

**RHB ESG THEMATIC CONFERENCE
“WHEN SHARIAH MEETS ESG”**

**ISLAMIC FINANCE AND SUSTAINABLE
DEVELOPMENT INSTRUMENTS IN
THE LIGHT OF MAQASID SHARIAH**

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INTRODUCTION

The Islamic finance industry **has grown considerably** over the last four decades and has a global reach. It is considered one of the **fastest-growing segments** of the global financial industry.

Islamic finance attempts to rearrange the modern financial practices to be in line with **Shari'ah principles and requirements**.

In the *Maqasidic* orientation, the Shari'ah compliance in Islamic finance **does not mean a mere satisfaction of the minimum legal requirement** of Islamic jurisprudence.

In other words, the meaning of shariah compliance should not be concerned with the legal-contractual arrangement. Instead, it should **comply with Islamic ethical system** and pursuing **the objective of Shari'ah (Maqasid al-Shari'ah)**.

MAQASID AL-SHARI'AH

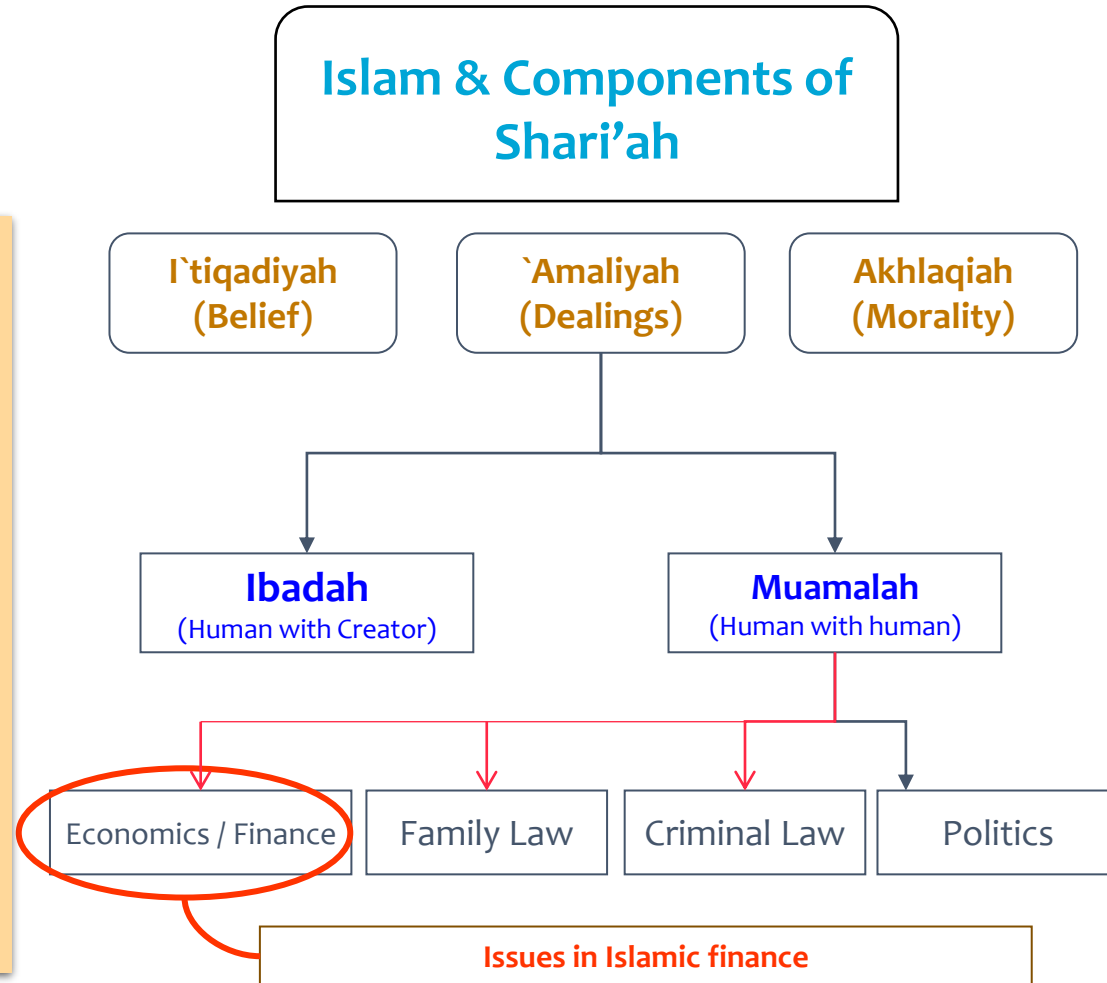
- ❑ Maqasid of the Islamic law are the objectives/purposes/intents/ends/principles/**behind the Islamic rulings.**
- ❑ Maqasid in the Islamic law (Shari'ah) is there for the “**Interest of Humanity**”.
- ❑ **Al-Shatibi** pointed out that Allah revealed the **Shari'ah for the benefit of mankind both in this world and the next.** This is the primary objective of the Lawgiver and a unifying factor which can be seen in all of the detailed rulings of the *Shari'ah*.
- ❑ Hence, Shari'ah was revealed with the **main objective** of **providing benefits** for mankind and **preventing them from Harm** (*Jalb Al-Masalih Wa Dar' Al-Mafasid*).

SHARI'AH AND FINANCE

شريعة

Shari'ah

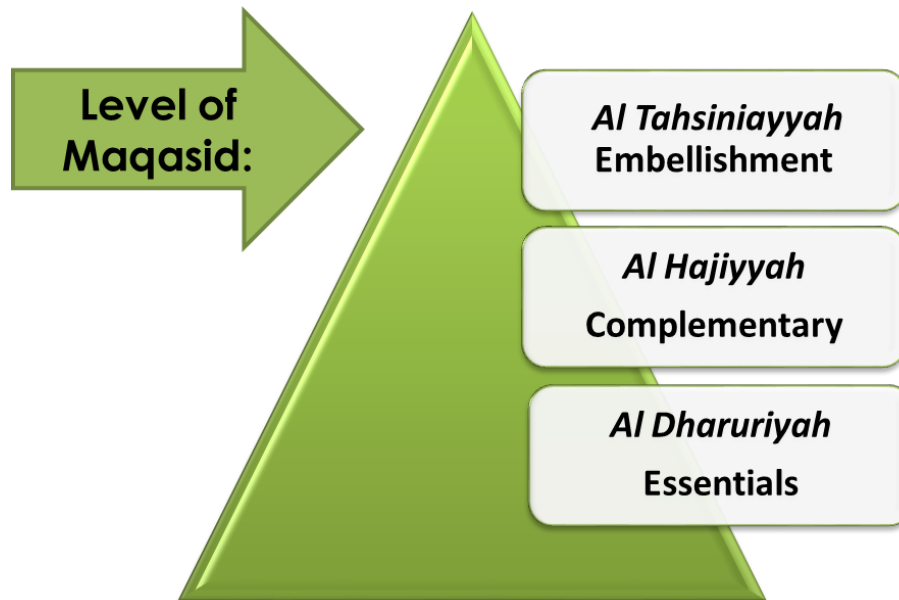
- ❑ Shari'ah encompasses the following meaning:
 - ✓ Path to tread for guidance in this world
 - ✓ Commands, prohibitions, values prescribed by Allah for His slaves either through Al-Quran or As-Sunnah (the teachings of the Prophet Muhammad s.a.w.)
- ❑ Shari'ah is a set of norms, values and laws that go to make up the Islamic way of life .
- ❑ Shari'ah encompasses the whole dimensions of human life



THE DIMENSIONS AND HIERARCHY OF MAQASID AL- SHARI'AH

The objectives of the *Shari'ah* is divided into three, namely:

1. **The Essentials or Necessities (*Daruriyyat*);**
2. **The Complementary (*Hajiyyat*); and**
3. **The Embellishment (*Tahsiniyyat*).**



MAQASID AL-SHARI'AH AL DARURIYYAH:

1. Din (Religion)
2. 'Aql (Intellect)
3. Nafs (Life)
4. Nasl (Lineage)
5. Mal (Property)

Ibn al-Qayyim al-Jauziyah

“الشَّرِيعَةُ مَبْنِيَّةٌ عَلَى مَصَالِحِ الْعِبَادِ”.

MAQASID: THE ULTIMATE OBJECTIVES OF SHARIAH

PROMOTING WELL-BEING OF MANKIND:
1. Facilitation of ease/promotion of good
2. Removal of hardship/harm for human being

Maqasid

Preservation
of Religion

Preservation
of Life

Preservation
of Intellect

Preservation
of Lineage

Preservation of
Wealth

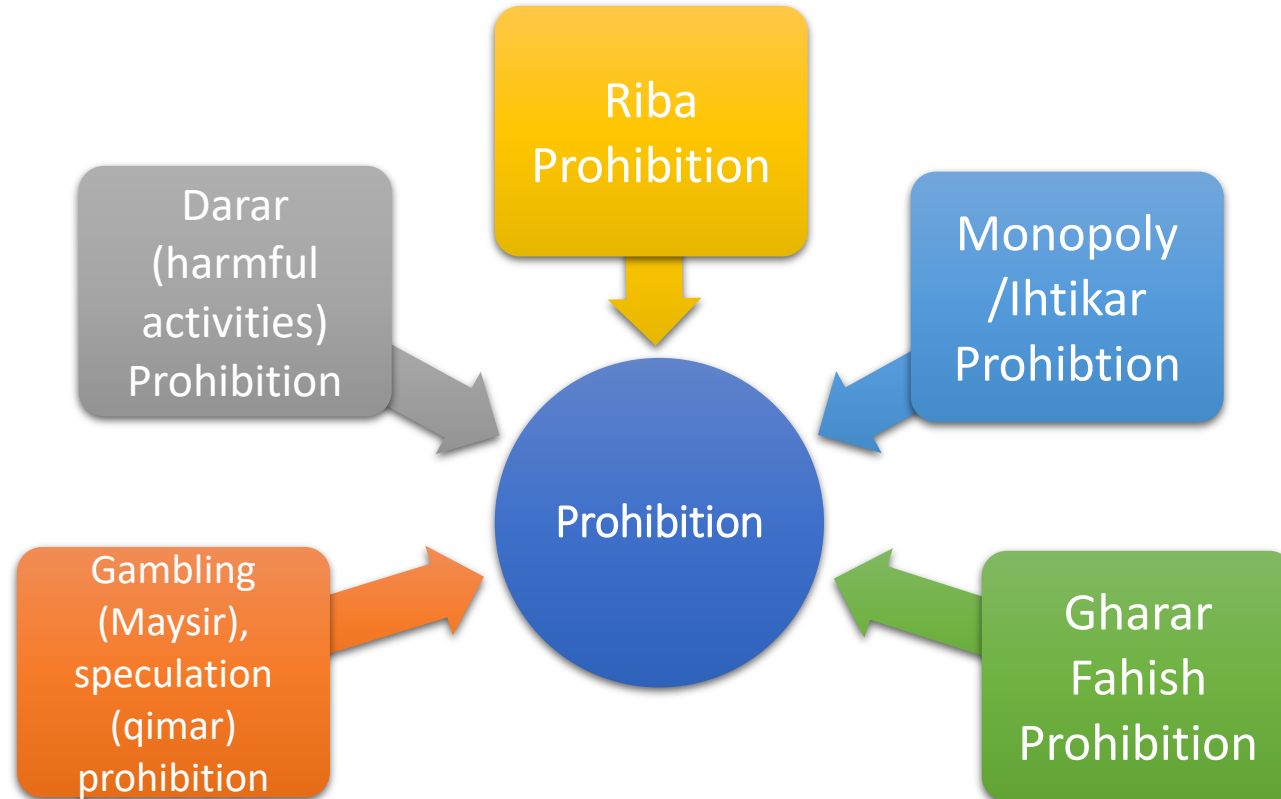
Parameters:

- **Ownership of wealth** via legal means
- **Punishment for transgressing others' right** (e.g., punishment for theft, corruption, etc.)
- Productive wealth creation via **permissible economic activities** such as trade & **prohibition of interest** (riba), **uncertainty** (gharar) and other **forbidden activities**

Includes:

- **Generate, accumulate & preserve wealth**
- **Distribute the wealth justly & fairly**

❖ **Shari'ah mechanism to realize the Maqasid Shari'ah in Islamic Finance**



❖ Shari'ah as the Basis in Islamic financial system and Islamic financial system is operating in Shariah ecosystem

PRINCIPLES

- The Core:
 - The prohibition of Riba
 - The avoidance of Gharar
 - The engagement in real economic activities
- The Ethical Principles
 - Avoidance of forbidden activities
 - Fair & transparent financial dealings
 - Commitment of Islamic values

MECHANISMS

- Observing the principles governing the contracts (*'aqd*)
- Forms/structures should be inline with the substances/goals
- Observing the criteria of efficient, effective, fair, just and transparent

GOALS

- Aims to realize the *maqasid al-Shari'ah* in the whole dimensions:
 - **Micro goals:** related to the Individuals
 - **Macro goals:** related to the society
 - **System goals:** related to the system itself

Environmental, Social and Governance - ESG

Environmental Social and Governance (ESG) refers to the three key factors when measuring the sustainability and ethical impact of an investment in a business or company. It is a generic term used in capital markets and commonly used by investors to evaluate the behavior of companies, as well as determining their future financial performance.

Governance

Deals with a company's leadership, executive pay, audit, internal controls and shareholder rights.

Social criteria

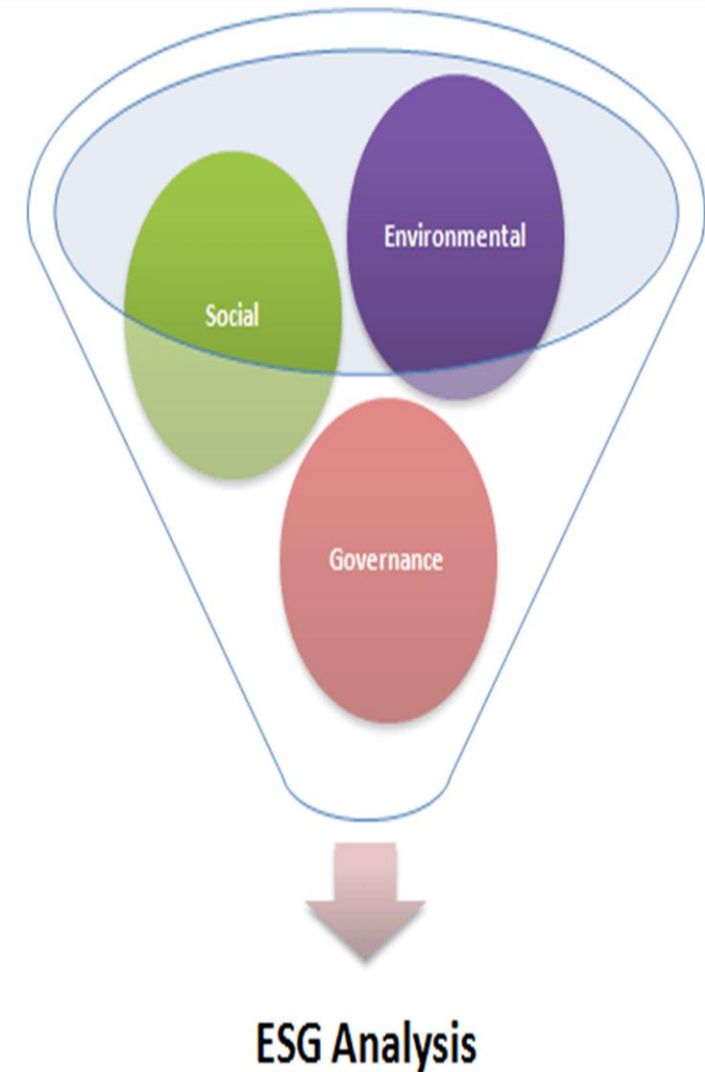
Examine how a company manages relationships with its employees, suppliers, customers and the communities where it operates.

Environmental criteria

Look at how a company performs as a steward of the natural environment.

ESG CRITERIA

- ESG criteria refer to three main factors investors consider with regards to a firm's ethical impact and sustainable practices.
- The criteria are used in ESG investing, also sometimes referred to as **Sustainable, Responsible and Impact investing** or **Social Responsible Investing (SRI)**
- Examples of ESG criteria used by investors include:



ESG AND ISLAMIC FINANCE AGENDA

❑ INNOVATION:

- Innovation means innovative ways to promote social mobility, sustainable impact to the economy, community and environment.

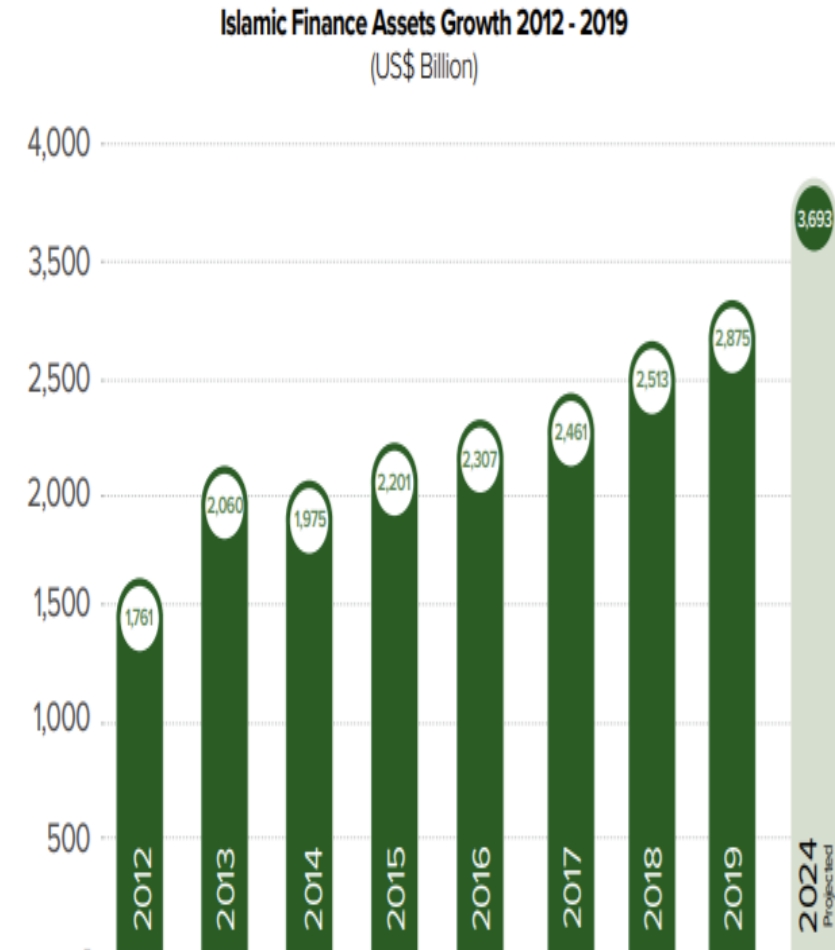
❑ IMPACT INVESTMENT:

- With the Islamic finance industry pushing \$3 trillion, why have we do not see larger scale social responsibly investment?

❑ SHARIAH COMPLIANT:

- Does the label “Islamic” mean it has a particular obligation to invest in economic or community development with social agenda? Or It is only about complying the Shariah contracts?

At the end of 2024, global size of the Islamic financial service Industry is forecasted to reach US\$ 3,693 billion (ICD, 2020).



Source: ICD, 2020

1. INNOVATION

✓ *INNOVATIVE WAYS TO PROMOTE ESG*

- ❑ The **traditional way** in doing finance in a Shariah compliant framework **should be improved** in line with the needs of society and the emergence of financial technology.
- ❑ **Integration of commercial and social finance** whereby Islamic finance should also be used to mobilize, institutionalize and empower the funds of *zakat*, *sadaqat*, *qard-al-Hassan* and *waqf*.
 - *Zakat* funds could be used to cover the default risk of microenterprises and to build capacity and skills.
 - *Qard-al-Hassan* resources should be made available to Islamic microfinance institutions to reduce the burden of high interest charges on their borrowers.

2. SHARIAH COMPLIANT

✓ *EXTENDED MEANING TO INCLUDE ETHICAL COMMITMENT AND SOCIAL ORIENTATION*

❑ **Shariah requires no distinction between legal imperatives and moral obligations.**

Law and ethics, from the Shariah perspective, should not be viewed as separable and should not be made contradictory in developing Islamic finance.

❑ **Islamic finance product structuring: marrying form and substance.**

The concern in product structuring is not merely to secure the narrow legal compliance of banking and finance practices by screening negative elements in conventional financial practices, but a more substantive movement towards inspiring a good financial system enshrining Islamic ethics and principles as implied in the concept of *maqāsid al-Shari'ah* (the goals of Shariah).

Is ESG relevant to Shariah (Islamic Business)?

- ESG is a **moral initiative** based on the belief that a **company should be “good”** regardless of its financial consequences, be it positive or negative. This is not to suggest that Islam is against profit-making. Rather, it is seen as a necessary condition, though not the sole purpose, of their existence.
- As such, the industry is expected to become **more proactive** in demonstrating how Islamic finance supports the economy by **giving increased consideration of ESG issues** in investment and financial decisions and **incorporating impact investing** and **sustainability-themed investing within the Shariah-compliance strategy**.



By pursuing ESG and Shariah compliance hand-in-hand, the Islamic finance industry would benefit from a larger investor base and gain broader mainstream relevance.

CONT...

Integration of ESG factors would motivate IFIs to move towards a more proactive approach in positively screening investments and in adopting the engagement strategy to better contribute to the welfare of the society at large.

Moreover, enforcing ESG values within the practice of Islamic finance will motivate Shariah committee members not only to deliberate on the Shariah structures of Islamic financial products but also question the purpose and impact of the financing provided.

For instance, when providing mudarabah (profit and loss) financing for a customer to build manufacturing plants, it will become important that the customer provides Environmental Impact Assessment (EIA) reports to ensure that the project does not harm the environment.

CONT...

THE NEED FOR REGULATORY INCENTIVES

There is a role for regulators and governments in motivating IFIs to embrace the move towards greater ESG integration by providing the necessary regulatory incentives.

REPORTING

Mandatory reporting of ESG factors can certainly influence IFIs in embracing ESG. This will lead IFIs to ensure that their investments become increasingly ESG/SRI-compliant over time.

AREA OF CONVERGENCE OF ISLAMIC FINANCE WITH ESG



- The convergence of the Islamic finance industry with the ESG sector is in line with the argument that IFIs **should not only seek to be formally legally compliant to the Shari'ah** (i.e. be concerned about *halal* and *haram*) but **should also promote compliance with the *Maqasid al-Shari'ah***, which integrate the broader ESG values and principles endorsed by the SRI industry.

- With this vision, Islamic finance is expected to **create greater impact in the ESG areas.**

Source: Riaz, et al (2017). Islamic Finance and Sustainable and Responsible Investment (SRI): An Ethical Dimension

❖ The launch of the FTSE4 Good Bursa Malaysia ESG Index as an attempt to improve the sustainability and ESG reporting

- In 2006, Bursa Malaysia began requiring publicly listed companies to provide information about their corporate social responsibility practices in their annual reports.
- In 2015, Bursa Malaysia amended the reporting requirements to make them more focused on sustainability, particularly the environmental and social impact of their activities as well as the economic impact on their stakeholders.

Bursa Malaysia Offers a Sustainability-related Index Called FTSE4 Good Bursa Malaysia, Which is Designed To:

- Highlight companies that demonstrate a leading approach to addressing environmental, social and governance (ESG) risks.
- Assist in managing exposure to ESG aspects.



Notable SRI Initiatives in the Malaysian Capital Market

2018

- Establishment of **RM6 million Green SRI Sukuk Grant Scheme** which is **tax exempted**
- Issuance of **ASEAN SBS and ASEAN SUS**

2017

- Launch of the SC's **Islamic Fund and Wealth Management Blueprint**
- Issuance of **social impact sukuk** by Khazanah (2nd tranche) with retail portion
- Issuance of **world's first green sukuk under SRI Sukuk Framework**
- Issuance of the **ASEAN GBS** followed by **inaugural ASEAN Green Bond**
- Issuance of the SC's **Guidelines on SRI Funds**
- **Tax incentive for SRI funds** for three years from YA 2018 to YA 2020, and extended for another three years from YA 2021 to YA 2023 (2020 Budget)
- Launch of the SC's revised **MCCG**

2016

- **Tax incentive for SRI Sukuk issuers** for five years from YA 2016 to YA 2020, and extended for another three years from YA 2021 to YA 2023 (2020 Budget)

2015

- Inaugural issuance of **social impact sukuk** under SRI Sukuk Framework by Khazanah
- Introduction of **Sustainability Reporting** through *Bursa Malaysia Listing Requirements*

2014

- Issuance of the SC's **SRI Sukuk Framework**
- Launch of **FTSE4Good Bursa Malaysia Index**
- Issuance of **MCII**

Some notable SRI initiatives including the establishment of a **MYR6 million tax-exempted green SRI Sukuk grant scheme in 2018** and the **issuance of the world's first green Sukuk under an SRI support framework in 2017.**

In November 2019, the Securities Commission (SC) in Malaysia launched the **Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market (SRI Roadmap)** which aims to create a **facilitative SRI ecosystem** and chart the role of the capital market in **driving Malaysia's sustainable development.**

SRI Sukuk and Bond Grant Scheme to encourage capital market fund raising for sustainable development

SRI SUKUK AND BOND GRANT SCHEME



OBJECTIVE

To incentivise and encourage more issuers to finance green, social and sustainability projects through sukuk issued under the SC's SRI Sukuk Framework or bonds issued in Malaysia under the *ASEAN Green, Social and Sustainability Bond Standards*.

ELIGIBILITY FOR ISSUANCES THAT QUALIFY FOR THE SRI SUKUK AND BOND GRANT SCHEME

- Green SRI sukuk issuances made under the SC's SRI Sukuk Framework from July 2017 onwards
- Social, sustainability or other SRI sukuk issuances made under the SC's SRI Sukuk Framework from 25 August 2020 onwards
- Bond issuances made under the *ASEAN Green Bond Standards, ASEAN Social Bond Standards or ASEAN Sustainability Bond Standards* from 29 October 2020 onwards.

CLAIM



Issuer can **claim** for the Grant based on **an issue or programme**

CLAIM AMOUNT



90% of the actual external review cost subject to a maximum of **RM300,000**

TAX INCENTIVE



5 years income **tax exemption** for the recipient of the SRI Sukuk and Bond Grant Scheme from Year of Assessment (YA) 2021 until YA 2025.

APPLICATION PERIOD FOR THE SRI SUKUK AND BOND GRANT SCHEME



From **January 2021** until fully utilised

**RANGE OF PRODUCTS
THAT AN ISLAMIC BANK
CAN OFFER TO CATER
FOR SRI**





SRI SUKUK - SUSTAINABLE FINANCE

Ensure Access to Affordable, Reliable, Sustainable and Modern Energy For All

7 AFFORDABLE AND
CLEAN ENERGY



The increase in the adoption of green sukuk to finance renewable energy projects is attributable to the following factors: *the increase in renewable energy projects, particularly solar energy projects, the low capital costs, and the fact that it is a Shariah-compliant instrument.*



- **Malaysia and Indonesia are among the first countries to issue this type of sukuk.**
- In Malaysia, **the first SRI sukuk, valued at RM 250 million**, was issued to partly finance large-scale solar construction in in Kudat, Sabah
- Following that, Quantum Solar Park Malaysia Sdn Bhd **launched the world's largest green SRI sukuk valued at RM1 billion** to fund the construction of Southeast Asia's largest solar photovoltaic plant project in three regions: Kedah, Melaka and Terengganu.
- **Indonesia** has also **recently issued USD 1.25 billion of green sovereign sukuk**, whose revenues will be partly used to finance renewable energy projects.

❖ Ensure Healthy Lives and Promote Well-being for All At All Ages

Case Study: Sukuk for vaccine fund

- The International Finance Facility for Immunisation Company (IFFIm) issued Sukuk, raising US\$ 500 million for children’s immunisation in the world’s poorest countries through Gavi, the Vaccine Alliance.
- This landmark transaction is the first socially responsible Sukuk with funds to be utilised for this purpose.





❖ Ensure inclusive and quality education for all and promote lifelong learning

• CASE STUDY:

- **SUKUK IHSAN**: the Malaysia's first **Sustainable and Responsible Investment (SRI)** issued by Khazanah Nasional Berhad and exclusively offered to institutional investors.
- The proceeds were channelled to Yayasan AMIR, a not-for-profit organisation incorporated in 2010 to improve the accessibility of quality education in Malaysian government schools.

TERMS & CONDITIONS OF THE RETAIL OFFERING

| | |
|---------------|---|
| Issuer | : Ihsan Sukuk Berhad |
| Obligor | : Khazanah Nasional Berhad |
| Amount | : Up to RM100 million including a retail portion of RM5 million |
| Tenure | : 7 Years |
| Profit Rate | : If KPIs are not met 4.60% and redemption at 100% |
| | : If KPIs are met Reduced to 4.20% via a mandatory reduction of 3.18% of the principal by redeeming the SRI Sukuk at 96.82% |
| Waiver Option | : Investors may waive the principal value and profit invested at any time during the tenure of Sukuk Ihsan |

HOW KPIs ARE MEASURED

| Number of Trust Schools | Senior Leadership | Teachers | Students |
|--|---|---|--|
| Minimum of 20 identified schools are selected during the term of the sukuk | Minimum of 50% of the senior leadership team of the identified schools are highly proficient in enabling positive and relevant learning environment | Minimum of 50% of the teachers of the identified schools are at establishing level or above | Minimum of 50% of students of the identified schools demonstrate positive values and at least 75% of the student population are able to pass the national literacy & numeracy test |



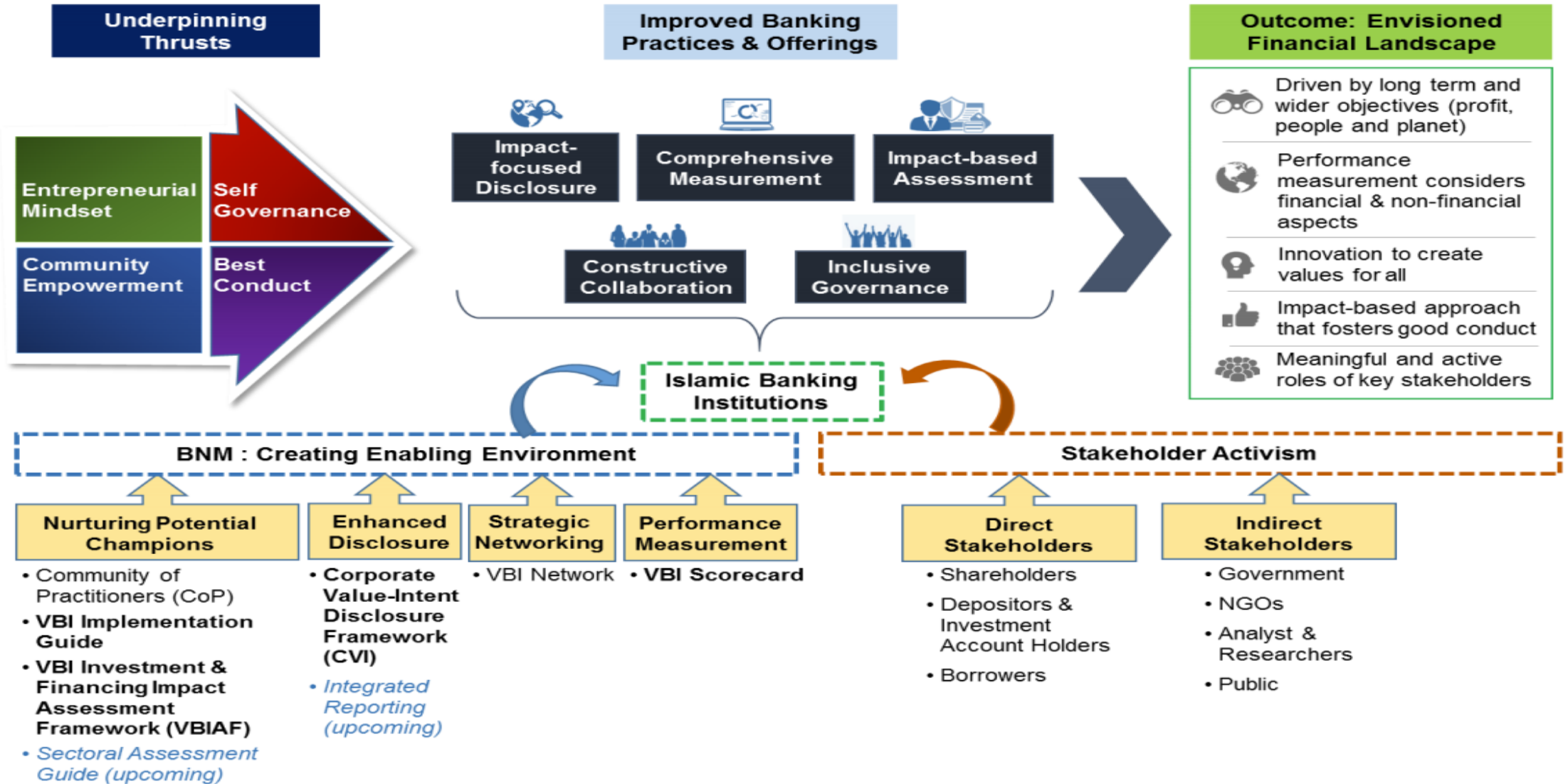
❖ BNM and Value Based Intermediaries (VBI) Initiatives

- The VBI initiatives by Bank Negara Malaysia (BNM) aims in **creating an enabling environment** for IBIs in Malaysia to adopt relevant practices, offerings and conduct that **generate positive and sustainable impact to the economy, community and environment**, without compromising the financial returns to shareholders.
- BNM requires IBIs to ensure that the intent, strategy and performance of their Islamic financial businesses are **premised on the underpinning areas of VBI** that will eventually **create values to the stakeholders**.
- VBI aims to **achieve the goals of the economy, society, and the environment, all within the Maqasid al-Shariah**, with these outcomes of Shariah being justice, wealth protection, and wealth circulation, amongst several others.



The underpinning Thrusts of VBI

Overall Framework of Value-based Intermediation (VBI)



Intended outcomes of Shariah in VBI

VBI aims to achieve the goals of the economy, society, and the environment, all within the Maqasid al-Shariah, with these outcomes of Shariah being justice, wealth protection, and wealth circulation, amongst several others.



KEY DIFFERENCES BETWEEN VBI AND SRI

Value-based Intermediation (VBI)

1. Intermediation that considers economics, social and environment in Islamic banking
2. Values derived from Maqasid al-Shariah
3. Retail, Corporate
4. Re-aligning Islamic banking towards “substance over form” based on Maqasid al-Shariah
5. Values fixed and permanent

Sustainable Responsible Investment (SRI)

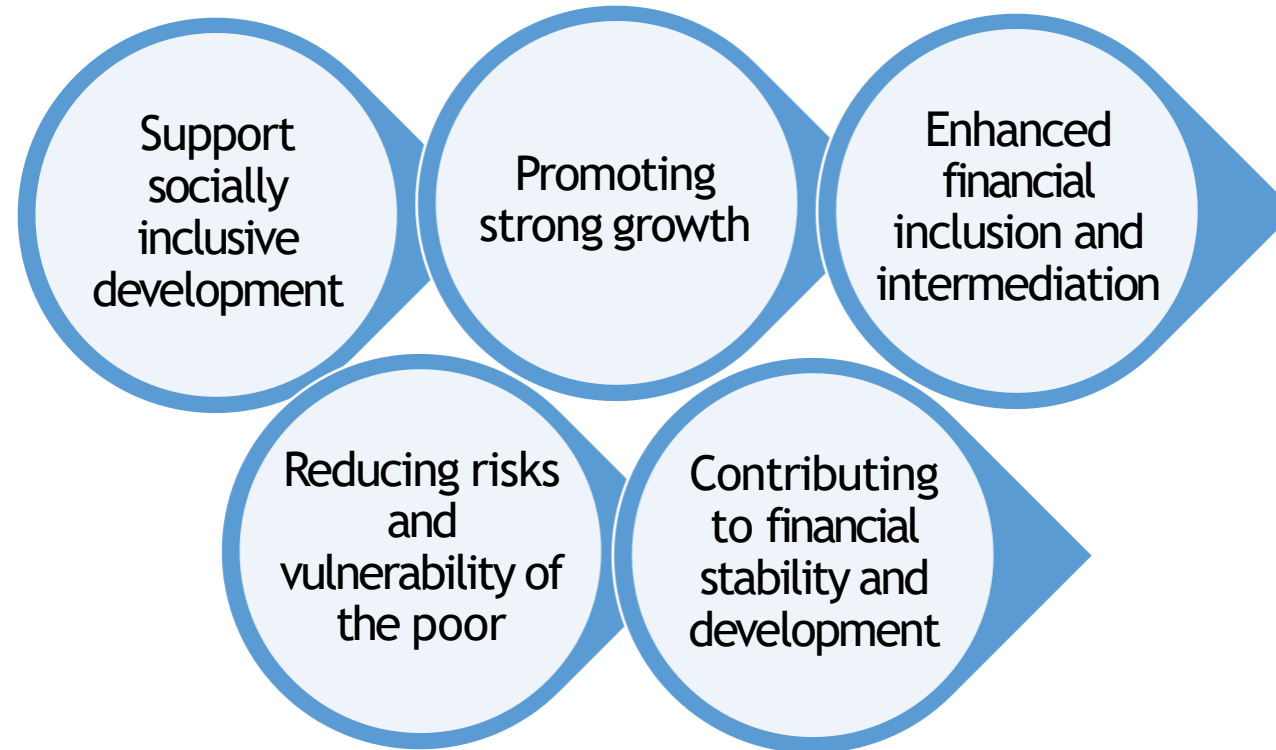
1. Intermediation that considers economics, social, environment and governance in capital markets
2. Values derived from pure economic, social and environmental frameworks, but may be Shariah-compliant
3. Corporate, Government
4. Re-aligning capital market activities towards “substance over form” based on local and global sustainable strategic initiatives (SDGs, ESG, etc.)
5. Values changeable and may affect SRI outputs

ISLAMIC FINANCE AND SDGs

- ❑ The Sustainable Development Goals, the global development agenda for 2015 through 2030, **set the stage for global support of ambitious development goals behind which the world must rally.**
- ❑ For developing countries, the required investment for the **Sustainable Development Goals (SDGs)** would be approximately **US\$4.5 trillion** per year, with an additional requirement of **US\$3.1 trillion** (UNDP, 2016).
- ❑ The **potential** for Islamic finance to **play a role in supporting the Sustainable Development Goals** should be **explored.**
- ❑ According to IFSB (2020), the total worth of the Islamic financial services industry (IFSI) **increased to an estimated USD 2.44 trillion in 2019** (from USD 2.19 trillion in 2018).
- ❑ The global **Islamic Finance assets** are forecast to reach **USD 3.69 trillion by 2024** (ICD, 2020).



ISLAMIC FINANCE COULD CONTRIBUTE POSITIVELY TO THE ACHIEVEMENT OF SDG'S



Alignment of Maqasid with Sustainability Agendas

PROMOTING WELL-BEING OF MANKIND:
 1. Facilitation of ease/promotion of good
 2. Removal of hardship/harm for human being

Maqasid

Preservation of Religion

Preservation of Life

Preservation of Intellect

Preservation of Lineage

Preservation of Wealth

ESG

Environment

Social

Governance

SDG

Goal 6: Clean Water and Sanitation
 Goal 7: Affordable and Clean Energy
 Goal 11: Sustainable Cities and Communities
 Goal 12: Responsible Consumption and Production
 Goal 13: Climate Action
 Goal 14: Life Below Water
 Goal 15: Life on Land

Goal 1: No Poverty
 Goal 2: Zero Hunger
 Goal 3: Good Health and Well-being
 Goal 4: Quality Education
 Goal 5: Gender Equality
 Goal 8: Decent Work and Economic Growth
 Goal 9: Industry, Innovation and Infrastructure
 Goal 10: Reduced Inequality
 Goal 11: Sustainable Cities and Communities

Goal 16: Peace and Justice Strong Institutions
 Goal 17: Partnerships to Achieve the Goal

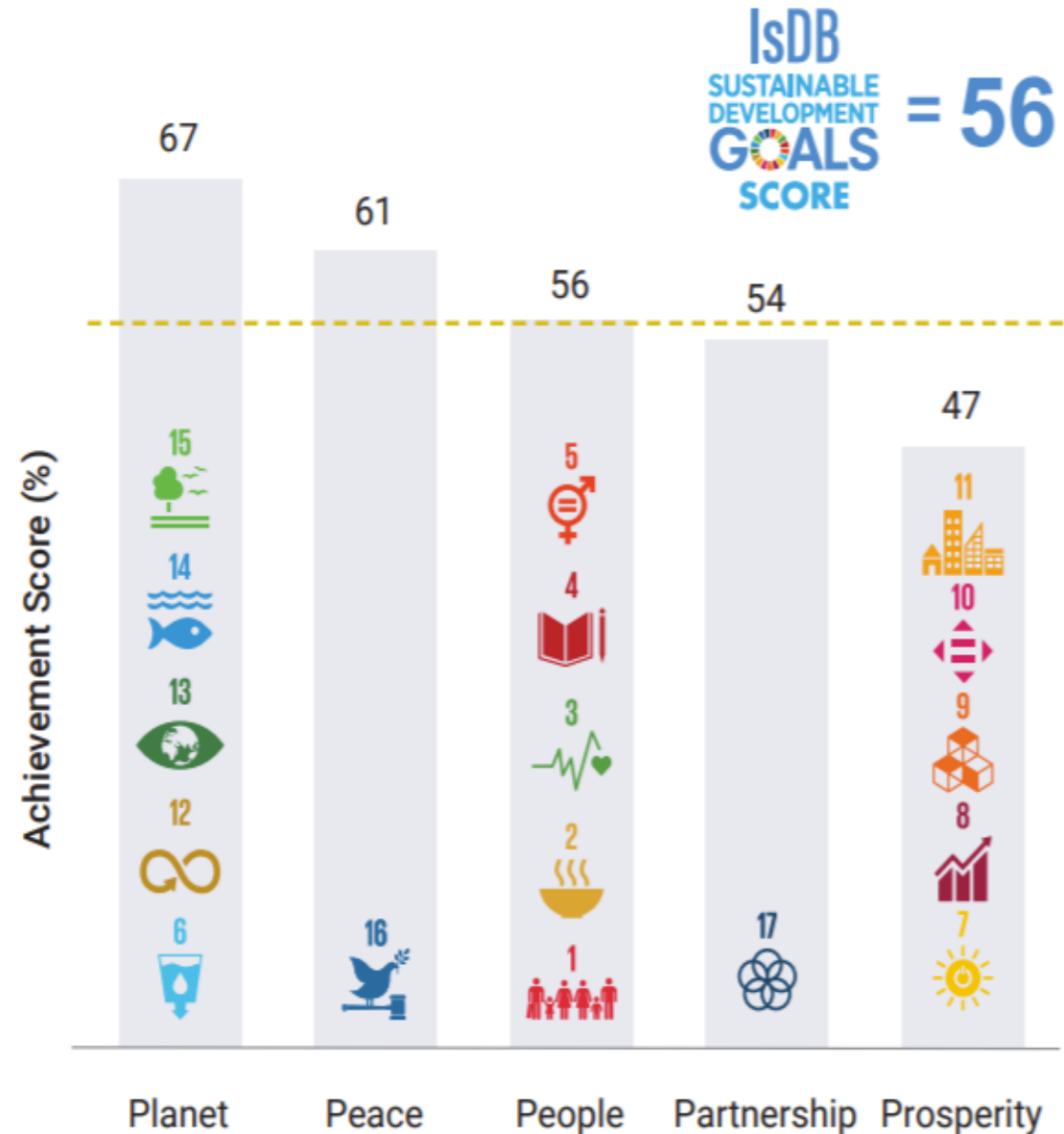


SDG Achievement in OIC Members Countries (As at 2019)

Below the global average of **60%**

Focus on **5** areas:

- People
- Planet
- Prosperity
- Peace
- Partnership



SDG Achievement in Malaysia (As at 2019)

Progress in **3** SDGs:



86%

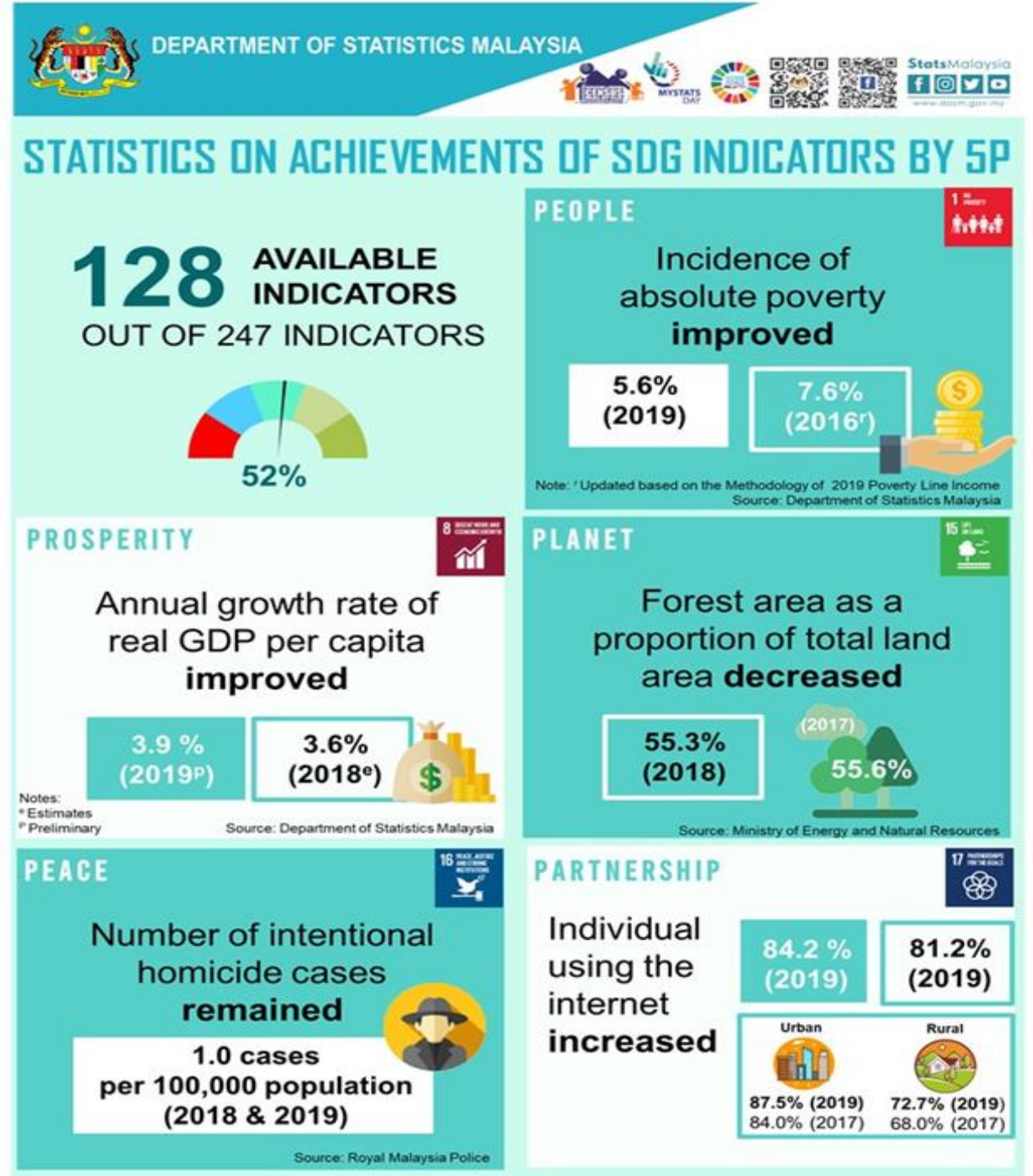


83%



75%

Source: Press Release, Department of Statistics Malaysia, 10 Dec 2020



RE-ORIENTING THE MISSION OF ISLAMIC FINANCE

- Islamic finance essentially plays a **major role** in addressing the problem face by society such as wealth distribution, social mobility and etc.
- The establishment of Islamic finance is **not only** for the reason of having halal (**shari'ah compliant**) financial structure.
- Its establishment is also purported to achieve various socio-economic justice as mandated by **the objective of Shari'ah (maqasid al-shari'ah)** which aims at realizing human wellbeing (*maslahah*).
- Islamic finance in the 21st century should **rethink financial strategy** to ensure the financial access to all dimensions of society and hence **promoting social mobility, sustainable impact to the economy, community and environment.**

CONCLUSION

SHARI'AH



Islamic Financial System

- ❑ IFIs should be developed with **broader understanding** of Shari'ah and **pursuing the higher objectives of Shari'ah**.
- ❑ Maqasid al-Shari'ah would **act as the framework and guideline** as well **basis** and **foundations** in **developing an Islamic financial system**.
- ❑ Maqasid *al-Shari'ah* constitute the objectives of the Shari'ah as a system of life and comprises the **basic philosophical foundations** that **give guidelines and justifications** for IBF's *raison d'être* in contemporary times.
- ❑ **Adherence to maqasid al-Shari'ah** as the grand objective of Islam is necessary for developing genuine and indisputable Islamic finance.

MOVING FORWARD

1 BROADENING THE MEANING OF SHARI'AH COMPLIANCE

Expanding the emphasis into the meaning and substance of Shariah rather than technical and operational sense in developing products

2 COMPREHENSIVE PERSPECTIVE OF CREATING A NEW FINANCIAL SYSTEM

Understanding the “bigger picture of economics” in Islam or the Islamic system of life as implied in the concept of *Maqasid al-Shari'ah*.

3 REAL CONTRIBUTION OF ISLAMIC FINANCE

Releasing “full potentials” of Islamic finance and hence its contribution to the society is more felt.

THANK YOU!