

Shariah and ESG: A natural pair



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The Islamic financial market is expected to play a huge role in helping the world to decarbonise via the issuances of green sukuk. Malaysia, along with the rest of ASEAN, is fast-tracking sustainable responsible investments to achieve positive impact and positive returns. Its global leader status in Islamic finance will thus pave the way for the green sukuk market to flourish.

Both Shariah and ESG investing are not new concepts and need no introduction. Both seek to promote responsible behaviour and as such have overlapping principles. This has led to their natural pairing and triggered a growing demand for Shariah ESG solutions in Malaysia and around the globe; Malaysia launched its Shariah ESG index, the FTSE 4Good Bursa Malaysia Shariah Index, in 2021 while Nasdaq saw its first listing of Shariah-compliant and ESG-aware exchange-traded fund in early 2022.

While the pairing of ESG and Shariah in the equity space gets more news headlines, it is worth noting that fixed income Shariah investments are also showing signs of this trend. In recent years there has been an uptick in environmental, social and governance (ESG)-related sukuk issuances. The sukuk market is important for ESG given

that it has grown larger than the conventional bond market owing to the various incentives given by the Malaysian government to develop the market including preferential tax treatment for both issuers and investors.

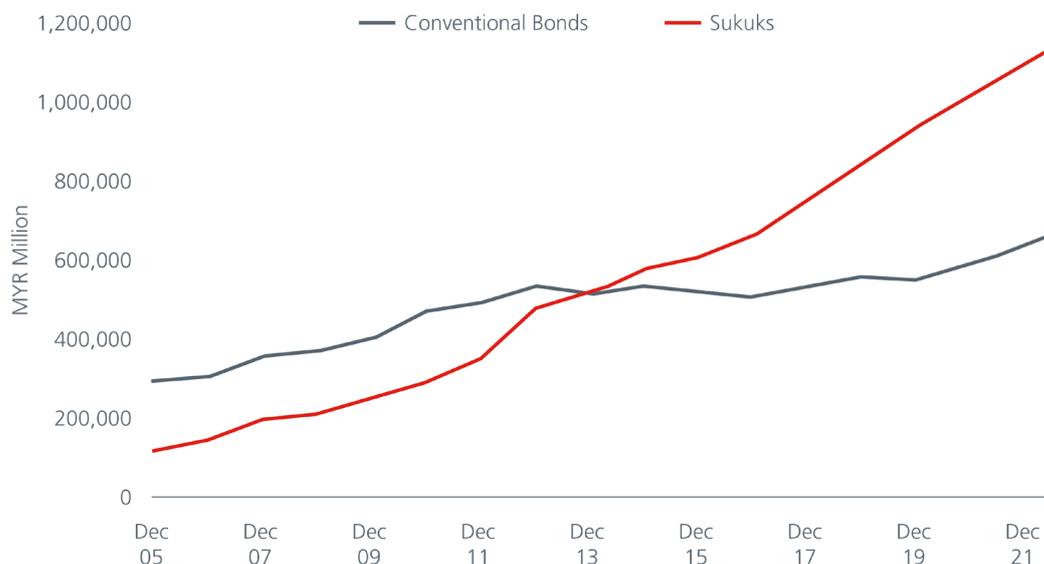
GROWING DEMAND FOR GREEN SUKUKS

WIn the primary market, sustainable-sukuk issuances have gained traction. According to Ernst & Young Consulting, Malaysia leads in sustainable and responsible investing (SRI) sukuk issuance among the ASEAN6 countries, accounting for USD3.9 billion of issuance value or 56% of the total ASEAN SRI sukuk issuance, as of November 2021 on a CAGR of 278% between 2016 to 2020¹.

Notable issuances include the world's first green SRI sukuk by a Malaysian company to finance the construction of large-scale solar photovoltaic power plants in 2017 and the world's first sustainability sukuk by the Government of Malaysia in 2021. This maiden issuance via a special-purpose vehicle is in line with the government's recently launched Sustainability Development Goals (SDGs) Sukuk Framework.

¹https://www.ey.com/en_my/news/2022-press-releases/01/malaysia-is-prime-issuer-of-sustainability-sukuk-in-asean-with-uss3-9-billion-of-total-issuance

Fig 1: Outstanding sukuku and conventional bonds



Source: Bond Pricing Agency Malaysia as of 31 May 2022

Fig. 2: ASEAN6 value of sustainable sukuku issuances, 2016-2021



Total ASEAN6 sukuku issued (as of 2 November 2021)	No. of issuers	Value (US\$)	% of total sukuku
Green sukuku	19	4.7b	66%
Sustainability sukuku	8	2.3b	33%
Social sukuku	1	27m	1%

Source: Ernst & Young Report, Feb 2022 - Trending: Sustainable responsible investment in Malaysia and the region

MALAYSIA’S REGULATORY INITIATIVES ARE SUPPORTIVE OF SHARIAH ESG SOLUTIONS

Two main statutory bodies i.e., Securities Commission Malaysia (SC) and Bank Negara Malaysia (BNM) have been

entrusted to support the government’s push in sustainable investments.

In 2014, the SRI sukuku framework was launched by the SC to promote socially responsible investment and financing.

²Securities Commission Sustainable and Responsible Investment Sukuku Framework – An Overview

The framework lays the foundation for a conducive and systematic ecosystem for both investors and companies that look to tap the market by aligning definitions and standards to United Nation’s Sustainable Development Goals, with emphasis on transparent reporting.²

In 2018, the SC established the SRI Sukuk and Bond Grant Scheme, which allows issuers to claim back up to 90% of the costs incurred on independent expert reviews of sustainable sukuk issuances under the SC’s SRI Sukuk Framework and bond issuances under the ASEAN Green, Social and Sustainability Bond Standards³.

In 2021, BNM introduced guidelines to help financial institutions categorise economic activities to meet climate objectives and promote the transition to a low-carbon economy. These guidelines complement the Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) Guidance Document issued by BNM in November 2019. The VBIAF is the foundation for ESG considerations in the financial sector, and whilst it is premised on Shariah tenets, its framework has universal application for financial institutions targeting to incorporate ESG measures in their operations.

DOING GOOD DOES EQUAL DOING WELL

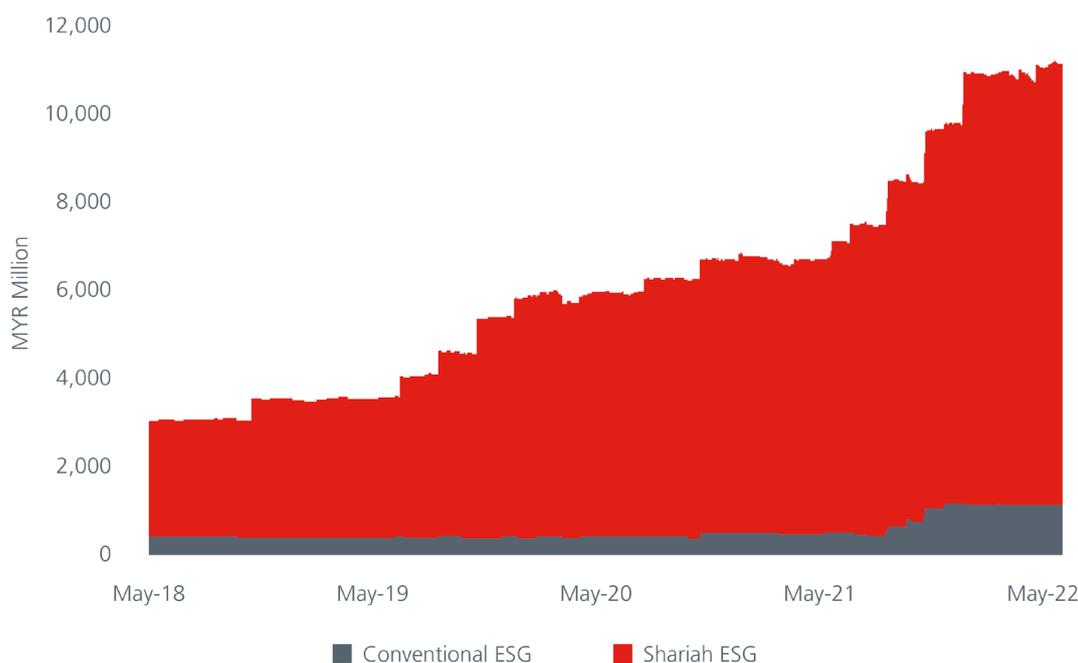
In our earlier article Do Well by Doing Good, we highlighted how Shariah and ESG combined delivered a better equity performance against the broader market and a standalone ESG index. Similar conclusions can be drawn for fixed income, in the Malaysian context at least.

Fig 4 depicts the performance of BPAM ESG Index, broken down into its conventional and shariah components. Evidently, the Shariah ESG sub-index has outperformed its conventional counterpart ESG sub-index since inception. This goes to show that it is possible to be rewarded for doing good and this transcends beyond the equity space.

DELIVERING RETURNS TO YOU, THE PLANET, AND THE NEXT GENERATION

We strive to uphold the philosophy of responsible stewardship which is inherently embedded within the Shariah principles. Instead of being seen as a competing force, we see ESG investment philosophy as complementary to Shariah investing by fine-tuning the approach for greater

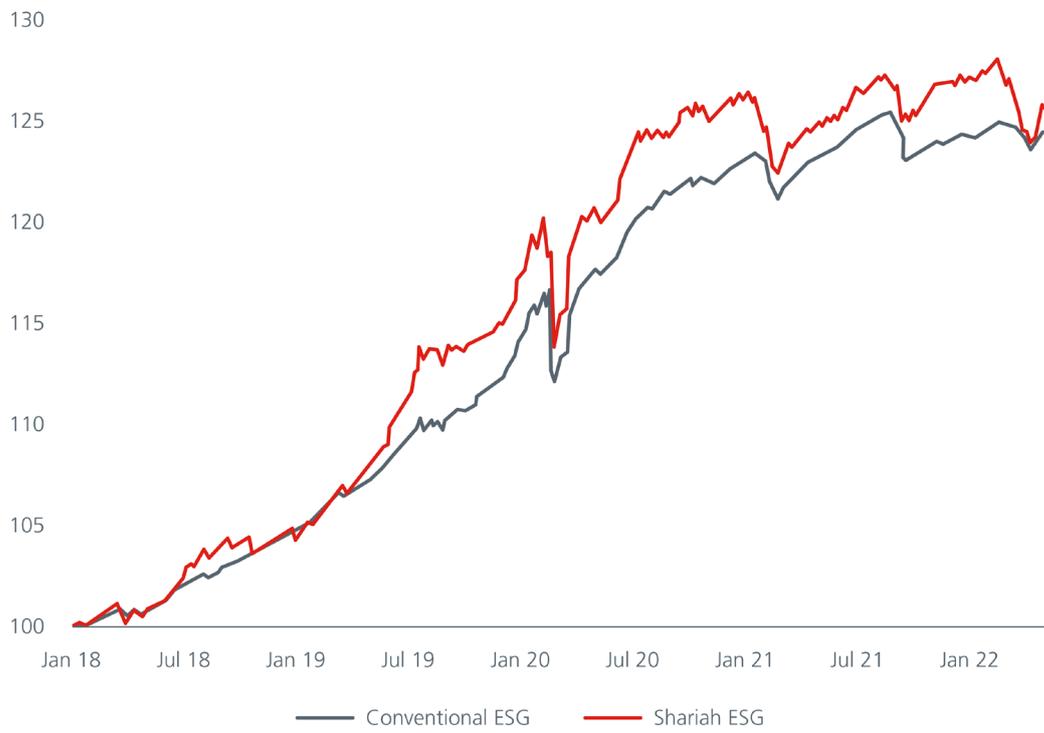
Fig 3: Shariah format has been the preferred mode for ESG issuances



Source: Bond Pricing Agency Malaysia as of 10 June 2022.

²<https://www.sc.com.my/resources/media/media-release/sri-sukuk-and-bond-grant-scheme-to-encourage-capital-market-fund-raising-for-sustainable-development>

Fig 4: ESG sukuk leading ESG bonds in performance, 2018-2022



Source: Bond Pricing Agency Malaysia as of 10 June 22

good, social justice and inclusive spirit in a more systematic manner.

We have seen and believe that we will continue to see quantifiable rewards for investors in the Shariah ESG space, both in equity and fixed income. While reaping the rewards today, we must also sow the foundation for our planet and the next generation's better future.

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