



# SOCIALLY RESPONSIBLE INVESTING: AN OPPORTUNITY FOR ISLAMIC FINANCE

Ethical, equitable, social and sustainable investments are all synonymous to both Islamic finance and SRI. In both instances, investors seek to achieve a strong return on their investments; and similarly, to take into account the social returns and society. Therefore understanding the scope of SRI and Islamic finance are essential in order to match the available opportunities.

**MALAYSIA**  
WORLD'S ISLAMIC FINANCE  
MARKETPLACE

## Islamic Finance and Socially Responsible Investing

Islamic finance is embedded on the principles of fairness, equality and ethics that lead to social well-being. It seeks social justice and economic prosperity of the society and encourages sustainable economic activity. Islamic finance come from fundamental requirements set by principles of the Islamic law. Socially Responsible Investing (SRI) has a similar rationale. SRI is sometimes referred to as “sustainable”, “socially conscious”, “mission,” “green” or “ethical” investing.<sup>1</sup> In general, socially responsible investors are guided by an ethical or moral code for ESG investments.

Islamic finance could broaden its investor portfolio by connecting these overlapping core values to access the large amount of SRI funds available in global markets. In some markets, it is clear that momentum is being built towards realizing the connectivity of Islamic funds with the global socially responsible investment funds which stands

### **Commonalities: Islamic Finance and SRI**

Islamic finance and SRI have been two of the most rapidly growing areas of finance over the last two decades.<sup>6</sup> During this period, they have each grown at rates that far exceed that of the financial markets as a whole.<sup>7</sup> By some estimates, the total volume of Islamic financial assets has grown by 15-20% a year

at about USD3.7tln.<sup>2</sup> In 2014, climate-themed bonds were estimated to total approximately USD502.6bln globally (an exponential jump from USD174bln in 2012).<sup>3</sup> Estimates record that nearly USD10tln in cumulative capital investments will be moved towards low carbon energy alone between 2010 and 2020.<sup>4</sup> Furthermore, over 1,300 signatories to the UN Principles for Responsible Investment (UN PRI) represent over USD45tln in managed assets (from USD4tln in 2006).<sup>5</sup>

In relation to these figure, Islamic finance remains a niche area that can benefit from broadening its horizon to tap into socially-conscious investments. This will appeal and attract both Islamic capital as well as a wider global interest. Therefore understanding the scope of SRI is pivotal for Islamic finance practitioners to match the segment opportunity available in the SRI space.

and now exceeds USD1 tln.<sup>8</sup> In 2013, the total volume of assets held by explicitly SRI investors exceeded USD3 tln, having increased by more than 30 percent since 2005.<sup>9</sup> In both instances, investors seek to achieve a strong return on their investments; and similarly, they also take into account social returns to the society and not only pure economic return.

<sup>1</sup> Forbes: Socially Responsible Investing: What You Need To Know, April 2013

<sup>2</sup> Islamic Banker: Liquidity management in the Islamic finance industry, August 2015

<sup>3</sup> IFN

<sup>4</sup> HSBC: Sizing the climate economy

<sup>5</sup> IFN

<sup>6</sup> World Bank Treasury: How socially responsible investing can help bridge the gap between Islamic and conventional financial markets

<sup>7</sup> ibid

<sup>8</sup> ibid

<sup>9</sup> ibid



Ethical, equitable, social and sustainable investments are all synonymous to both Islamic finance and SRI and global efforts have been made to integrate these commonalities. Examples among others include the UK Financial Services Authority which adopts a broad spectrum policy of fairness and justice, and similarly this policy has also been strongly endorsed for Islamic finance by the Islamic Financial Services Board (IFSB 2009b: Principle 1).<sup>10</sup> Apart from the above, the UK based BMO Global Asset Management's F&C Responsible Shariah Global Equity fund which was launched in 2011<sup>11</sup>, aims to achieve long-term capital

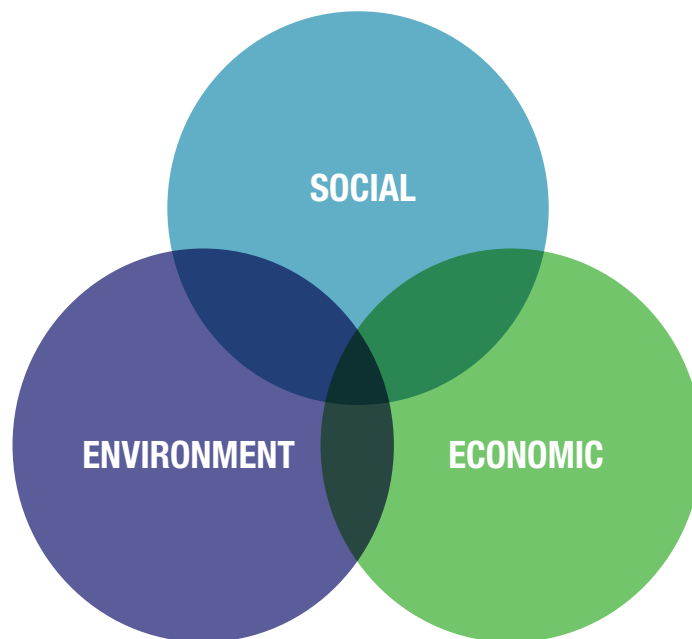
growth through a portfolio of global equities and seek out companies whose products and operations are not felt to be harming the world, its people or its wildlife, and are considered to be making a positive contribution to society. Furthermore, sustainability is a key common factor between Islamic finance and SRI. A notable initiative is traced back to 2009 with SAM (Sustainable Asset Management), one of the leading asset managers in the field of sustainability investments, partnered with Gatehouse Bank to introduce the first ever Shariah-compliant water-focused investment strategy.<sup>12</sup>

### **Sustainable Development**

Sustainable development is a process whereby human development objectives are achieved through natural systems. This can be achieved by providing natural resources and ecosystem services upon which the economy and the society depends.<sup>13</sup> Sustainable development is centric to the

overlapping factors for both Islamic finance and SRI, which are the economy, the environment and social impact. Resorting to bearable social environments, equitable socio-economies and viable enviro-economies will result in sustainable models that will ensure the well-being of the society.

### **Sustainable Development**



Source: Adapted from "The Future of Sustainability: Re-thinking Environment and Development in the 21st Century", Adams, W.M.

<sup>10</sup> Business Ethics: A European Review

<sup>11</sup> <http://live.bmo.realise.com/>

<sup>12</sup> Zawya

<sup>13</sup> Wikipedia

There is a great need for convergence between business and societal interests to:

- Promote shared values emphasising ethical and socially responsible conduct.
- Broaden inclusiveness to ensure benefits are fairly shared across society.
- Achieve sustainability and better living conditions through more efficient use of natural resources and public infrastructure.<sup>14</sup>

Thus, sustainable investments, which are a sub set of SRI,<sup>15</sup> may very well serve as a viable platform for Islamic finance to grow its SRI portfolio. This is because through sustainable development initiatives, it is symmetric in meeting the objectives of both Islamic finance and SRI.

**Sustainable Investment Market in Asia**

US\$ MILLIONS	2011	2013	CAGR
Bangladesh	NA	\$14	NM
China	\$1,535	\$1,729	6%
Hong Kong	\$7,328	\$11,329	24%
India	\$153	\$115	-13%
Indonesia	\$595	\$1,142	39%
South Korea	\$6,288	\$8,426	16%
<b>Malaysia</b>	<b>\$9,956</b>	<b>\$15,087</b>	<b>23%</b>
Pakistan	\$427	\$505	9%
Singapore	\$2,967	\$5,660	38%
Taiwan	\$724	\$714	-1%
Thailand	\$14	\$20	19%
Vietnam	NA	\$195	NM
<b>ASIA</b>	<b>\$29,988</b>	<b>\$44,937</b>	<b>22%</b>

Source: Adapted from Asia Sustainable Investment Review 2014 – Association for Sustainable and Responsible Investments in Asia

In Asia, sustainable investments are robust and growing. Indonesia and Singapore lead the sustainable investments sector in the Asian Market with 39% and 38% CAGR, respectively.<sup>16</sup> Hong Kong and Malaysia

follows in third and fourth place with 24% CAGR and 23% CAGR<sup>17</sup> respectively. In the case of Malaysia, Shariah-compliant investing represents the largest part of their sustainable investment strategy.<sup>18</sup>

<sup>14</sup> Securities Commission Malaysia: Unlocking Capital Market Potential for Sustainable Financing

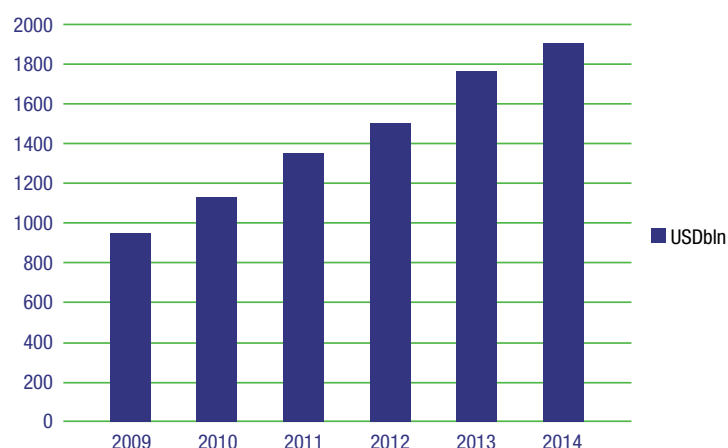
<sup>14</sup> <http://globalwarmingisreal.com>

<sup>15</sup> Ibid

<sup>16</sup> Ibid

<sup>17</sup> Ibid

**Growth Trends of Islamic Finance**  
**USDbln**



Source: Central Banks, Annual Reports, Bloomberg, IFIS, Zawya, ISRA

The Islamic financial industry has experienced robust expansion in the past five years, recording a 17.3% Compounded Annual Growth Rate (CAGR) between 2009 and 2014.<sup>19</sup> During this period, Islamic finance activities have expanded to non-key Islamic finance jurisdictions.<sup>20</sup> For example, in Africa, countries like Senegal, Kenya, South Africa and Nigeria have all made progressive efforts to tap the Islamic finance market.<sup>21</sup> Moving to Asia, countries like Bangladesh and the Maldives have

also shown progress in growing their Islamic finance portfolios.<sup>22</sup> More developed economies such as US, Europe and Singapore has also witnessed more Islamic finance activities in their countries.<sup>23</sup> Notably, the recent expansion of the industry in the latter part of the last decade has spurred further growth and busted it into a more competitive and resilient industry. Moving forward, the industry's assets are expected to expand further to USD3.4tln by end-2018.<sup>24</sup>

**Growth Trends of SRI**

Proportion of SRI Relative to Total Managed Assets		
	2012	2014
Europe	49.0%	58.8%
Canada	20.2%	31.3%
United States	11.2%	17.9%
Australia	12.5%	16.6%
Asia	0.6%	0.8%
Global	21.5%	30.2%

Source: Adapted from the Global Sustainable Investment Review, 2014

<sup>19</sup> IFSB Stability Report, 2015

<sup>20</sup> MIFC

<sup>21</sup> MIFC

<sup>22</sup> MIFC

<sup>23</sup> MIFC

<sup>24</sup> ISRA estimates

As shown in the diagram above, globally, the proportion of SRI in relation to professionally managed assets has increased to 30.2% in 2014, from 21.5% in 2012.<sup>25</sup> Among the fastest growing region over this two year period are the United States, Canada and Europe. These three regions

### **Global Initiatives – Islamic finance and SRI**

Recent years has seen great development, particularly in the capital markets, in social responsible investments in both Islamic finance

### **Social Impact Bonds & Sukuk**

Social Impact Bonds (SIB) sees private investors invest capital and manage public projects, usually aimed at improving social outcomes for at-risk individuals, with the goal of reducing government spending in the long-term. Government will only pay out if projects achieve outcome and investors are typically NGOs, charities and foundations. For example, in 2010, Social Finance UK launched the first SIB with an oversubscribed fund of £5mil (USD7.57mln) to finance prisoners' rehabilitation program.<sup>27</sup>

Similarly, in 2012, in the US, the state of Massachusetts

### **Green Bonds & Green Sukuk**

Green bonds are issued to raise financing for climatic change solutions and environmental causes. The first widely known "green bond" was issued in 2007 by the European Investment Bank.<sup>30</sup> These instruments are well received by SRI investors.<sup>31</sup>

The Islamic finance sector in Malaysia, as of last year, contributed almost 20% or RM300mln (USD80.78mil) of the RM1.5mln (USD403.9mln) financing for 120 projects approved by the

are also the largest regions in terms of assets, accounting for 99 percent of global SRI.<sup>26</sup> Islamic finance requires scalability. Penetrating the SRI and conventional market will provide the impetus to mainstream Islamic finance.

and SRI. Some key developments like Social Impact bonds, Green Bonds and SRI Sukuk initiatives should be extended to further explore the extent to which these two sectors can converge.

became the pioneer state to use a competitive procurement process to secure social innovation financing of USD50mln for social services from an allocated USD100mln SIB pilot scheme set up in 2011.<sup>28</sup>

On the sukuk front, the International Finance Facility for Immunization Company issued USD500mln Immunisation Sukuk in November 2014.<sup>29</sup> The proceeds are to be utilised for vaccination programmes under the Global Alliance for Vaccines and Immunisation (GAVI).

Malaysian Green Technology Financing Scheme.<sup>32</sup>

Moving to the green sukuk, the Green Sukuk and Working Party (GSWP) has been established by the Clean Energy Business Council (MENA), the Climate Bonds Initiative and the Gulf Bond and Sukuk Association (GBSA), to promote and develop Shariah compliant financial products to invest in climate change solutions.<sup>33</sup> However, it has yet to make its debut.

<sup>25</sup> ibid

<sup>26</sup> ibid

<sup>27</sup> Securities Commission Malaysia: Unlocking Capital Market Potential for Sustainable Financing

<sup>28</sup> Ibid

<sup>29</sup> IFFIm

<sup>30</sup> Securities Commission Malaysia: Unlocking Capital Market Potential for Sustainable Financing

<sup>31</sup> Ibid

<sup>32</sup> IFN

<sup>33</sup> <http://www.climatebonds.net/projects/facilitation/green-sukuk>

### **SRI Sukuk**

To further promote SRI sukuk, key Islamic finance jurisdiction such as Malaysia has recently issued this type of sukuk. For example, this year, Khazanah Nasional Bhd through a Malaysian-incorporated independent special purpose vehicle (SPV) Ihsan Sukuk Bhd. has established a RM1bln (USD 225mln) SRI sukuk programme.<sup>34</sup> The sukuk programme is the first of its kind to be approved under the Securities

### **Moving Forward**

Central values in Islamic finance and SRI could be matched to optimize prospects for Islamic finance to tap the large pool of global SRI funds.

Moving forward, greater interplay between these

Commission Malaysia's SRI sukuk framework.

Apart from the above, the Malaysian stock exchange has also recently begun working with the Finance Times Stock Exchange (FTSE) to implement the FTSE4Good Index series based on companies listed on the Malaysian exchange. This ESG Index series is expected to attract the USD 3.4 tln SRIs from around the world.<sup>35</sup>

two markets should be explored. Key stakeholders on both ends, including financial experts, research centres, rating agencies, non-governmental organisations and even regulators should pursue ways to consolidate the connectivity of these markets.

<sup>34</sup> Bloomberg  
<sup>35</sup> Bursa Malaysia

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