic finance and social infrastructure is important, but hard to articulate precisely. Islamic investors can be assumed to be at least to some extent value-driven, and Sharia' forbids certain classes of investment. However, what it allows is very broad, and most financing by Islamic banks, for example, has nothing to do with social infrastructure. In addition to banks, there is the possibility of financing through Islamic capital markets, and it is arguable that Sukuk offer instruments well suited to infrastructure financing, including the possibility of linking returns to the achievement of social goals. Malaysia in particular has tried to develop a specific class of socially responsible investment Sukuk, though this initiative has not been widely followed by others.

So far as Islamic banking is concerned, the regulatory position is relatively straightforward. Nothing prevents Islamic banks from investing in infrastructure; the key question is how the investments will be treated for prudential regulatory purposes. The paper published by the Basel Committee on Banking Supervision (BCBS) on December 7, 2017 introduced

a new treatment for project finance, including infrastructure projects, but this still involves relatively high-risk weights. It is likely that the Islamic Financial Services Board (IFSB) will broadly follow the BCBS treatment when it updates its own capital adequacy standard in the near future. The BCBS standard deals principally with loan financing, and in Islamic finance circles there has been interest in more equity-like financing, using Mudharaba and Musharaka contracts. However, Islamic banks have in practice made little use of these, and the fundamental question remains how far they have an appetite for longer term and essentially risky projects. A limited risk appetite is likely to remain, even if funding comes from unrestricted profit-sharing investment accounts, since investors in these are likely to be looking for stable returns, and have the right to withdraw their funds on timescales much shorter than those of projects. However, it is certainly possible that Islamic banks could use the vehicle of restricted investment accounts to match willing, value-driven investors with social infrastructure projects.

The capital market possibilities

Sukuk allow investors to choose specific investments which fit their values, and many Sukuk have in fact supported infrastructure projects, for example power stations or airports. In general, Sukuk have been structured to be economically as close as possible to conventional bonds, but this does not have to be the case.

Returns can be linked to project performance, whether in pure economic terms or in terms of the achievement of social goals.

The question here is whether there is investor appetite for Sukuk of this kind. If there is not, and Sukuk therefore simply mimic conventional bonds, then their higher structuring costs place them at a disadvantage, except where there is a specific wish to target Sharia'-sensitive investors.

From a regulatory point of view, the market for Sukuk, as for bonds, is dominantly one of institutional or professional investors. In a non-retail market like this, regulators will normally assume that investors can make their own judgements about the things that are important to them, if they are provided with adequate information. Hence, regulators focus on disclosures in an offering document of some kind, plus continuing disclosures to the market. The IFSB has published a standard covering appropriate disclosures for Sukuk.

It is certainly possible that Islamic banks could use the vehicle of restricted investment accounts to match willing, value-driven investors with social infrastructure projects.

In conclusion

- It has become clear from several cases that the complex legal structures underpinning some Sukuk lead to the possibility that, if there are problems, some party may try to unpick the structure, possibly, though not necessarily, by raising Sharia' issues. Disclosure of the risks in this area is important.
- Some regulators have not been vigilant in enforcing continuing disclosures for Sukuk, partly because Sukuk are often held to maturity

rather than traded. The more Sukuk returns are linked to project performance, the more important it will be to disclose any developments that may affect those returns.

- If Sukuk are launched in a retail market, not only will information need to be provided in a more comprehensible form than a typical Sukuk offering document, but regulators will probably need to supplement disclosure with some product regulation, and take their own view on the suitability of the product for retail investors.

Financing social infrastructure projects: A case for sustainable Islamic finance standards

By Tallat Hussain, Environmental Counsel, White & Case LLP

The ICMA Green Bonds Principles (GBP) have provided issuers with a voluntary framework since 2014. In that time period issuance of green bonds has risen to over US\$ 150 billion and the GBP have achieved the status of best practice.

For environmentally and socially sustainable finance to flourish there must be an alignment of investor interests (and appetite for risk) with issuer goals (and commitments). Green bonds have led the way as they move into mainstream finance. The convergence of diverse issuers and a varied investor base have provided a point of reference for innovative approaches to addressing environmental and social funding gaps. Not surprisingly, with global issues such as the impacts of climate change and numerous human health crises, there is a need for broader scope solutions.

Taking environmental and social sustainability finance onto the global stage means consideration of cultural imperatives around the world as well as regulatory differences. For example, MENA countries are becoming more attuned to environmental and social sustainability, so “green” Islamic finance solutions are a logical facilitator.

The principles of environmentally and socially responsible investment underlying green bonds are premised on the same core values as Sharia’ principles, including positive obligations of environmental and social stewardship, managing negative impacts on air, water and biodiversity, as well as human health and the well-being of society.

Although green shoots of Islamic finance are developing with the recent issuances of environmental and social Sukuk, in order for Islamic or Sharia’-compliant financing for sustainability to grow and

enter the mainstream of financing solutions, there needs to be acceptance by conventional investors seeking responsible investment as well as those seeking Sharia’ compliance. A broader market appeal requires investor confidence. This highlights the need for in-country and regional support for innovative approaches to financing environmental, sustainable and socially responsible projects and programs.

The merits of an infrastructure that supports green Sukuk can be seen in the example of green bonds generally. The ICMA Green Bonds Principles (GBP) have provided issuers with a voluntary framework since 2014. In that time period issuance of green bonds has risen to over US\$ 150 billion and the GBP have achieved the status of best practice. They have even been incorporated into the regulatory structures for green financing in countries like China.

Following on from the GBP and in response to investor demand, in 2017 ICMA developed the Social Bond Principles (SBP), which apply the “use of proceeds” concept to bonds financing projects with social objectives. The GBP and SBP define the parameters of green and social bonds through the four key principles of (i) identification of use of proceeds (e.g., environmental and/or social objectives, assessed and quantified by the issuer); (ii) the process for eligible project evaluation and criteria for selection; (iii) management of proceeds from financing (such as ring-fencing and tracking proceeds); and (iv) reporting on

the use of proceeds, including performance indicators and confirmation of continued alignment with the core principles (preferably through external review by consultants or rating agencies, or through verification or certification).

To implement this approach to Islamic financing requires a coherent regulatory infrastructure in and amongst Islamic countries. A framework for environmental and social finance through instruments such as Sukuk is needed to define environmentally sustainable or socially responsible assets or project categories to which the proceeds of Sharia'-compliant instruments such as green Sukuk would be dedicated. A common definition for projects (such as for renewable power, energy efficiency, social housing and healthcare), as well as qualifying financing arrangements (such as Sukuk, Murabaha or Istisna') would be included in the framework. The use of proceeds for environmental or social purposes would be ensured through the commitment to ring-fence the proceeds of the financing, which, based on a simple Sukuk structure, for example, would be easy to effect as the project to receive the funding under Islamic finance instruments is identifiable. Perhaps not as easy to ensure, for reasons such as commercial sensitivity or confidentiality and the way Islamic financing tend to be structured, would be the requirement for transparency in financing and reporting obligations, respectively.

A framework for green Islamic finance instruments

Nonetheless, a framework for green Islamic finance instruments can build on the principles for environmental, social and sustainability bonds in order to ensure the alignment of the issuances with investor expectations (e.g., environmental and/or social benefits of the investment). The GBP and SBP provide proven examples that can be made to conform for Islamic financing structures to instill confidence in sustainable Islamic finance products based on a coherent and coordinated system supported by MENA countries and others. In turn, this should facilitate a broadening of the investor base for Sharia'-compliant financing of environmental and social assets and programs. With these objectives, a strong case can be made for standards of "green financial conduct" to springboard forms of sustainable Islamic finance, such as green Sukuk, from the marginal to the mainstream.

Human capital and collaborative initiatives

Human capital development

By Nyra Mahmood, Managing Director, SSHC Limited

Human capital development best practice begins at the education level. Despite over 378 institutions providing Islamic finance education globally, there is a lack of consistency in the delivery of courses; in academic information and definitions; in assessments, curriculum and even the competencies candidates acquire. Many courses from reputable universities are heavy on the Islamic finance knowledge, but lack the practical knowledge needed to work in the industry and innovate through technology. It is essential for the industry to address this mismatch between education and skills, and to work with educators to formulate, develop and agree on professional standards, and the use of Fintech and digital expertise to raise competencies.

The industry must also make a concerted effort to create pathways for graduates, including graduate schemes, internships and placements. Graduates must become a part of the recruitment armory of Islamic finance. As an industry we cannot exclusively rely on conventional financial services for talent at the expense of non-investment in young graduates, who are agile, digitized and connected. One way to tackle this is through talent development programs, which foster knowledge, mentorship, support, employee

engagement and a mindset that is flexible towards change. HR departments in IFIs have to take the long view and invest time and resources to create such programs and continuously review, assess and evaluate them, so that employees get the most out of them.

The industry must also make a concerted effort to create pathways for graduates, including graduate schemes, internships and placements. Graduates must become a part of the recruitment armory of Islamic finance.

Similar investments are needed in the Sharia' space, ensuring members of Sharia' bodies and associations are aware of the latest industry developments and trends, are up to date on training, technological advances and are actively setting up apprenticeship schemes for young potential scholars. Nurturing and investing in young scholars is vital to help

shed the image that the Sharia' space in Islamic finance promotes conflict of interest, is insular in its thinking and lacks diversity.

An important aspect of best practice also involves looking at company culture. By 2020, over 35% of the workforce will be millennials, and 24% Generation Z – both as a demographic have distinct expectations. They want to work for organizations, which offer a work-life balance; they expect rapid progression in their career path, regular feedback, encouragement and learning on the job, as well as working for companies which have a positive social impact. Islamic finance principles have a natural affinity to address ethical, sustainable and socially responsible business practices. However, the industry must be more transparent and foster a culture to demonstrate how and where this is happening with concrete case studies from all Islamic 'hubs'.

In terms of transparency, one of the most crucial areas for human capital best practice and governance is the provision of credible and reliable data. Islamic finance has little to no validated data. We are unable to truly verify the extent of talent development, human capital

capacity, recruitment gaps and statistics on the extent of the talent shortfall across different facets of the industry. HR departments of banks and financial institutions and CEOs in the industry must collectively work to close the data gap and commit to sharing data for research and development purposes, which in the long term will help us identify talent gaps.

The Islamic finance talent pool must reflect diversity and inclusion. Women are an untapped resource, especially across Muslim-majority countries, which house the biggest Islamic finance institutions. There are no Sharia' restrictions on women occupying important roles in the development of Islamic finance at all levels, yet we see few rising up the ranks in the industry. If the industry is serious about talent development, then female participation in the workplace must become a strategic priority at all levels, beginning with inclusive workplace policies, identifying and removing obstacles to women in the workplace, training and creating career pathways to leadership for women and establishing returnship programs for women to re-enter the workforce, for instance after having children.

Developing human capital in Islamic finance

Nurturing Islamic finance talent means to invest in supporting people, in training, engagement and creating a culture which fosters skills, creativity, inclusion and innovation. CEOs and Islamic finance leaders must pilot this change, and make talent development best practices a strategic priority. This requires implementing a framework which supports people and innovation – not just a symbolic gesture, but also a forceful stance crystallizing real development in human capital.

Harnessing the value of Islamic finance for infrastructure projects, in the context of SDGs

By Dr Osman Babiker Ahmed, Lead Economist, IRTI-IDB Group

The success of infrastructure projects in using Islamic finance has inspired project benefactors (equity investors) in countries such as Bangladesh, Djibouti, Indonesia, Kazakhstan, Malaysia, Mali, Morocco, Nigeria, Pakistan, Saudi Arabia, Turkey, and Uzbekistan to continue to pursue Islamic finance, along with conventional finance, in undertaking yet to come infrastructure projects.

WB and IsDB Report, 2017

Remarkable progress was made globally in translating the MDGs into reality with a huge reduction in the levels of life-threatening poverty over 2000-2015. Most regions of the world experienced poverty reduction during this period.

Nonetheless, poverty reduction was very slow in some regions such as Sub-Saharan Africa and Asia. Income inequality has also very narrowly declined across countries but increased in many countries. The progress on other MDGs in relation to education and health has not been fully seen. Worldwide environmental issues need serious attention alongside other development objectives.

Because of these reasons, the world, through the UN, adopted a new set of development objectives: the Sustainable Development Goals - SDGs. SDGs are a new round of global goals to follow the 15-year MDGs period.

The range of SDGs is more generic than the MDGs, focusing on economic and environmental sustainability issues including inclusive growth, industrialization, job creation, and climate change [Shirazi (2016)]. Besides, SDGs reframe development as a universal project and SDGs are comprehensive and indivisible with a great deal of interaction among them (Ahem, Rami [2017]).

In reality, the implementation of SDGs needs a set of preconditions, including financial resources, sovereign leadership commitment, partnership, effective institutions, good governance, physical infrastructure, human capital, technology, social inclusion and effective policies.

The infrastructure finance is estimated at around US\$ 3-4 trillion annually until 2030. All development finance available does not exceed US\$ 300 billion – only

10% of the need (WB and IsDB Report, 2017). The challenge is how to promote a financial system with the right institutions and governance that incentivizes a redirection of some of this investment toward sustainable development. Therefore, both private and public financing from domestic and international sources are necessary, and both need to be effectively exploited (Roundtable on the Role of Islamic Finance in Sustainable Development Financing, 2014).

The Addis Ababa Actionable Agenda (AAAA) calls for resource mobilization, of public and private capital, at local and global levels. The UN states that innovative financing initiatives will be required at all levels, especially the private sector, to secure funding for the SDGs and achieve the global sustainable aspirations of societies.

Studies have revealed that access to finance has a strong correlation with poverty reduction, economic growth and development and overall social welfare (Shirazi, 2016). Given that, how can Islamic finance help and contribute to achieve this ultimate goal of poverty reduction by providing funds for infrastructure projects?

Islamic finance has been accepted as a workable mechanism of dealing with poverty alleviation and augmenting inclusive economic development. It encourages economic activities and entrepreneurship, ensures financial and social stability, and addresses financial inclusion and supports comprehensive human development, which are all relevant to sustainable development.

Islamic finance can also offer new ways of addressing both small and medium projects on one side, and mega infrastructure and public-private

partnership (PPP) projects on the other side. The global need for infrastructure is huge. It extends across all regions, giving rise to a massive deficit in infrastructure investment. Given the global infrastructure financing deficit (US\$ 2.5 trillion annually), Islamic finance can mobilize resources for mega projects and equally for SME and micro enterprises. Different Islamic financial instruments can provide flexible tailored-funding for specific small-sized or mega projects. Examples of modes for financing are Sukuk, Ijarah (leasing), installment sale, Istisna' (order to make) and equity.

Many of the Organization of Islamic Cooperation (OIC) member countries are on a drive to entice private capital to finance their infrastructure projects. Islamic finance can provide a complementary source of financing to these efforts.

In view of that, and to bring in more Islamic finance, the state of affairs must be set for infrastructure projects to attain a much larger share of total investment. This can be done if the preparedness of developing countries for infrastructure projects can be upgraded, and additional sources of finance, such as Islamic finance, can be put in order for the infrastructure projects.

The evidence from a number of OIC member countries (Pakistan, Djibouti, Turkey, Saudi Arabia, Jordan, and Malaysia) illustrates the flexibility of Islamic finance in putting together Sharia'-compliant solutions across different countries and sectors. These cases span power, airports, sea ports, health care, and roads (WB and IsDB Report, 2017). It should be noted that these countries vary greatly in terms of their (i) macroeconomic environments, (ii) readiness to support infrastructure projects, and (iii) institutional maturity vis-à-vis Islamic finance.

The asset-backed feature of Islamic finance modalities and their emphasis on shared risks make them naturally

appropriate for infrastructure projects. A wide diversity of Islamic finance structures exists to provide sufficient flexibility to practitioners in selecting appropriate financing modalities.

The success of infrastructure projects in using Islamic finance has inspired project benefactors (equity investors) in countries such as Bangladesh, Djibouti, Indonesia, Kazakhstan, Malaysia, Mali, Morocco, Nigeria, Pakistan, Saudi Arabia, Turkey, and Uzbekistan to continue to pursue Islamic finance, along with conventional finance, in undertaking yet to come infrastructure projects (WB and IsDB Report, 2017).

The Islamic Development Bank Group (IsDBG) has been a pioneer in offering Islamic finance for infrastructure projects. In addition, other multilateral development banks and international financial institutions, including the IFC and MIGA of the World Bank, and the Asian Development Bank, have started positioning Islamic finance instruments to support infrastructure projects, thus providing much-needed assurance to fund providers. For each transaction that takes place, innovations in the structures used contribute to the body of knowledge and experience, and prepare the way for future dealings.

Yet Islamic financing is not consistently used in infrastructure projects. More knowledge about Islamic finance is required by countries seeking infrastructure finance and techniques to facilitate the practice of Islamic finance instruments in order to mobilize private investment in infrastructure projects. Assuming that many stakeholders, including project promoters and commercial banks, have a rather modest understanding of the application of Islamic finance to infrastructure projects, there is a substantial opportunity for awareness and knowledge building in this space.

In conclusion, and in terms of financing infrastructure projects, Islamic finance is

among the workable alternatives to fund development based on SDGs. The two basic principles behind Islamic finance are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest.

Theorists, practitioners and regulators recognize the ethical, multi-channel and diverse dimensions of Islamic finance, as well as its link to the real economy. In terms of the diversity of application, the use of Islamic finance extends to a range of economic subsectors (international trade, housing, education and health, food and water security, infrastructure and energy, agriculture and rural communities). While each sector has its own peculiarities, Islamic finance has suitable ways to address them.

Moreover, tradable securities (Sukuk, shares, Waqf certificates, etc.) originate from these mechanisms. Islamic finance is possible and provided through a multitude of channels, including through public, private and voluntary sectors for a wide range of goods and services (food and water security, housing, energy and infrastructure, education and health, trade) to further economic development.

The diversity of Islamic finance

Islamic finance is provided through a diversity of modes, including Murabaha; Istisna' (a contract of exchange with deferred delivery, applied to specified made-to-order items); Mudharaba (a partnership whereby one party provides capital (Rab al-Maal) and the other party provides labor (Mudharib); and Musharaka (a partnership, where two or more financiers provide finance for a project and all partners are entitled to a share in the profits resulting from the project in a ratio, which is mutually agreed upon. However, the losses, if any, are to be shared to exactly the same ratio.

Conclusion

In defining and accepting the Sharia'-compliant funding structure for social projects, there should be continued industry dialogue among practitioners, policy makers and market institutions, to assess, validate and articulate suitable investment structures that will create bold commercial and investment propositions between both sides of the market – supply and demand.

In this exercise, the institutions offering Islamic financial services (IFFSs) should consider addressing the following considerations and objectives:

- **Sharia' Compliance**

- Achieve Sharia' compliance through a corporate purpose culture, embracing the essence of Sharia' objectives in business and investment, which correspond with those of the UN SDGs, to achieve sustainable social prosperity.

- **Process and Guidelines**

- Consider developing voluntary process guidelines of products such as those of the ICMA's Green Bond Principles (GBP) and the Social Bond Principles (SBP)
- This will help rationalize and harmonize transactional controls and reduce costs and operational risks.

- **Regulatory & Risk**

- Address regulatory requirements regarding asset ownership, tax, bankruptcy laws and investment legislation, and identify key business and financial risks.
- This will help create subsidiaries, affiliates, and alliance partners.

- **Human Capital & Leadership**

- Identify investment and sector specific skill sets required in developing the social Sukuk.
- Develop a matrix reporting structure, and the required skills, experience, and expertise.

Clearly, embedding a standardized 'investment principles' approach continues to be a source of significant, transformational value for the Islamic finance practices worldwide. The fact that the industry is rapidly evolving, driven by economic, cultural, scale and technological changes, makes a collaborative investment approach culture both a strategic imperative and a growing challenge.

By focusing on the principles and considerations outlined in this whitepaper, corporates and governments, on the one hand, and investment institutions, on the other hand, can successfully design and articulate sustainable partnerships through the creation of innovative Sharia'-complaint investment structures to fund social and other infrastructure projects.

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