SRIs & THE CASE FOR ISLAMIC INVESTMENT FUNDS

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WORLD'S ISLAMIC FINANCE MARKETPLACE

SRIs & THE CASE FOR
ISLAMIC INVESTMENT FUNDS

SECTION 1

01

Foundation and Growth of Investing Through Principles

A Century of Principled Investing

Back in the 1920's, the Methodist church in the UK refused to invest in what they considered "sinful companies". These included companies involved in the production of alcohol, tobacco and gambling. Pioneer fund, founded in 1928, was the first modern mutual fund employing screens based on religious traditions. These groups placed ethical constraints based on human welfare and non-violence that excluded firms engaged in alcohol, tobacco, arms and ammunition.[1]

Modern Sustainable Responsible and Impactful (SRI) investments can be traced back to the 1970s with the establishment of the PAX World Fund in 1971 that kept their portfolio free from the firms that dealt in arms and ammunition or any military related products during the Vietnam War.[2] A substantial amount of SRI funds have been established since then, with the intention of incorporating investors' desire to achieve ethical objectives beyond the profit motive.

[1] Schepers, 2003 and Bauer et al., 2005
[2] Fowler and Hope, 2007

Growth of SRIs

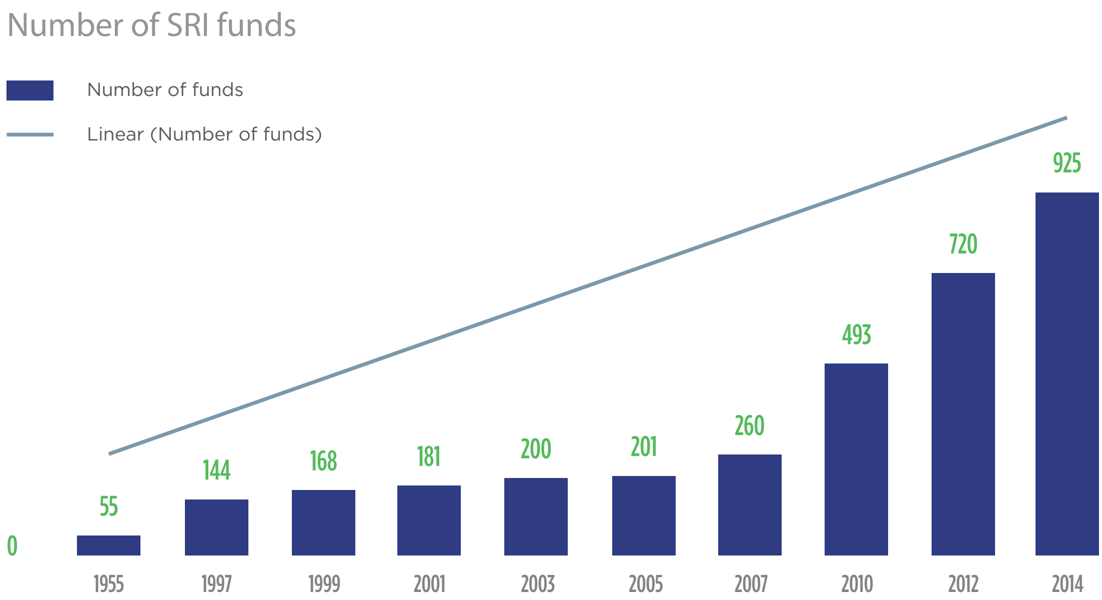

Figure 1: Growth of SRIs between 1995 and 2014 based on US SRI Funds
Data: EurekaHedge, Bloomberg

Sustainable Responsible and Impactful investments have grown tremendously over the past few years as they have experienced a sharp rise in both the increase in amount of assets under management and the number of investors as well. According to US Sustainable, Responsible and Impact Investing Trends 2014, an organization which is dedicated to socially responsible investment and corporate social and environmental responsibility, the total amount of assets under management in the US alone had grown by 22% from \$3.07 trillion in 2010 to \$3.74 trillion in 2012.

Growth of SRI 2005 - 2014

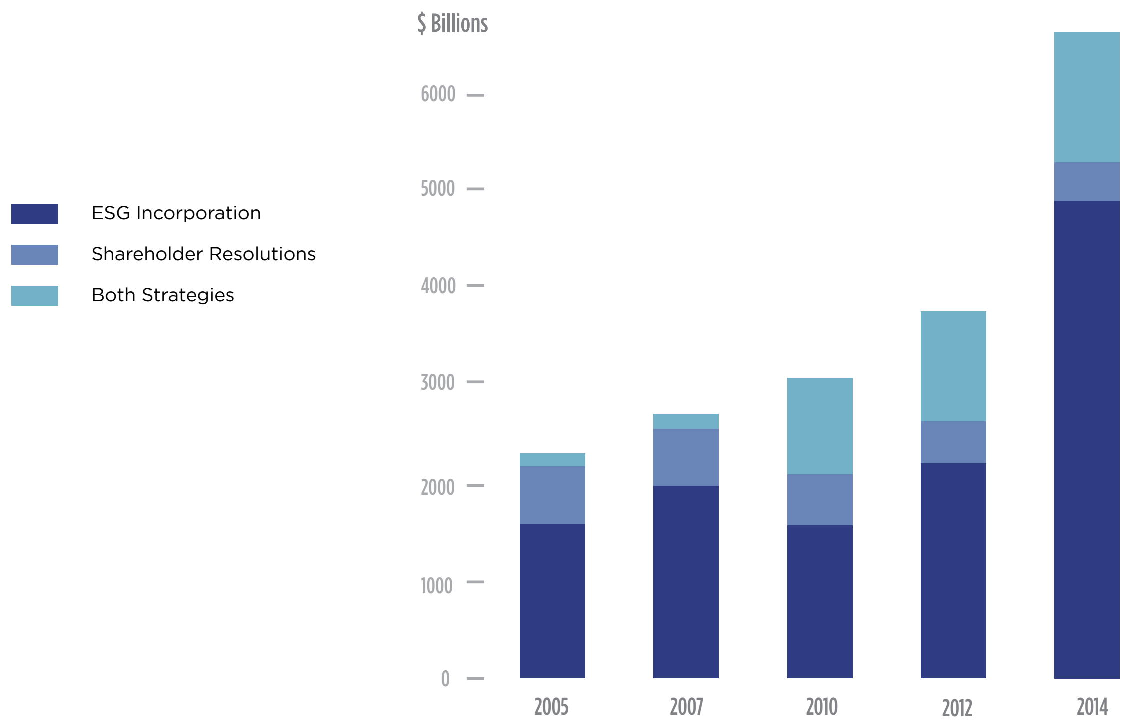

Figure 2: Growth of SRIs between 2005 and 2014 based on ESG Incorporations, Shareholder Resolutions and a combination of strategies[3]

It is reported that in 2014, $3.31 trillion of the 2012 SRI total was held by 443 institutional investors, 272 money-managers and over 1,000 community investment institutions. These investors utilised Environmental, Social and Governance (ESG) screening criteria to construct their portfolios indicating a more active portfolio construction than general equity. ESG refers to the three main components of concern which developed as key factors in measuring the sustainability and ethical impact of an investment in a company or business.

[3] USSIF 2014 discussion on community investing: http://www.ussif.org/communityinvesting

Total Net Assets (Billions) for SRIs

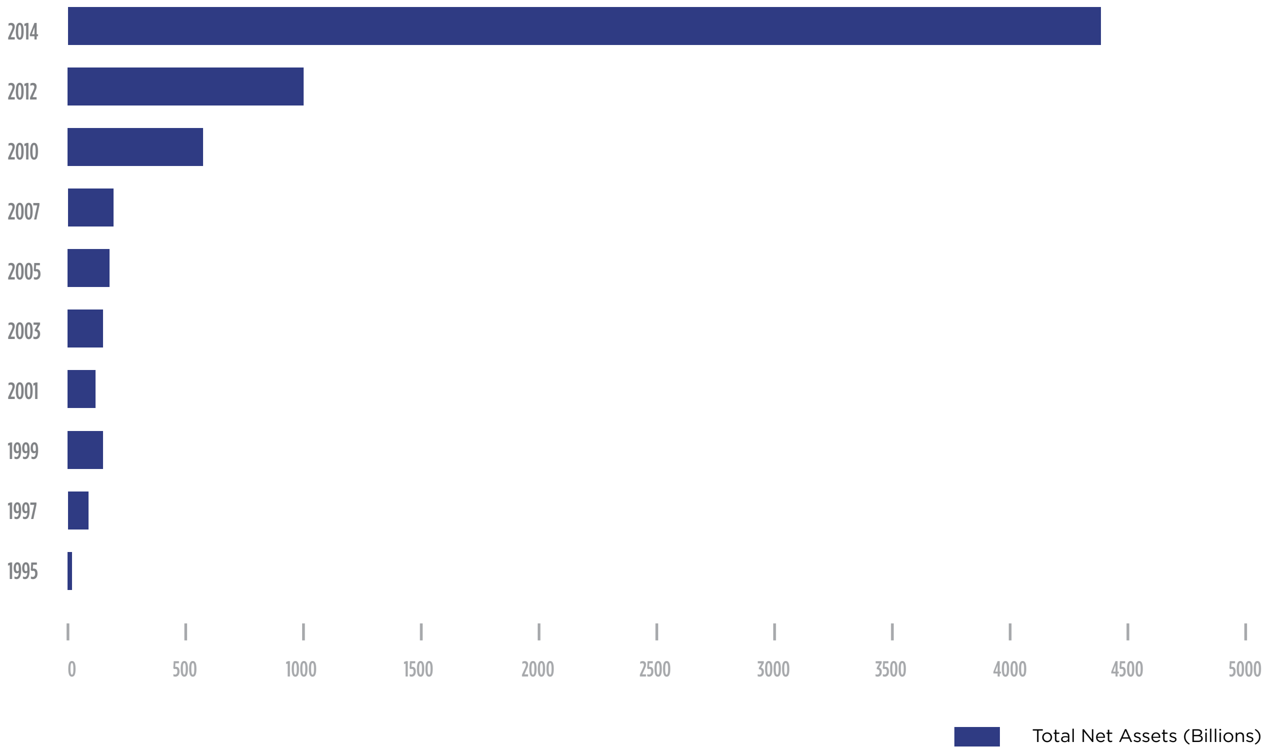

Figure 3: Growth of net assets of SRI Funds (excluding selected securities) in the US between1995 and 2014.
Data: EurekaHedge, Bloomberg

In 2012, the SRI portion represented 11.2% of total investment in the US (total assets under management estimated to be $33.3 trillion in 2012). This notable growth was overshadowed by later gains made between 2012 and 2014, at a phenomenal 76% from $3.74 trillion at the beginning of 2012 to $6.57 trillion by 2014 (this includes all asset classes – equities, bonds and money market instruments), estimated to represent over 20% of all assets under management in the US alone.

Community Investing:
Investing in People Over Profit

Community investing is a traditional form of investment that often explains the 'sustainable' portion in SRIs. It is actually a form of financing that is provided for much needed services and development in an attempt to restore the inequalities and gaps arising from purely profit-driven motives. Public and private investment has successfully been directed to deserving communities with generally lower income levels with the objective of providing skills training, capital and overall job creation and stimulation for sustainable investment.

Community Investing Growth 1997 - 2014

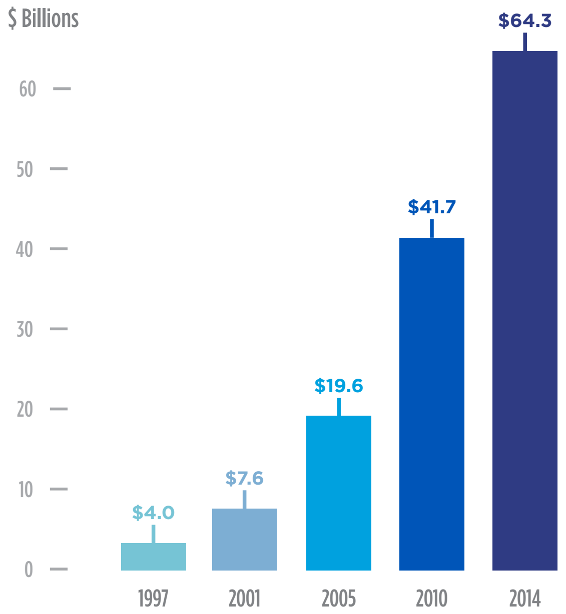

Figure 4: Community Investing Growth between 1997 and 2014[4]
Data: US SIF

The significant growth of community investment of over 54% between 2010 and 2014 indicates a strong awareness of the community plight and a conscious effort towards sustainable investment strategies taking hold in diverse communities across the US, where the largest SRI fund is domiciled.[5]

This form of investment has its roots informally as co-operative investing that is gaining popularity in communities globally.

[4] USSIF 2014 discussion on community investing: http://www.ussif.org/communityinvesting
[5] Ibid

SRIs in the form of community investing have contributed to :

- Services in health, education, childcare and access to food;
- Job creation especially through employing locally for infrastructure development;
- Sustainable community development over the long term.

As community investments increase, thousands of lives are changed for the better where the sequence repeats itself and finance recipients become investors in a societal empowerment cycle.

Incorporating social and moral concerns into investment strategies is becoming popular as it is in line with what is referred to as "doing well while doing good".[6] The basic notion behind this idea is that socially responsible investors can manage to earn higher returns even when they choose to invest responsibly. The evidence suggests that a firm that is not classified as socially responsible, releases negative news from irresponsible activity, the stock value would inevitably be driven down whilst socially responsible firms releasing similar news would not be affected.[7]

[6] Hamilton et al., 1993
[7] Ibid.

02

SRI: Definitions, Strategies and Drivers

SRI and Shariah-compliant funds: Shared Values and Accountabilities

The Social Investment Forum defines SRI as:

"Integrating personal values and societal concerns with investment decisions. SRI considers both the investor's financial needs and an investment's impact on society."

The Forum considers 'socially responsible' investing to be used interchangeably with 'social investing', 'socially aware investing', 'ethical investing' and 'mission-based investing'. If we consider 'ethical' and 'mission-based' investing, this covers the niche market of religiously-based investment. Shariah-compliant investment has established itself as a niche market within and alongside the SRI context as there is a *fusion*[8] between the two concepts. This form of investment stems from the fundamental Islamic beliefs, similar to the establishment of the very first SRIs (based on Christian beliefs), that emphasise individual decision-making within the gambit of responsible behaviour and accountability.

[8] Barkatulla : "Ethical Fusion", Islamic Banking & Finance, Vol 7, Issue 3 No 3.

Shariah-compliant funds or investments, as the name suggests, comply with the tenets of the Islamic law. Islamic tenets consider the mission of man to be two-fold:

a. Man's mission as a servant of the Creator
b. Man's mission as a trustee of the Creator

The first refers to Man's relationship with his Creator in fulfilling the obligations and acts of worship clearly prescribed.

As a trustee, he is accountable for his actions in managing the trust that he has been made responsible for. This trusteeship considers man as a steward and holds him accountable for the management of his relationship with fellow man, society and the natural environment. Hence the strong base of SRI concepts form the fundamentals of Shariah-compliant investments or Islamic investment.

An academic measure of the consistency between Islamic tenets and the ten SRI principles outlined in the UN Global Compact found that there is convergence between the two.[9] In fact, the report states that Islamic tenets often go beyond the requirements of SRIs and have the benefit of providing clearer codification and ethical standards together with mechanisms for implementation that are supervised and reported upon Shariah Supervisory Boards. The report iterates the convergence of values between SRIs and Shariah-compliant fund concepts and highlights the agreements of ethical and social protection.

However, it should be noted that Islamic investment screening criteria applies a more standardised approach of negative screening for industries and businesses that do not comply with the basic Shariah-compliant funds and investments criteria. Whilst there exists diversity in interpretation of appropriate filters in the Islamic investment screening process, the differences are minor and actually harmonising as the market develops. Differences that existed between the two major Islamic investment regions, Malaysia and the GCC (Gulf Co-operative Council) have narrowed significantly since the promulgation of the Islamic Financial Services Act 2013 (Malaysia), promoting a more global-centric set of investment screens that make it easier and simpler to discern Shariah-compliant investments from non-Shariah-compliant investments.

Amidst the globally accepted SRI strategies as defined by Eurosif[10] and ALFI[11] , Shariah-compliant investment falls within the categories of norms-based screening and exclusions (items 3 & 4).

[9] Zinkin, J. (2007). Islam and CSR: a study of the compatibility between the tenets of Islam, the UN Global Compact and the development of social, human and natural capital. Corporate social responsibility and environmental management, 14(4), 206-218.
[10] European Social Investment Forum
[11] Association of the Luxembourg Fund Industry

	Strategy	Description	Link with ALFI's categorisation
01	Sustainability theme	Investment in themes or assets linked to the development of sustainability. Thematic funds focus on specific or multiple issues related to ESG.	eSg (social) category Esg (environment) category
02	Best-in-Class selection	Approach where leading or best-performing investments within a universe, category, or class are selected or weighted based on ESG criteria.	RI positive screening sub-category
03	Norms-based screening	Screening of investments according to their compliance with international standards and norms.	RI negative screening sub-category Ethics (cross-sectoral)
04	Exclusions	An approach that excludes specific investments or classes of investment from the investable universe such as companies, sectors or countries.	RI negative screening sub-category Ethics (cross-sectoral)
05	ESG integration	The explicit inclusion by asset managers of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources.	ESG (cross-sectoral) category
06	Engagement and voting	Engagement activities and active ownership through voting of shares and engagement with companies on ESG matters. This is a long-term process, seeking to influence behaviour or increase disclosure.	esG (governance) category
07	Impact investing	Impact investments are investments made into companies, organisations and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market-to-market rate, depending upon the circumstances.	Social impact sub-category Microfinance funds sub-category
	Source: European SRI Study 2014, Eurosif		

Figure 5: SRI Strategies according to Eurosif

The New Investor-Driven Standards for Performance

Although there is no consensus to one standard definition of SRIs due to its wide range of screening criteria, according to "The European Sustainable Investment Forum", the following definition can accommodate most of the SRIs based on their screening and objectives:

"Socially Responsible Investment (SRI) . . . incorporate Environmental, Social and Governance (ESG) issues as well as criteria linked to a values-based approach. For example, it can involve the application of pre-determined social or environmental values to investment selection. Investors may choose to exclude or select particular companies or sectors because of their impact on the environment or stakeholders. Negative screening (such as weapons exclusions) and positive screening (such as best-in-class or thematic approaches) typically fall in the remit of such investments."

By relying on the above definition, we can differentiate SRIs from traditional investment in at least two ways:

i. Firstly, investors pay attention to all the implications of their investment and not just monetary gains. They achieve this by being environmentally responsible and attaching ethical and societal values to their investment strategies so as to give back to the society they belong to.

ii. Secondly, the objective is to promote long-term sustainable investment that is environmentally friendly and promotes social and ethical values. Hence, it can be argued that socially responsible investors are in for the 'long-haul' and short-term gains might not be as attractive to them.

These objectives are critical in driving change in society as global calamities rise in the wake of climate change, human trafficking, unethical labour practice and catastrophic environmental abuse is taking place under the auspices of officials through corruption.

ESG Conscious Trends

The European Sustainable Investment Forum definition brings to light an additional pathway for SRIs that focuses on environmental, social and governance issues or 'ESG'. ESG investments use specific screening methods to identify corporates with stronger corporate social responsibility (CSR) policies before including them in portfolios whilst others use internally prepared ESG criteria to rank best-in-class corporates for balancing portfolios. More asset managers are actively including ESG criteria for a portion of their portfolio construction in order to contribute indirectly to environmental and social benefits.[12]

Hence, the increased awareness that ESG filters are not effectively identified or even considered in traditional investment are persuading investors to avoid corporates that have been flagrantly abusing these principles.

However, the challenge in adopting ESG criteria globally has always been the belief that a sacrifice is needed in terms of performance.

Principles of Responsible Investment (PRI)

With almost 1,400 participating institutions/signatories globally, representing approximately $60 trillion in assets under management, or 50 percent of the world's investable assets, the 'Principles of Responsible Investment' project launched by the United Nations in 2006 is representative of the global move towards sustainable consciousness. Assets under management have grown from its humble beginnings ($4 trillion) at a rate of 29% per annum, the vast majority of the signatories being investment managers.

Figure 6: PRI status as at April 2015[13]

The principles are a set of practice standards that are adopted on a voluntary basis and request signatories to consider the extent to which ESG-compliant companies can be invested in without material loss of overall portfolio performance. This approach strikes a balance between selecting companies that are SRI compliant but loss-making and profit-maximising companies that have no SRI or ESG standards. Analysis therefore considers ESG criteria along with traditional risk indicators to build sustainable portfolios that are attractive and profitable.

[12] http://blueandgreentomorrow.com/features/alternative-wall-street-journal-the-financial-advantage-of-socially-responsible-investing/ accessed 22 June 2015

[13] http://www.unpri.org/whatsnew/signatory-base-aum-hits-59-trillion/accessed 24 June 2015

Growth of the PRI Initiative

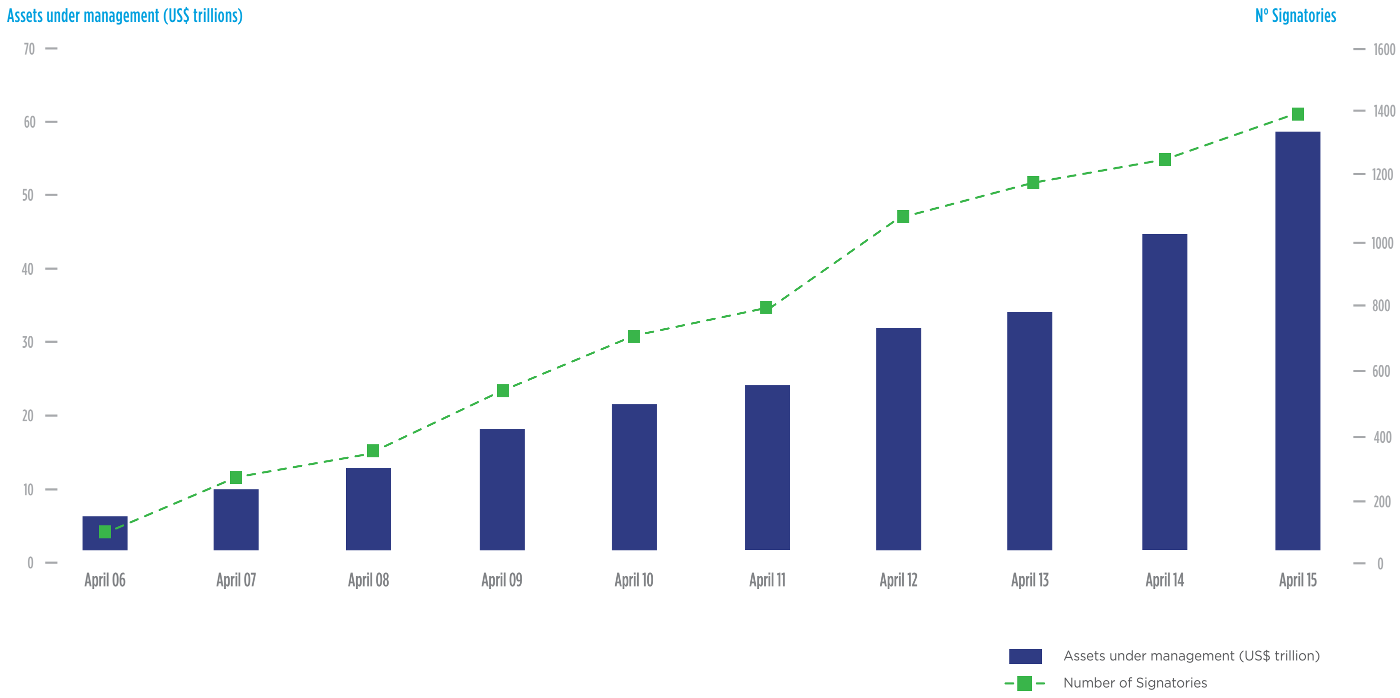

Figure 6: Growth of SRI assets under management between 2006 and 2015[14]

[14] UN PRI

The 6 Principles of UN PRI[15]

Principle 1:
We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2:
We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3:
We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4:
We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5:
We will work together to enhance our effectiveness in implementing the Principles.

Principle 6:
We will each report on our activities and progress towards implementing the Principles.

[15] Ibid

Supportive Research

Since ESG criteria are fairly inconsistent, reporting and disclosure has been inadequate, resulting in a lack of reliable data for analysis. Moving forward, the approach is geared towards a standardised ESG approach to ensure better reporting that would result in more effective decision-making. This is notwithstanding the fact that an abundance of research exists validating claims that ESG factors are correlated with superior risk-adjusted returns for securities.[16]

The Deutsche Bank Climate Change Advisors review (2012) of over 100 empirical and academic studies on sustainable investment states that both Corporate Social Responsibilty (CSR) and ESG factors contribute to higher returns.

Interestingly, the study revealed that 100% of the research confirmed that companies with higher CSR and ESG ratings actually had a lower cost of capital. Further, the study found that 89% of studies indicated that companies with high ESG ratings demonstrated market-based outperformance whilst 85% showed outperformance from an accounting perspective.

Furthermore, research conducted by Harvard University[17] found that the long-term result in considering ESG factors when investing was not well understood. The study compared 180 companies and divided them into categories of 'high sustainability' and 'low sustainability' (90 per category). The factors considered included issues on governance, performance and corporate culture. Bucking the thought-trend, the study found that high-sustainability firms over a period of 18 years markedly outperformed low-sustainability firms in both ratio analysis, disclosure and accounting measures as well as stock prices.

The overwhelming evidence indicates that investments into ESG-considered corporations are better performing over the long-term, empirically establishing the sustainable investment motive in both ethical and stock market values.

Shareholder Activism

Shareholder advocacy has been used successfully over the last few decades to highlight critical issues stemming from sustainable and responsible business activity. The impact has been significant. For example, between 2010 and the first 2 quarters of 2012, over 200 institutional investors and asset managers filed resolutions relating to ethics, sustainability, governance and corporate social responsibility.

The US Securities & Exchange Commission issued guidelines in 2010 requiring the disclosure of information related to climate risk for public companies. Shareholders are now arguing that this disclosure should include material corporate exposure to ESG factors and other non-financial data that relates to sustainable investing to provide stakeholders with superior information for a more effective decision-making process.

Regulators have also entered the foray by emphasising a move towards sustainable investing. For example, the Sustainability Accounting Standards Board (SASB) is also developing industry-specific sustainability accounting standards that public companies can use to report on ESG issues when providing statutory filing with the authorities.

In the UK, the Pensions Act (2000) requires that pension funds disclose the manner in which they have considered sustainability components during the process of portfolio construction.

South Africa requires that institutional investors consider any factors that "may materially affect the sustainable long-term performance of the investment, including those of an environmental, social and governance character".[18]

In Australia, retirement funds and mutual funds are required to disclose the scope of ESG factors that have been considered in the selection of investment.[19]

[16] DB Climate Change Advisors (Deutsche Bank Group), Sustainable Investing: Establishing Long-Term Value and Performance, June 2012. http://www.dbcca.com/dbcca/EN/_media/Sustainable_Investing_2012.pdf.

[17] Eccles, Ioannou and Serafeim, The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance. Harvard Business School, November 2011. www.hbs.edu/faculty/Pages/download.aspx?name=12-035.pdf.

[18] Hawley, Johnson and Waitzer, "Reclaiming Fiduciary Duty Balance", Rotman International Journal of Pension Management, Vol. 4, Issue 2, Fall 2011, p. 11 and footnote 35. http://www.rijpm.com/article/reclaiming-fiduciary-duty-balance.

[19] Global CSR Disclosure Requirements, Initiative for Responsible Investment, http://hausercenter.org/iri/about/global-csr-disclosure-requirements.

Top Shareholder Resolutions Filed in 2014

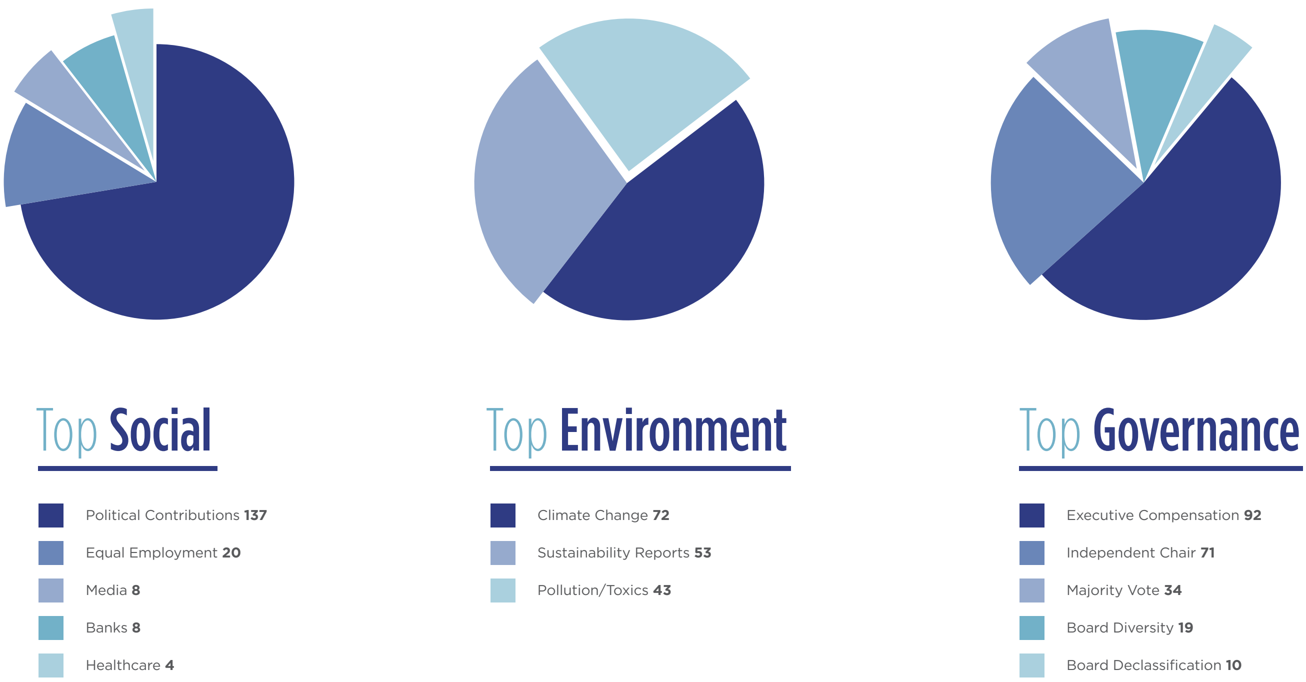

Figure 8: Top Shareholder resolutions filed in 2014

More than 200 institutional investors or money managers that held assets worth $1.54 trillion, filed or co-filed shareholder resolutions on ESG issues at publicly traded companies between 2010 and 2012 in the US alone. International shareholder activism is gaining momentum as regulators heed investor sentiment towards sustainable, responsible and impact investing. A brief review of shareholder resolutions filed in 2014 in the US show a significant awareness of corporate governance issues, environmentally safe investment and political lobbying.

In the forthcoming section, we will consider the advantages that SC investments bring to portfolios and the trends in the growth of SRIs and Islamic/ Ethical funds globally.

A Brief History of SRIs

An Investment is a planned activity to generate the maximum rewards from every unit of resource used within a set level of risk and investment horizon. The greater the risks assumed and the longer the investment horizon, the more rewards are expected by investors. This basic premise of investment is universal, irrespective of whether the investments are generated within a conventional, Ethical, Socially Responsible or a Shariah-compliant (SC) system. The only difference is that different systems have their own modus-operandi and constraints based on the philosophy or belief-system they profess.

Social advocates often argue that conventional investment activity is focused on 'profit-maximization' without due ethical and/or socially responsible consideration. The profit motive dominates and if there is any consideration for social responsibility, it is often in support of a profit objective (for example, receiving tax advantages for their socially responsible activities or a public relations exercise in displaying their generosity). For business entities that believe and profess the idea of well-being of the society in which they are engaged, profitability is achieved in harmony with the core values of society thereby positively impacting on growth and sustainability for the long-term.

The traditional view of an SRI or sustainable, responsible and impactful investment is that it refers to non-financial criteria that are integrated into investment decisions[20], encompassing ethical concepts or systems that promote social and environmental stability and sustainability. Focus has changed over time though, and depending on the types of investors and their motivation, impetus is accorded to establishing a variety of investment options that fall within the ambit of SRIs. Since churches in the US and UK in 1900s played an important role in introducing the concept of SRIs to the markets, SRIs have been driven by faith-based objectives, universally-accepted ethical values and sustainable development. Some notable beginnings of SRIs are usually traced to religious groups like the Quakers that started in the 18th century to exclude companies from their business dealings that were involved in the slave trade, alcohol, tobacco and gambling.[21] One of the first modern SRI funds was initiated by the Methodists in 1971 that excluded arms producers as a reaction to the Vietnam War.[22]

Despite being historically rooted with religious groups, modern SRI activists emerged as part of the political climate of the 1960s and 1970s and as a result of the rise in human rights awareness, anti-war activism namely against the Vietnam War and opposition against apartheid. Companies benefitting from South African investment were excluded as part of international sanctions, giving rise to the first funds that screened company activities in banned countries.[23] In the 1980s and the 1990s, SRIs evolved further to include positive screening by focusing on industries that promote alternative energy sources, equal employment opportunities and those who adopt sound corporate governance among other non-profit considerations.[24] A total of 60 mutual funds were based on SRI principles managing $640 billion in assets.[25]

In the last decade, a number of new threats and challenges have been facing the global populace, from climate change to corporate fraud and large-scale wars. Hence a new age of SRIs developed, focusing on ethics and beliefs and often opposing the industry focused on profits first.

The concept of SRIs is consistently evolving to dispense appropriate policies depending on the changing environment. In its most recent adaptation, SRIs are moving from negative screening to include positive screening to promote positive innovations and contributions to society, no longer simply to reduce the negative impact of business and industrial practices on man and his environment.

[20] Kurtz, L. (2009). "Socially Responsible Investment and Shareholder Activism," in A. Crane, A. McWilliams, D. Matten, J. Moon, & D. S. Siegel (eds.), The Oxford Handbook of Corporate Social Responsibility. Oxford: Oxford University Press. PP.250.
[21] Schwartz, M. S. (2003). "The "Ethics" of Ethical Investing," Journal of Business Ethics 43(3), pp. 195–213.
[22] Osthoff, P. (2008). Socially Responsible Investment. Berlin: Logos.
[23] Caplan, L., Griswold, J. S., & Jarvis, W. F. (2013). From SRI to ESG: The Changing World of Responsible Investing. Common Fund Institute.
[24] Binmahfouz, S. 2012. Investment Characteristics of Islamic Investment Portfolios: Evidence from Saudi Mutual Funds and Global Indices. Durham theses, Durham University. Available at Durham E- Theses Online: http://etheses.dur.ac.uk/4440/
[25] Social Investment Forum, 2005 Report on Socially Responsible Investing Trends in the United States, January 24, 2006, pp. iv, v, 1. http://ussif.membershipsoftware.org/files/Publications/05_Trends_Report.pdf. The Social Investment Forum was the predecessor to the US SIF Foundation.

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SECTION 2

01

Why are Investors Increasingly Attracted to SRIs?

Performance of SRIs has Surprised the Sceptics

Studies on the performance of SRIs are increasing. Advocates of socially responsible investment maintain that SRIs contribute non-financial advantages that are often unquantifiable in value and extend beyond performance, especially over the short-term. Opponents argue that social and moral screening will reduce diversification opportunities.[1]

It's also argued that such portfolios can be inefficient as they limit the choice of an investor by creating investment constraints.[2] Finally, portfolios concentrating on socially responsible firms will be more exposed to specific risks as they introduce industry and style biases.[3]

However, a glance at performance globally indicates that trends are actually unexpected. SRIs, although beginning from a lower base, have quickly aligned themselves with the levels of conventional funds proving that performance is in fact not compromised through SRI investment. Hence, if value is increased in unquantifiable factors and performance does not suffer then the obvious question must be considered:

What prevents an Investor from opting for responsible investment?

[1] Barnett and Salomon, 2006
[2] Adler and Kritzman, 2008
[3] Rudd, 1981; Kurtz, 1997; DiBartolomeo and Kurtz, 1999

International Regulation Supporting SRIs

Global moves in promoting SRIs have been led from the highest levels of government and regulation. Governments are increasing their initiatives for SRIs, and this has been a contributing factor in the recent surge for 'saint stocks' and avoiding 'sin stocks' in contemporary investment portfolios. Belgium, Italy, Sweden and the United Kingdom encourage such investments by requiring pension fund managers to disclose the extent of their involvement in social and ethical securities.[4]

South Africa, the Netherlands and the UK are some of the earliest to have introduced SRI-related regulation. For instance, South Africa established the 'King Committee' in 1992 to encourage Corporate Governance practices among corporates. This pioneering effort is regarded as the most complete report on corporate governance practices ever produced at the time. The report not only included regulatory and financial aspects of corporate governance but also covered the essential axioms of ethical and socially responsible firm practice. The King Report (as it became known) was amended and updated twice, first in 2002 (King II) and then in 2009 (King III). King III has become the global benchmark for corporate governance, contributing to a dramatic shift in corporate board structures and governance practice. In fact, for a firm to be listed on the Johannesburg Stock Exchange (JSE) and the Socially Responsible Investment (SRI) Index, it must adhere to the principles of King III.

SRI Initiative in Europe

Developed economies in Europe are effectively buoying towards SRIs via incentives and new promulgations. The Netherlands for example, has systematically introduced certain acts (Dutch Market Abuse (Financial Supervision Act)) and codes (Dutch Corporate Governance Code) to encourage firms to be ethical and socially responsible. In 1995, the Netherlands provided tax relief under the 'Green Investment Directive' incentivising proactive SRI-compliant firms. Under the 'Green Investment Directive', firms involved in clean energy production including wind and solar energy and firms farming organically have all benefitted from tax relief.

On the other hand, firms providing loans and acquiring shares in landmine and cluster munitions manufacturers was outlawed through a newly introduced act called the 'Dutch Market Abuse (Financial Supervision Act)'.

Germany and the United Kingdom have also used similar strategies in emphasising the importance of SRI. For instance Germany, in 1991, established 'The Renewable Energy Act' under which it provides tax benefits to mutual funds that invest in wind-energy.

The UK, in 1999, amended the 1995 Pensions Act disclosure regulation to include the extent to which these funds invested ethically. By 2000, the UK government established the 'Trustee Act', with the objective of amending the rules governing trustees and persons having investment powers of trustees. Under this act, it was prescribed that charities must be invested ethically. More recently, the UK established 'Stewardship Code, 2009' initially intended for institutional investors investing in UK listed firms. The Code consists of principles and guidelines that relate to stewardship responsibilities and like the 'UK Corporate Governance Code', the 'Stewardship Code' is also based on 'comply or explain' basis. The Financial Services Authority in the UK requires authorised fund managers to disclose "the nature of its commitment" to the Code or "where it does not commit to the Code, its alternative investment strategy" (under Conduct of Business Rule 2.2.3. In the last five years or so, other emerging countries such as China, India, Indonesia, Malaysia and Pakistan have also taken initiatives to encourage firms and asset management companies to include certain ethical social considerations in their investments.

[4] Renneboog et al., 2008

Denmark
2008

ESG Integration

Amendment to the Danish Financial Statements Act
"Mandatory ESG disclosure for companies and investors. Information must include:
- Policies on corporate social responsibility.
- Implementation methods.
- An evaluation of what has been achieved through corporate social responsibility, in the last financial year, and what is expected for the future."

Netherlands
1995

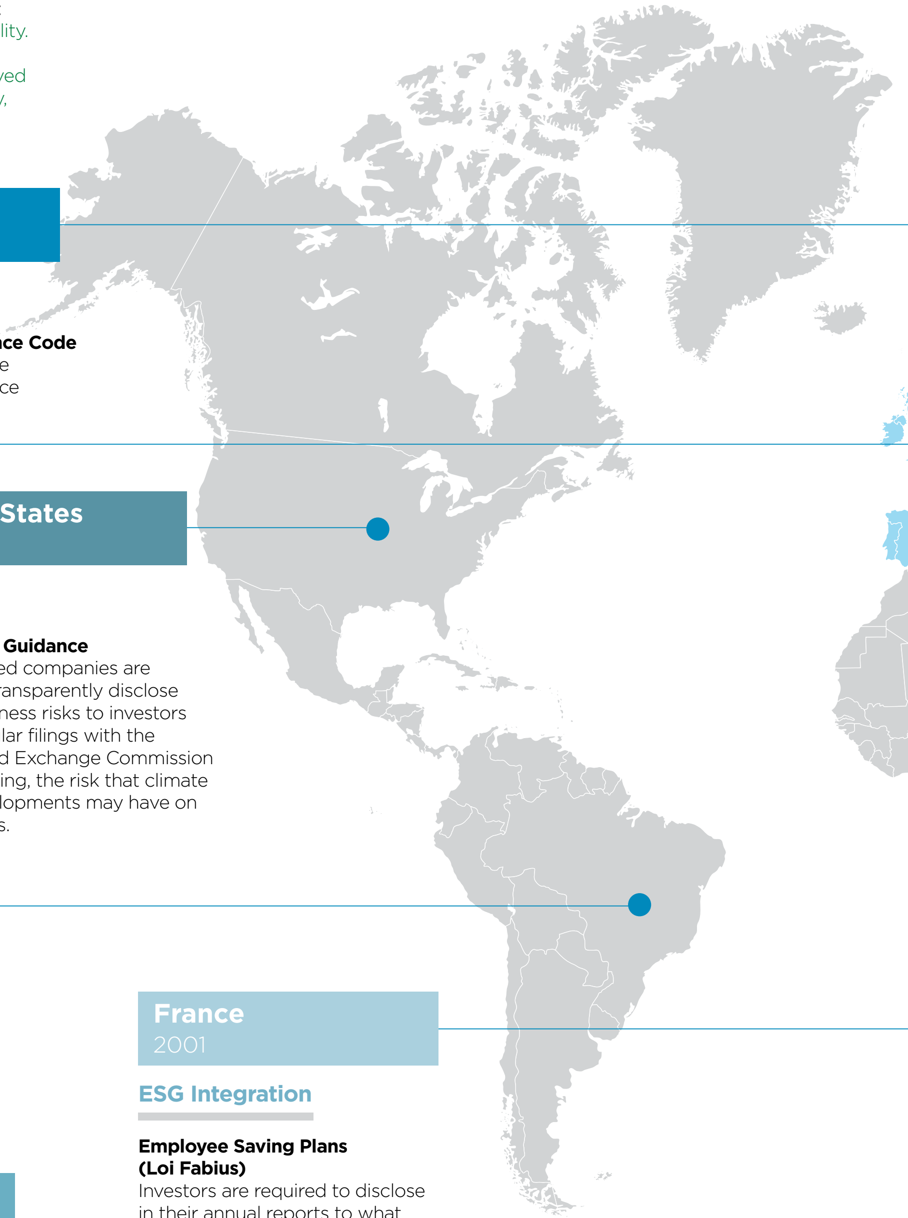
ESG Integration

Green Investment Directive
Tax reduction for green investments, such as wind and solar energy or organic farming.

Netherlands
2004

Stewardship

Dutch Corporate Governance Code
Principles of good corporate governance and best practice provisions.



United States
2010

Securities

SEC Climate Guidance
Publicly traded companies are required to transparently disclose material business risks to investors through regular filings with the Securities and Exchange Commission (SEC), including, the risk that climate change developments may have on their business.

United Kingdom
2010

Stewardship

UK Stewardship Code
The Code sets out a number of areas of good practice to which the FRC believes institutional investors should aspire and operates on a 'comply or explain' basis. The FCA requires UK authorised asset managers to report on whether or not they apply the Code.

France
2001

ESG Integration

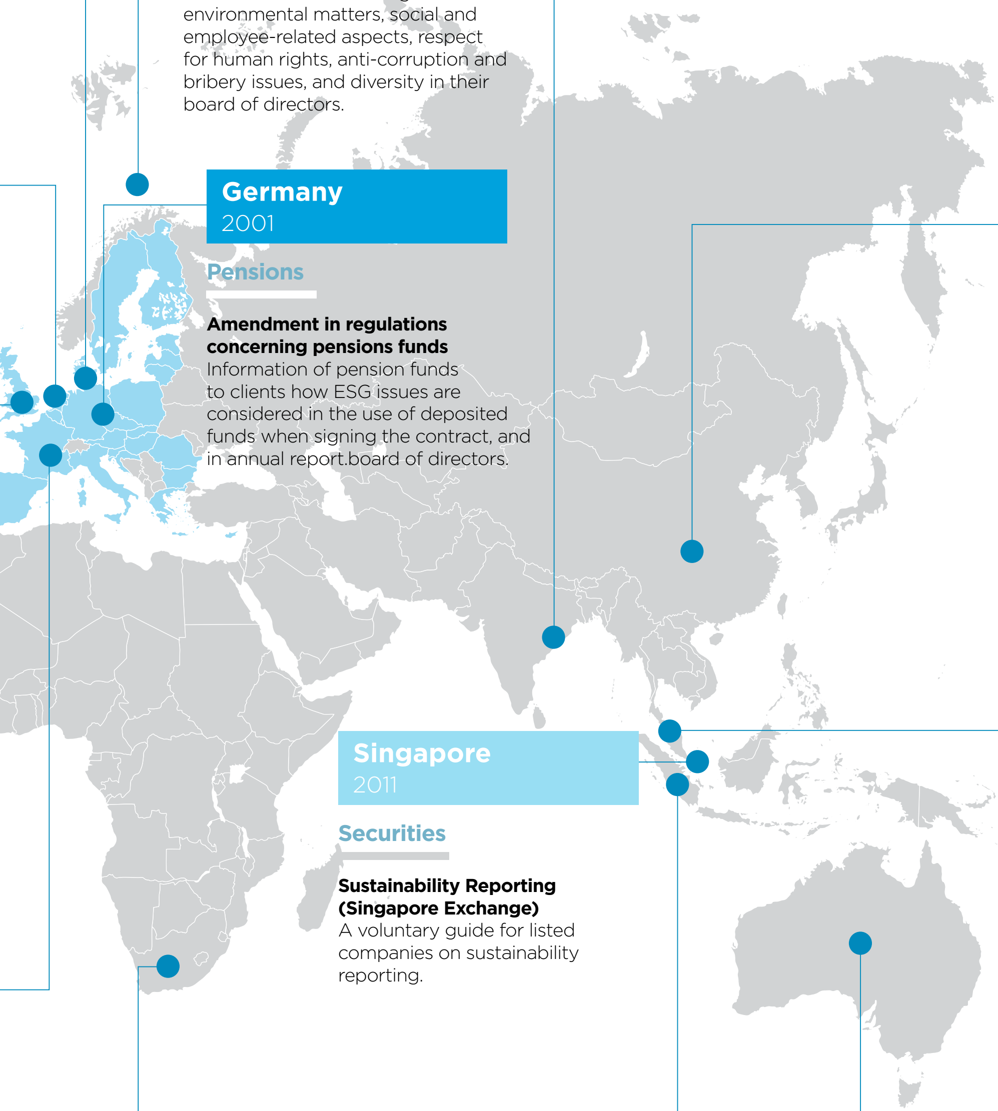
Employee Saving Plans (Loi Fabius)
Investors are required to disclose in their annual reports to what extent they take SEE indicators into account when buying or selling stocks and securities and when exercising their shareholder rights. This must be reflected in investment policy.

Brazil
2012

Securities

Brazil stock exchange (BM & FBOVESPA Stock Exchange)
Report or Explain allows companies' progressive adhesion to the practice of reporting information and results related to the social, environmental and corporate governance dimension, providing investors and interested parties with a quick means of access to this information.

Table 1: Regulatory standards and regulation regarding SRIs



Europe
2002

Securities

Non-Financial Reporting
Companies concerned will need to disclose information on policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors.

Germany
2001

Pensions

Amendment in regulations concerning pensions funds
Information of pension funds to clients how ESG issues are considered in the use of deposited funds when signing the contract, and in annual report.board of directors.

India
2009

Securities

CSR Voluntary Guidelines
Business entities should formulate a CSR policy to guide its strategic planning and provide a roadmap for its CSR initiatives, which should be an integral part of overall business policy and aligned with its business goals.

China
2006

Securities

Social Responsibility Instructions to Listed Companies (Shenzhen Stock Exchange)
A requirement for companies to formulate environmental protection policies based on their impact on the environment.to greenhouse gas emissions and energy consumption and production.

Singapore
2011

Securities

Sustainability Reporting (Singapore Exchange)
A voluntary guide for listed companies on sustainability reporting.

Malaysia
2008

Securities

CSR disclosure and framework (Bursa Malaysia)
Malaysian stock exchange requirement for disclosure of CSR activities.energy consumption and production.

Malaysia
2014

Stewardship

Malaysian Code for Institutional Investors
The Code is intended to give institutional investors guidance on effective exercise of stewardship responsibilities to ensure delivery of sustainable long-term value to their ultimate beneficiaries or clients.

South Africa
2011

ESG Integration

Reg 28 of the Pension Funds Act
Integration of ESG considerations to fiduciary duty.

South Africa
1994, 2002 and 2009

Securities

King Code
A principle-based code for corporates, now a requirement of listing on the JSE, including integrated sustainability reporting, in King II (2002).

Indonesia
2012

Securities

Regulation No. 47/2012
Article 2 of the GR provides that every company has social and environmental responsibility. Article 3 provides further in its section 1 that this social and environmental responsibility is an obligation for companies that are engaged in the business field of or related natural resources.

Australia
2002

Stewardship

Corporate Governance: A guide for fund managers and corporations
Guidelines for determining approach to Corporate Governance, voting and other issues proposed by public companies in which a fund invests.

Australia
2007

Securities

NGER Act
The National Greenhouse and Energy Reporting (NGER) Scheme was introduced in 2007 to provide data and accounting in relation to greenhouse gas emissions and energy consumption and production.

SRI Opportunities have Broadened with Shariah-compliant Investments

SRIs have been shown to trace back to religious roots and practices. It is no surprise therefore, that the recent growth of investing and finance that agree with Islamic tenets, owes it success to its high ethical values and 'responsible investing' philosophy. Islamic investment can be seen both as a niche form of SRIs and as a unique investment class in its own right. The word 'Islamic' refers to where the philosophy is founded in terms of the law and lifestyle, without any restriction or limit on who is involved irrespective of their religious or non-religious affiliation.

The basic premise aims to achieve a business environment that enables all of mankind, Muslims and people of other faiths, to live and thrive in a world where there is justice, prevention of acts against society and the promotion of mutual benefit whilst maintaining the dignity of all parties concerned. As such, real private ownership, open trade for all members of society and the possible creation of wealth across the board are key components of the Islamic philosophy, advancing equitable and feasible generation and distribution of wealth among people. An SRI within the Islamic proposition brings the following elements/advantages to the business scene and the economy/society as a whole:

The Islamic Proposition to SRIs

i. A reduction in uncertainty and in leverage levels in the business community;

ii. Establishing a level playing field through reasonable profit-taking and equitable bargaining power for transacting parties;

iii. Maintaining stability by removing of business operations based on speculative ends;

iv. Eradication of business activities that have destructive objectives on men and nature for the sake of continued and assured economic stability for future generations;

v. Promoting sustainable business and investment activities that entail positive results with stable future prospects and the welfare of men and the societies they live in;

vi. Stimulating entrepreneurial vision, trade and industry growth based on sound relationships that span industries, suppliers and customers and on mechanisms that channel wealth and assets originating from capital owners, savings and charitable funds to achieve profits. All this is achieved while providing opportunities for success for those seeking to improve their circumstances. This approach reduces the insular nature of conventional saving and investment schemes;

vii. Linking capital markets to real economic activities where capital owners and financial institutions become buyers, sellers and partners instead of creditors. This translates in a more active business environment where investors take part in clearly specified businesses and transactions;

viii. As a result of all of the above, greater stability builds its way into the economies of nations, ensuring socio-economic wellbeing and spurs growth in a tenable manner that can be seen in carefully choosing business activities anchored in Sharia and characterised by long term perspectives.

Using Islamic Investment Screens for Tailor-made Investment Portfolios

Placing funds with Islamic fund managers has an added benefit for the savvy portfolio investor. Since the most notable aspect of Shariah-compliant investment involves the screening methodology, Islamic fund managers have advanced and excelled in using software that can filter stocks considerably beyond the conventional, allowing the investor to select stocks based on detailed and technical preferences.

Islamic fund managers have a track record of selecting companies that comply with complex financial and quantitative screening criteria that can now be used based on the unique risk profiles of investors. This means that investors can be especially unique in their portfolio selection, for example accepting or rejecting companies that have changed their gearing, their liquidity, and even their interest-based income. Whilst the standard Shariah-compliant investment criteria have the obvious advantages of selecting good-value stocks that have lower conventional gearing, these screening filters can be adjusted to suit investor preferences.

Since the very first SRIs, screening filters have been used to include and exclude firms from the investable universe. Some of these widely used criteria are based on environmental protection, human rights, firms engaged in manufacturing arms and ammunition, tobacco, liquor and generally what is referred to as 'sin stocks'. These screening criteria can broadly be classified into negative and positive filters.

As far as the original screening filter of these investments are concerned, it is clear from the Quakers and Lutheran Brotherhood and even the PAX world fund that was established in 1971, that they were based on negative filters as they refused to invest in firms that dealt with arms and ammunitions and slave trading amongst other dubious businesses. These negative screenings were based on ethical, socially responsible and environmental protection criteria.

Some of these funds use certain thresholds to allow degrees of flexibility such that the exclusion of firms is contingent on reaching a prescribed maximum level fixed by these funds.

Islamic investment funds form a part of this overall consideration with specific screening criteria that have been set through the consensus of authorities in the field of Islamic jurisprudence and finance. Whilst these screening criteria differ in application, the fundamental qualitative and quantitative screening do not, inspiring a fairly standardised approach to selecting the investable universe. Referred to by traditional SRIs as negative screens, Islamic investments apply two key screens:

i. A Qualitative Screen, and
ii. A Set of Quantitative Screens.

i. Qualitative Screen

The first screen is known as the qualitative or business screen. All businesses involved in the following are excluded immediately from the investable universe. The differences in application between regions differs somewhat and will be explained later.

Table 3: Qualitative or Business Screens for Islamic investing

ii. Quantitative Screen

The second set of screens is known as the financial or quantitative screen.

	Financial Screen	Dow Jones Islamic Index	FTSE Islamic Index	MSCI Islamic Index	Bursa Malaysia Shariah Index
01	**Leverage (Debt/Equity)**	Debt/ 2 Yr Average Market Cap < 33%	Debt / Total Assets < 33%	Debt / Total Assets < 33.33%	Debt / Total Assets ≤ 33%
02	**Liquidity (Accounts Receivable + Cash)**	Acc Rcvbl + Cash / 2 yr Average Market Cap < 33%	Acc Rcvbl + Cash / Total Assets < 50%	Acc Rcvbl + Cash / Total Assets < 70%	Cash / Total Assets ≤ 33%
03	**Impermissible Income[5]**	Revenue from Prohibited Items + Total Interest / 2 yr Ave Market Cap < 5%	Revenue from Prohibited Items + Total Interest / Total Assets < 5%	Revenue from Prohibited Items + Total Interest / Total Assets < 5%	Revenue from Prohibited Items[6] + Total Interest / Total Assets < 5%
04	**Cash & Interest-Bearing Instruments**	Cash + Interest Bearing Instruments / 2 yr Ave Market Cap < 33%	Cash + Interest Bearing Instruments / Total Assets < 33%	Cash + Interest Bearing Instruments / Total Assets < 33.33%	N/A

[5] Income for non-compliant activity including interest income[11] Association of the Luxembourg Fund Industry
[6] Slight differences exist in the categorization of prohibited items between Bursa Malaysia and the other indices. Additional qualitative analysis including the image or public perception of the company, its importance to the community and its social responsibility is also considered.

Comparative Risk-Adjusted Movements in SRI Returns

1 Sharpe Comparisons of Islamic/ Ethical Markets vs Conventional Investments

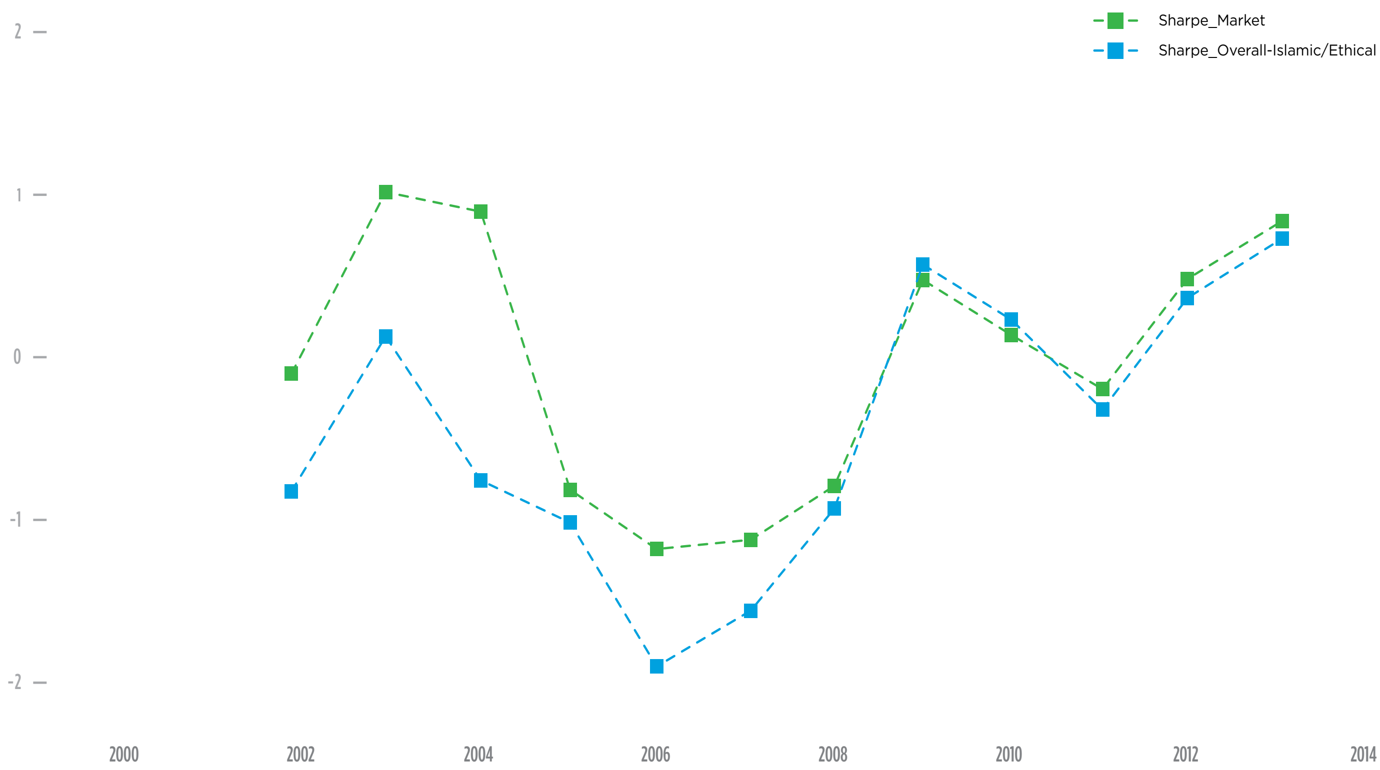


Figure 1: Sharpe Ratios for the Islamic and Ethical Market combined, versus the overall Market
Source: EurekaHedge

Overall Islamic funds /ESG returns began from a lower base and have been driven down by market perception that has been socially-motivated as opposed to profit-motivated returns being less focused on shareholder maximisation

Negative sentiment pervades during the financial crisis when investors lack confidence and have distrust for the market move into interest-based safe-havens

However, in the long-term, Islamic funds/ ESG have proven their resilience and as markets become more stable, confidence in these forms of investment increases

Returns are closely matched, indicating no loss of return in Islamic funds over the long-term

2 Sharpe Ratios – Islamic Funds vs Global Market Funds

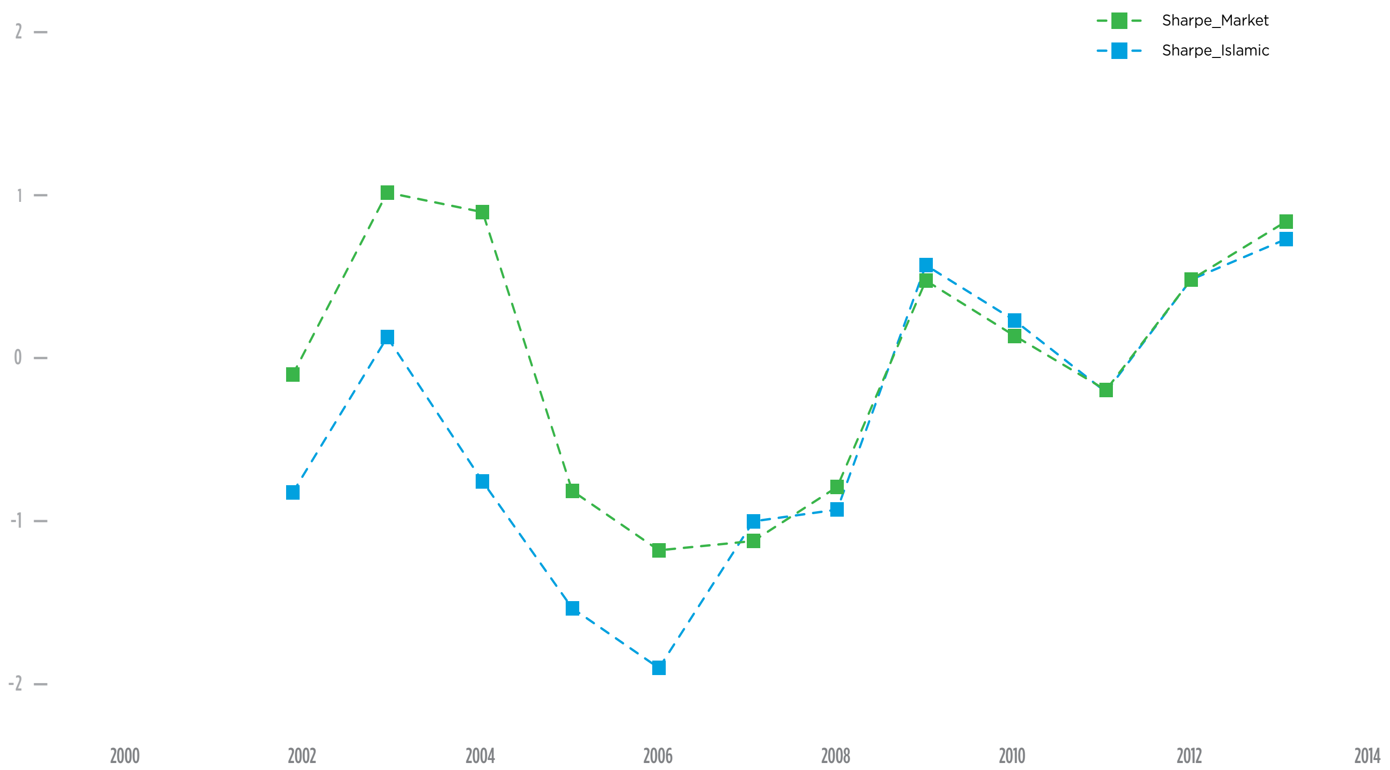


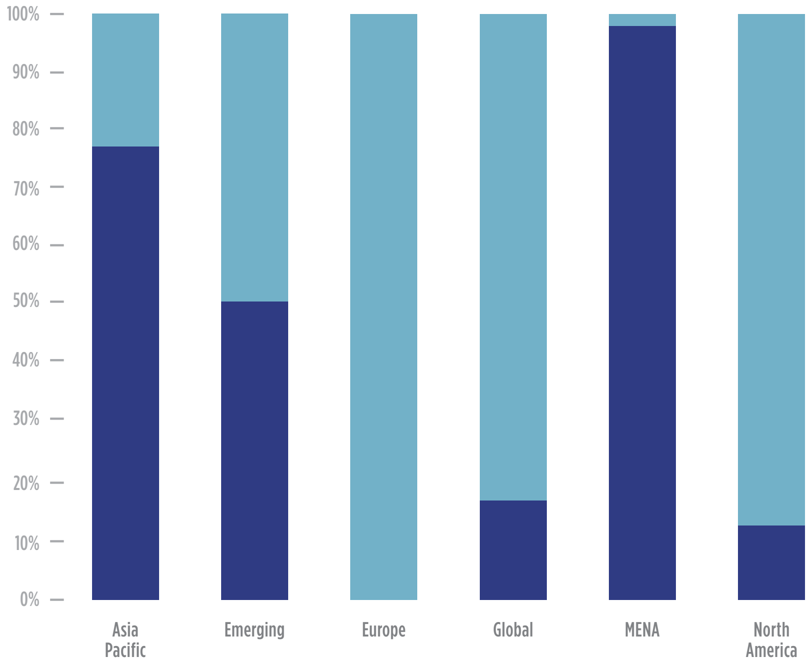
Figure 2: Sharpe Ratios for the Islamic Market alone versus the overall Market
Source: EurekaHedge

Islamic investment returns were in fact closer to general market movements before the crisis, probably due to a variety of reasons including lack of awareness in the functioning of these investments

As awareness and overall understanding increases, Islamic investments tend to buck the trend at financial crisis

Overall, Islamic investments on a risk-adjusted basis prove to be as good if not better investments over the long-term

3 Global Distribution of Islamic & Ethical Funds



ASSETS UNDER MANAGEMENT

Islamic
SRIs

The overall joint distribution of the number of Islamic / Ethical funds in 2015, when compared to Islamic funds alone, shows that the vast majority of Ethical funds in the MENA and Asia-Pacific region are actually Islamic funds (96% of MENA funds and 80% of Asia-Pacific Funds).

OVERALL- ISLAMIC AND ETHICAL

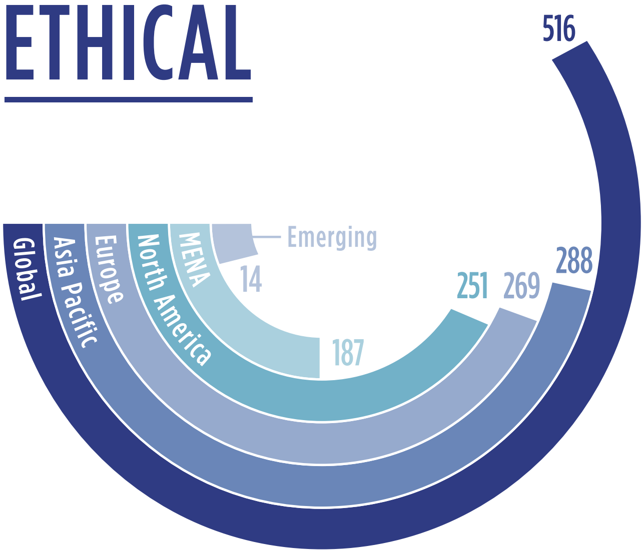


Figure 3: Global Distribution of Islamic and Ethical Funds-combined in terms of No. of Funds
Source: EurekaHedge

ISLAMIC

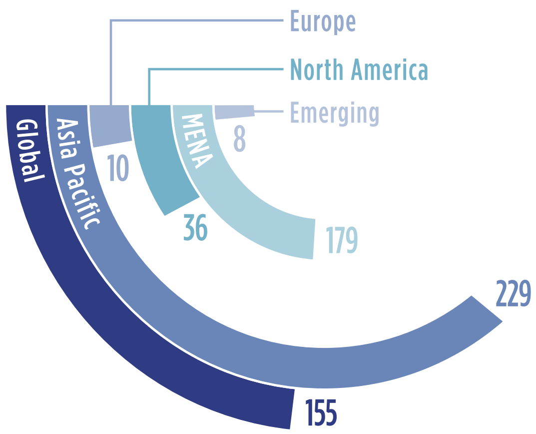
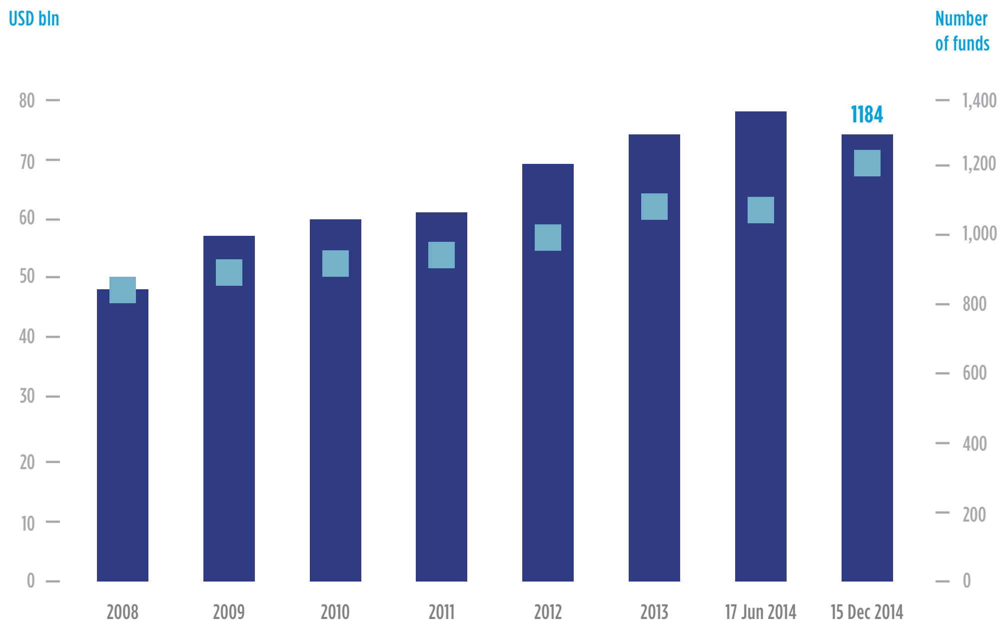
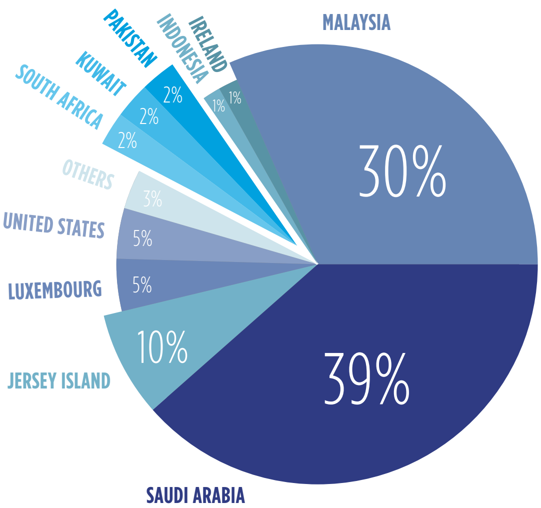


Figure 4: Global Distribution of Islamic Funds only, in terms of No. of Funds
Source: EurekaHedge



GLOBAL ISLAMIC FUNDS AUM
(2008 - 15 DEC 2014)

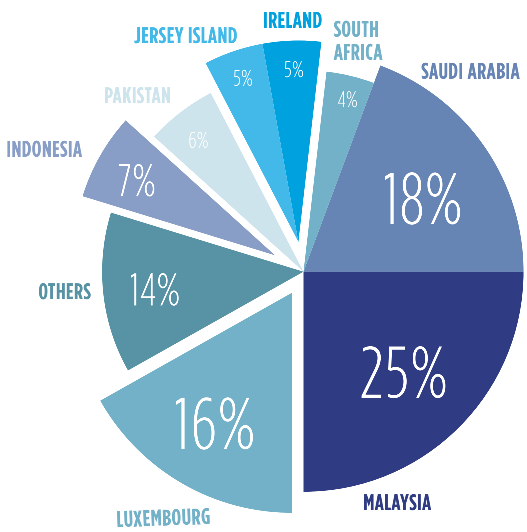
Source:
KFH Research Ltd



GLOBAL ISLAMIC FUNDS ASSETS UNDER MANAGEMENT
(AUM) BY DOMICILE (USD BILLION)

Islamic fund size globally has continued its growth path since 2008 with a CAGR of 9.1% between 2008 and 2013. By 3Q2014, the sector was valued at USD75.8 billion. The steady growth of the niche market indicates the limited effects of geo-political sensitivities since 2011 upon the sector and a sustained growth pattern that is expected to pass the $100 billion mark within the next 2 to 3 years.

Source: ISRA and Zawya



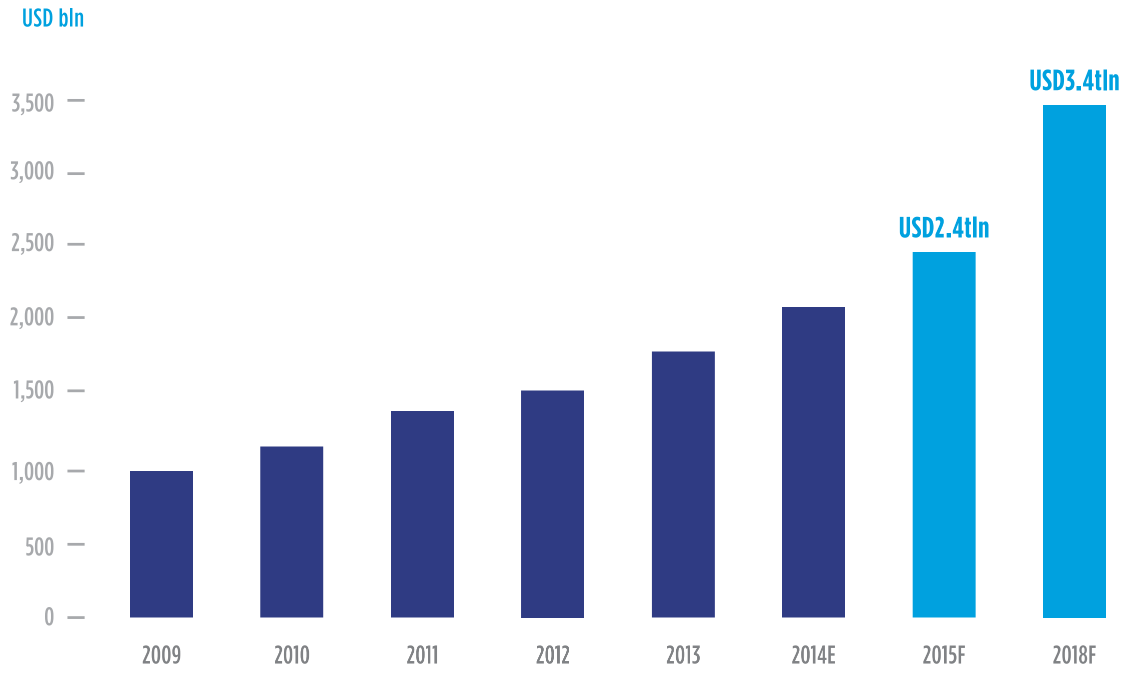
NUMBER OF ISLAMIC FUNDS
DOMICILE BY COUNTRY

At the end of June 2015, a total of 1,018 active funds were on the market based on Islamic investment principles. Saudi Arabia and Malaysia jointly manage approximately 69% of the total Islamic funds in terms of assets under management.

Source: ISRA and Zawya

4 Future Outlook for the Islamic Fund Industry: Beyond 2015

Global Islamic Assets Trend (All sectors)



Source: Various and KFH Research Database

As the global economy is expected to build on the gains made in 2013 and 2014, a growth of 3.8% is forecasted.[7]

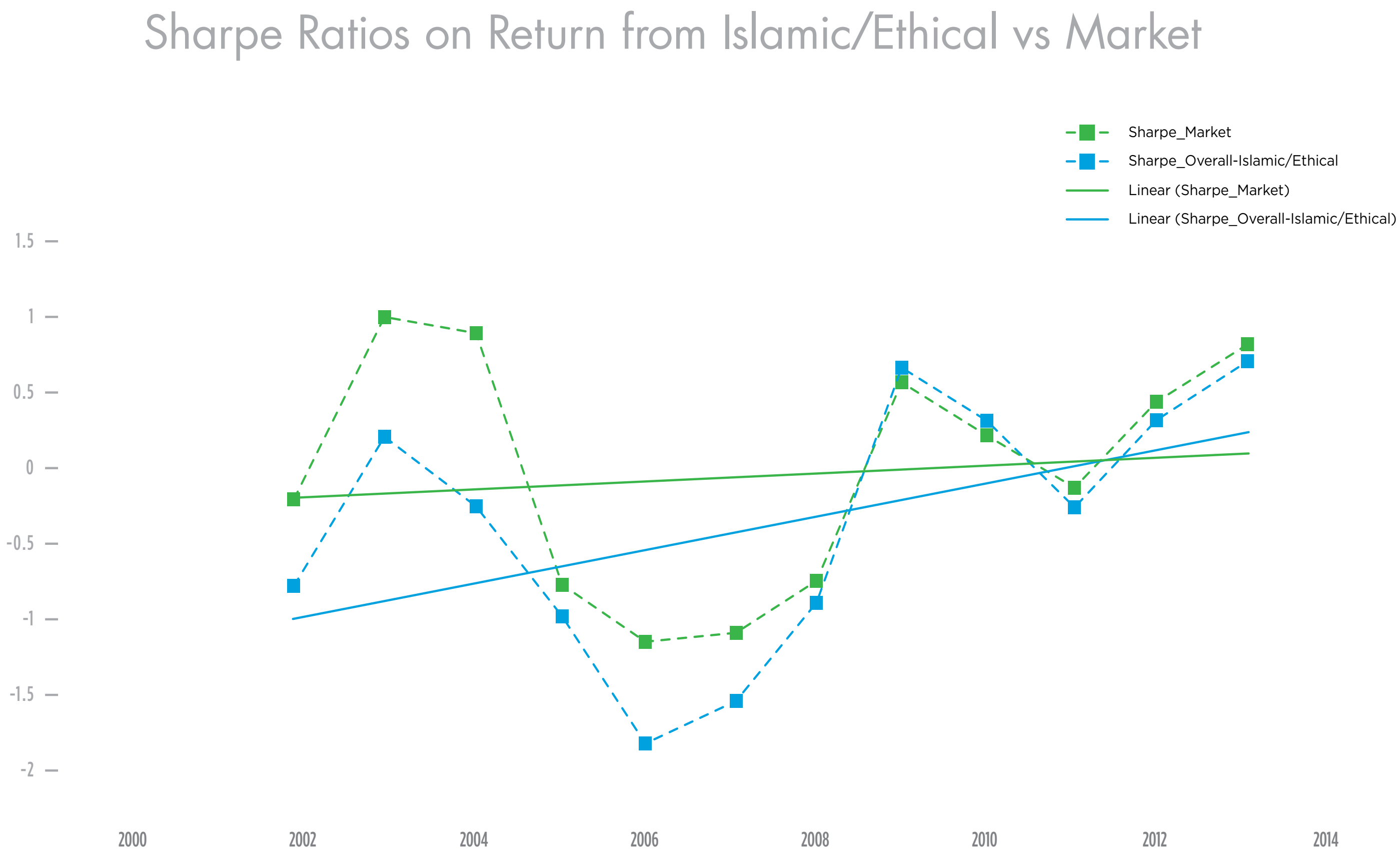
Emerging markets are expected to enjoy a significant portion of this growth and stronger trade demand is pushing countries in Asia Pacific and the Middle East towards an improved future outlook. With the concentration of Islamic funds in the Asia-Pacific and MENA, these investments are expected to benefit directly from forecasted market movements.

Certain jurisdictions like Saudi Arabia (capital market reforms allowing foreign investment[8]) and Malaysia have the advantage of enhanced regulation (IFSA 2013) that pave the way for a more harmonised approach to Islamic finance and investment between the MENA and Asia Pacific regions, exceedingly benefitting the global Islamic investment market.

In 2014, Malaysia, Singapore and Thailand were signatories to a cross-border framework for fund managers, making the process of distribution between countries more efficient.[9]

[7] International Monetary Fund (IMF) forecasts for economic data (October 2014)
[8] "Saudi Arabia prepares to open USD530bln bourse to foreigners", Zawya (July 2014)
[9] "Investors in 3 Asean markets get wider range of options", Asia One Business (August 2014)

5 Returns from SRI Funds



Several factors could have contributed to the dip in performance beginning late 2002 to 2006. To begin with, the stock market crash of 2002 affected the US, Canada and Europe significantly. As stock markets recovered from the 9/11 terrorist attack, several high profile corporate frauds (Arthur Anderson, Enron and Worldcom) added fuel to the already burning stock markets. The mutual fund scandal of 2003 in which some of the mutual funds companies were accused of late-trading and market timing practices[10] was the final straw, driving markets down. At least 20 mutual fund companies were involved in the illegal trading scandal that had violated securities laws. Some of these firms were the industry's largest firms as they managed more than a thousand with total assets under management of over $1 trillion. It can be argued that corporate frauds coupled with the mutual fund scandal could have done more damage to the ethical fund industry than the stock market crash as the market has a long memory and customer confidence was damaged. All these incidences can provide a connection to the decline in the Sharpe ratio from 2003 to 2006. However, the reason for the slow recovery could be the fact that most of the countries did not have sufficient regulation that would be able to govern and regulate firms. As regions began enhancing and implementing regulation, markets have improved, experiencing a noteworthy recovery.

[10] McCabe, P., 2008. The economics of mutual the fund trading scandal. Board of Governors of the Federal Reserve System (http://www.federalreserve.gov/pubs/feds/2009/200906/200906pap.pdf).

As the comparison has shown, Shariah-compliant investments have provided an alternative to traditional investment and as more conscientious investment decisions are made, investor demand in responsible investment is already driving change in the industry. Shariah-compliant investments have proven themselves over the investment horizon as a stable long-term investment that, when managed in well-regulated environments, can provide sustainable returns at manageable risk. Malaysia is at the forefront of Shariah-compliant investments sophistication and experience, possessing some of the most accomplished and proficient Islamic Fund Managers the industry has to offer.

A rapidly expanding trend towards SRIs has gained an unprecedented pattern of growth from both the North American and European regions. Although, the religious origin of SRIs instill no surprise that Islamic investments have inherent SRI characteristics.

The overall objectives of Islamic investments in terms of the reduction of uncertainty, removal of business with immoral objectives and the encouragement towards real sector development promote superior stability without compromising return over the long-term.

The next section discusses emerging market growth and what is required to enhance that growth. Innovative solutions that are market-related can be found within the Islamic finance sphere including sukuk, real sector investment & finance and SRI endowment options.

The challenge is identifying Shariah-compliant SRI initiatives within a robust regulatory environment that has a track record over the medium to long-term. The Malaysian option presents that option as a global leader in Islamic finance innovation, offering a robust solution for investment that can be adapted to suit both individual and institutional requirements.

SRIs & THE CASE FOR
ISLAMIC INVESTMENT FUNDS

SECTION 3

01

Emerging Markets & Islamic Investment

Growth in the Islamic Finance & Investment Sector

Between 2006 and 2010, emerging markets contributed to approximately 60% of global GDP or $8 trillion, through aggressive market expansion and an annual growth rate of 15%.[1] Whilst economies have slowed down over the last five years, the IMF still predicts emerging economies will surpass developed ones by more than 2% for 2014 and 2015.[2]

The established contribution of financial services to GDP growth and development requires a banked population.[3] More and more Africans, for example, are joining the banked albeit via unconventional methods.[4]

Globalisation has quickly nudged even those in rural areas to become technologically connected. The Guardian newspaper reported in June 2014 that Africa's mobile phone users are expected to increase significantly in the next five years. With more than 635 million mobile subscriptions (Approximately 60% of the estimated African population) expected before the end of the year and a comparatively insignificant 20% of banked families in Africa, many of the newly banked have probably never seen a bank.

[1] Mahomed, Z (2014) : AMERC Paper at IOSCO Conference, Brazil.
[2] International Monetary Fund, 2014
[3] King and Levine, 1993a, 1993b, 1993c
[4] http://www.economist.com/blogs/economist-explains/2013/05/economist-explains-18

The World Bank estimates that 38% or 2 billion of the adult world population in 2014 did not have access to or did not use formal financial services. More concerning is the estimate that 73% of the poor are unbanked or financially excluded due to high banking costs, bureaucracy or accessibility. The link between income level and being financially excluded indicates that 20% of the wealthiest individuals in developing countries are more than twice as likely to have a bank account as compared to the poorest 20%. Financial inclusion through savings products and restricted withdrawal products have been shown to improve economic conditions of a society as they offer a multitude of benefits including financial discipline, economic empowerment, entrepreneurship, savings for education, property purchase and lower mortality rates due to affordability of better healthcare.[5]

Research[6] over the last decade has shown that micro-credit increases the number of business start-ups and improves the profitability of existing ones, giving credence to the belief that financial inclusion can have significant positive effects for individuals and firms.

In the efforts to make Malaysia a high income developed nation by 2020, Bank Negara Malaysia drafted its Financial Sector Blueprint 2011-2020 and made the following recommendations, in order to achieve the high income country status:

i Encourage the establishment of family offices to better accommodate the demands of ultra-high net worth individuals and families, which will also contribute towards Malaysia's aspirations to become a global centre for Islamic wealth management.

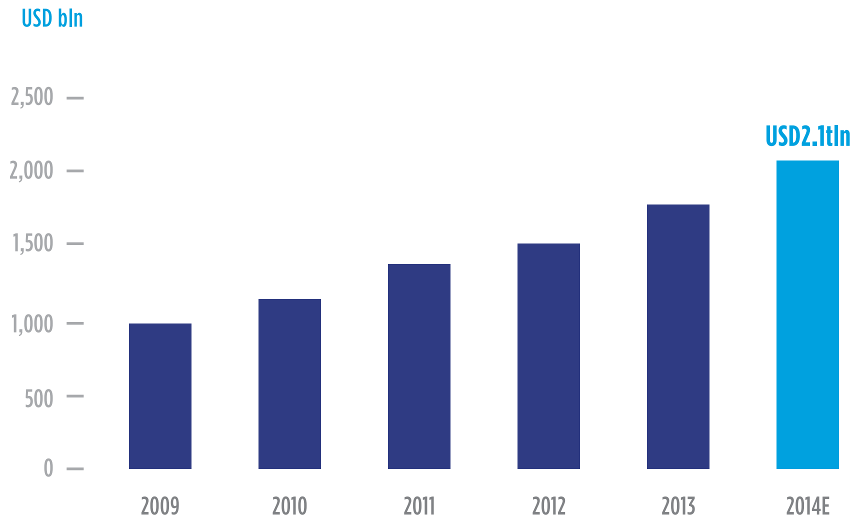
ii Promote Islamic fund and wealth management activities through the offering of innovative financial solutions to meet the more sophisticated investment demands of the increasingly affluent population, including households in Asia.

iii Enhance the development of important ancillary services that support the wealth management industry, such as legal services and real estate planning, in collaboration with relevant regulatory agencies and industry associations.[7]

[5] Global Findex (2014); World Bank: http://www.worldbank.org/en/topic/financialinclusion/overview#1
[6] Banerjee et al. (2010)
[7] BNM's Financial Sector Blueprint 2011-2020, page 68-69 under recommendations 2.1.8, items ii,iii, iv

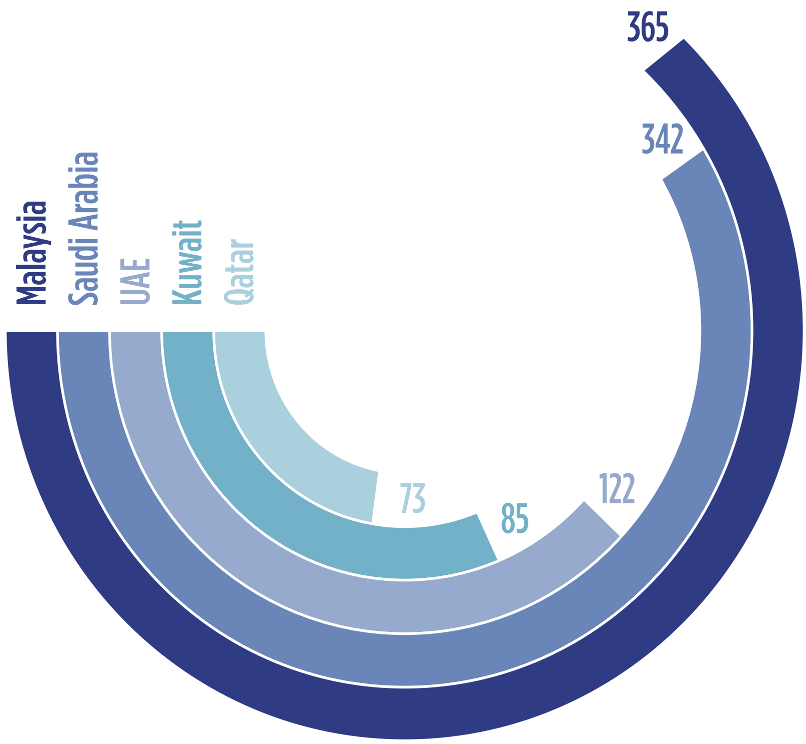
GLOBAL ISLAMIC FUND ASSETS TREND
(2009 - 2014E)

By the beginning of 2015, Islamic finance assets globally are estimated at $2.1 trillion on the back of a Cumulative Average Growth Rate (CAGR) of 17.3% post financial crisis (between 2009 and 2014). The leading jurisdictions[8]: Malaysia, Saudi Arabia, UAE, Kuwait and Qatar, have contributed significantly to the global market with the Islamic banking market in Saudi Arabia growing at a CAGR of 23.1% compared to conventional banking that grew 10.7% for the same period.



Source: KFH Research Database

ISLAMIC FINANCE ASSETS BY DOMICILE
(2014E)



Source: Various, KFH Research Database

[8] Excluding Iran

Emerging Markets and Innovative Products

1 Innovative solutions

Emerging markets are unique on a country basis. These developing economies require that financial institutions design products that adapt to their individual needs. The unbanked population across Asia is estimated to be 73%, 10% more than the global median.[9] The potential for banking and finance in Asia and emerging markets as a whole makes for a formidable platform, designing innovative Islamic finance solutions as Asia is home to more than 62% of the world's Muslim population.[10]

Islamic finance and investment structures provide solutions to reach those requiring finance but have refrained due to the lack of options available to them. Structures like Forward sale financing (salam), Crop-farming through partnership (muzara'ah) and Agricultural financing (musaqat) provide immediate solutions to farmers across developing regions.

Each of these structures has the ability to be scaled down to provide micro-financing and micro-investment to low-income households. At the same time, these instruments can be scaled up for capital market issuance in the form of interbank notes, negotiable deposits and the darling of the Islamic finance industry: Sukuk. These investment certificates that comply with the tenets of the Islamic law inherently consist of ethical and socially responsible elements, maintaining the restrictions mentioned earlier in terms of share investment. This means that sukuk have been contributing to the SRI sector as they restrict investment or financing of what is considered socially harmful (casinos, indecent material, arms and ammunition, alchohol, etc.)

2 Sukuk

Defined as :

"Certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity"[11]

and often referred to as an Islamic bond, sukuk have quickly become the preferred method of capital raising for Shariah-compliant funding requirements. Conventional firms as well, have been issuing sukuk (for example, Shell which issued the first corporate sukuk in 1990), making it a strong and successful capital-raising tool that has gained significant momentum over the last decade.

The sukuk market has become a formidable growth area within Islamic finance, recording USD116.23 billion in global issuance in 2014[12], 100 times more than in 2001 (USD1.17bn). With all the sukuk issuances in the pipeline and continuous demand for these products, global sukuk issuances are expected to surge within the next 5 years to become a major contributor to the sector overall.

Global challenges like climate change and equitable social development lend themselves to principles that are inherent in Shariah-compliant products. 'Social Sukuk' or 'Green Sukuk' are some of the most recent instruments in the socially responsible Shariah-compliant investment sector.

An example is the $500 million 'Vaccine Sukuk' issued in 2014 to fund disease prevention and eradication. The International Finance Facility for Immunisation Company (IFFIm) issued its inaugural sukuk in late 2014, raising half a billion dollars for an immunisation programme for children, focused on the world's poorest countries. The IFFIm partnered with Gavi, the Vaccine Alliance, with the objective of protection against preventing disease for millions of young children in countries like Yemen, Mali and Afghanistan.[13]

9 Nakao, T, (2015). "Banking Asia's unbanked " by President of Asian Development Bank. http://www.emergingmarkets.org/Article/3450148/Banking-Asias-unbanked.html
10 http://www.pewforum.org/2011/01/27/future-of-the-global-muslim-population-regional-asia/
11 AAOIFI Shariah Standard No 17
12 Zawya
13 http://www.iffim.org/Library/News/Press-releases/2014/International-Finance-Facility-for-Immunisation-issues-first-Sukuk,-raising-US$-500-million/

Khazanah Nasional Bhd, a Malaysian sovereign wealth fund, has also stepped into the foray of niche sukuk SRIs, offering RM100 million (USD25 million) as part of the Ihsan Sukuk Berhad's RM1 billion sukuk programme (USD250 million) for responsible investment within the recently issued Sustainable, Responsible and Investment Sukuk framework by the Securities Commission Malaysia. The issuance can be classified as impact investing as it focuses on funding schools under the Yayasan AMIR Trust School programme, with the objective of improving the accessibility and quality of education through a public-private partnership with the Malaysian Ministry of Education. Beyond the uniqueness of the issuance, it will also allow sukuk-holders to convert their investment into a donation at any point of the tenure.

The 'Green Sukuk' initiative has also been gaining momentum as a part of the recent SRI sukuk structures. 'Green Sukuk' intend to encourage the issuance of investment certificates focused on renewable energy through the funding of projects including:

- Solar & wind parks
- Biogas plants
- Renewable transmission and infrastructure
- Electric vehicles and infrastructure, light rail.[14]

Domiciles with Debut Sukuk Issuances (2013 - 2014)

	Issuer	Structure	Domicile	Currency	Issue Date	Issue Size (in millions)	Tenor	Issuance Type
01	Golden Assets International Finance	Murabahah	Mauritius	MYR	1 Aug 13	153.89	5	Corporate
02	Salam III Limited	Wakalah	Luxembourg	USD	1 Oct 13	20	5	Corporate
03	Osun Sukuk Company Plc	Ijarah	Nigeria	NGN	1 Oct 13	70.82	7	Sovereign
04	South Africa	Ijarah	South Africa	USD	17 Sep 14	500	5.75	Sovereign
05	Oman	Ijarah	Oman	USD	22 Oct 14	519.62	5	Sovereign
06	Hong Kong	Ijarah	Hong Kong	USD	11 Sep 14	1,000	5	Sovereign

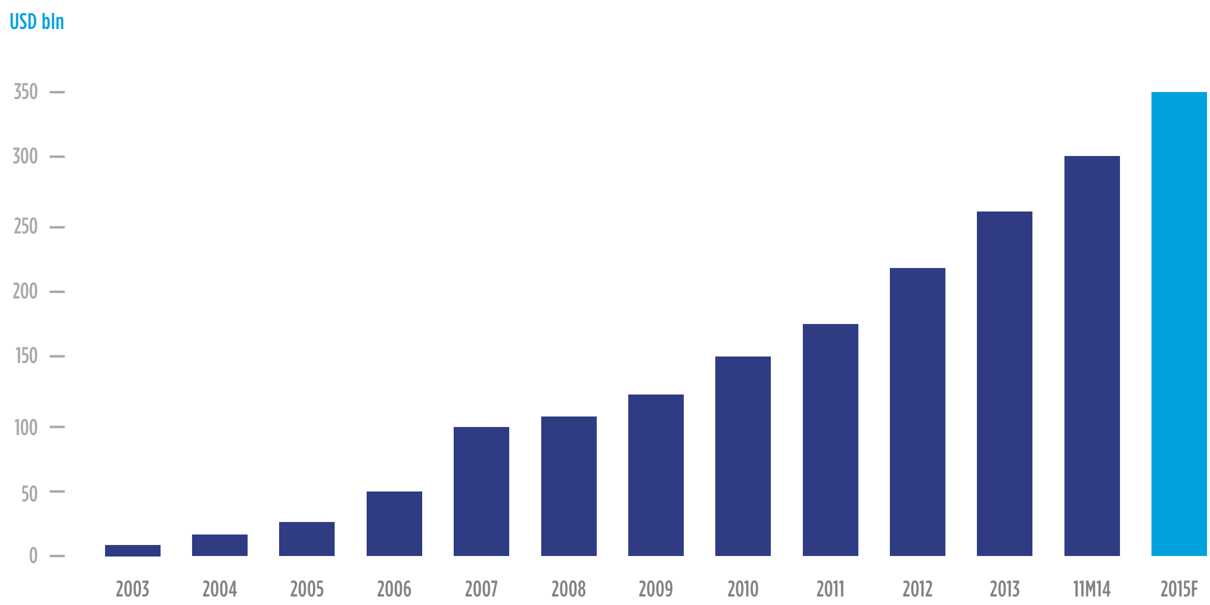
Source: ISRA, Zawya and Bloomberg KFHR

New sukuk issuances in 2013 were generally for medium term maturity and used a variety of structures as the foundation. Specific emerging markets have quickly recognised the benefit of sukuk issuance. By 2014, South Africa, Japan and the UK were all making inroads in their first sukuk issuances, spurring a move towards sukuk issuance globally.

The growth of sukuk as an asset class has surpassed other forms of investment with a cumulative average (CAGR) of 16% pa between 2010 and 2015. This trend is expected to continue to a forecasted value of sukuk outstanding to be around $640 billion by 2020.[15]

[14] http://www.climatebonds.net/projects/facilitation/green-sukuk accessed 29 June 2015
[15] KFH Research

Global Sukuk Outstanding (2006 - 2015F)



Source: ISRA and Zawya

Due to significant infrastructure requirements across the developing regions, emerging markets have and are expected to continue issuing more sukuk that ultimately improve standards of living on the back of wealth generation. As Malaysia enters its final segment of its Economic Transformation Programme (ETP), the 2020 goals that it has set are expected to be achieved with the majority of the spending towards socio-economic development.

Malaysia's established regulation and adoption of international best practices including Basel and the IFSB[16] standards and its strong arbitration and financial mediation have attracted foreign corporates in raising capital using the Malaysian sukuk platform.

[16] Islamic Financial Services Board based in Kuala Lumpur, Malaysia

A CLEAR LEADER IN GLOBAL SUKUK ISSUANCE

SUKUK ISSUANCE BY DOMICILE

MALAYSIA

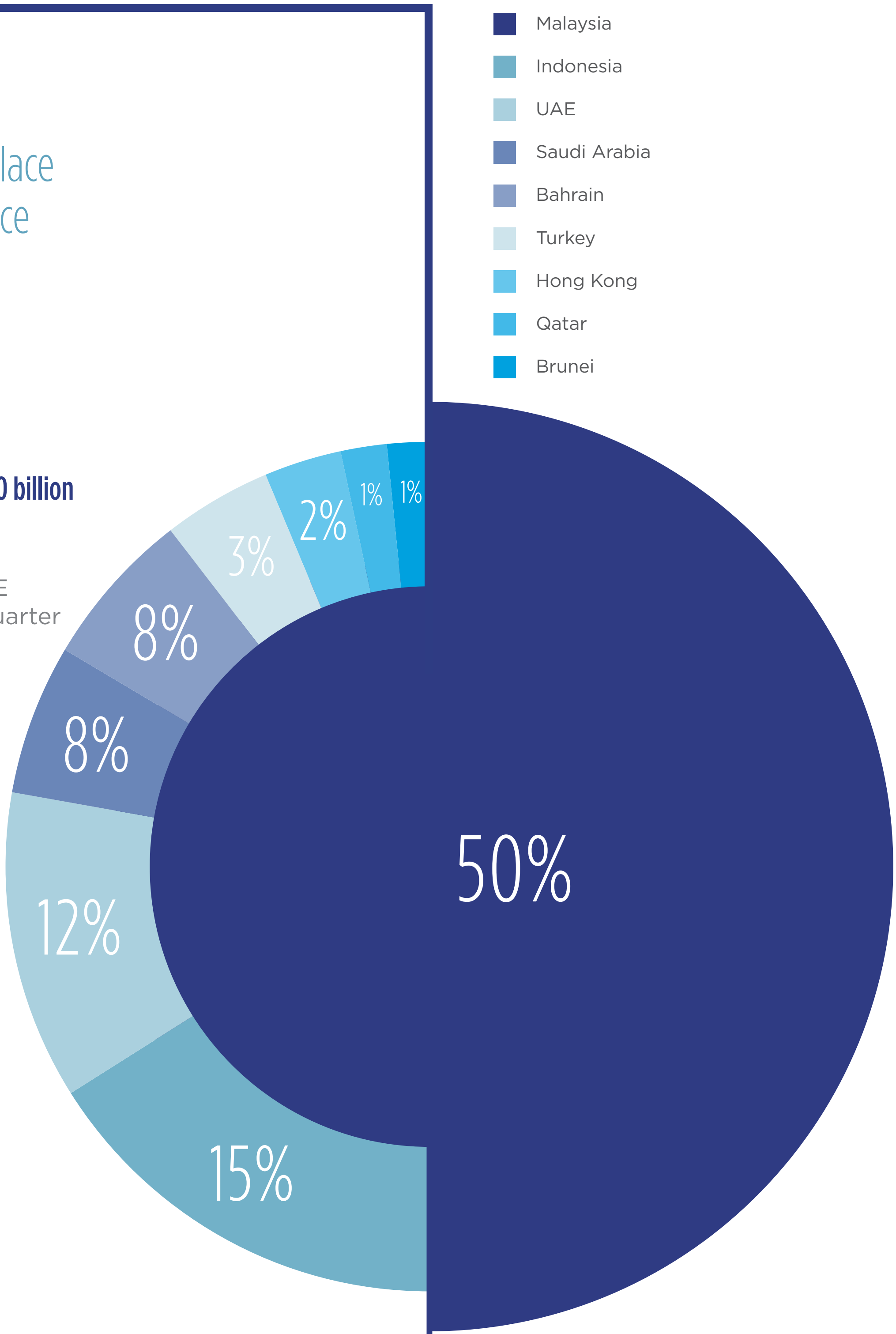
remains a key marketplace for global sukuk issuance in 1H2015 with

49.9%

of total new issuances of USD39.70 billion of the year 1H2015

Malaysia, Indonesia and UAE leading issuances for this quarter

Source: ISRA and Zawya



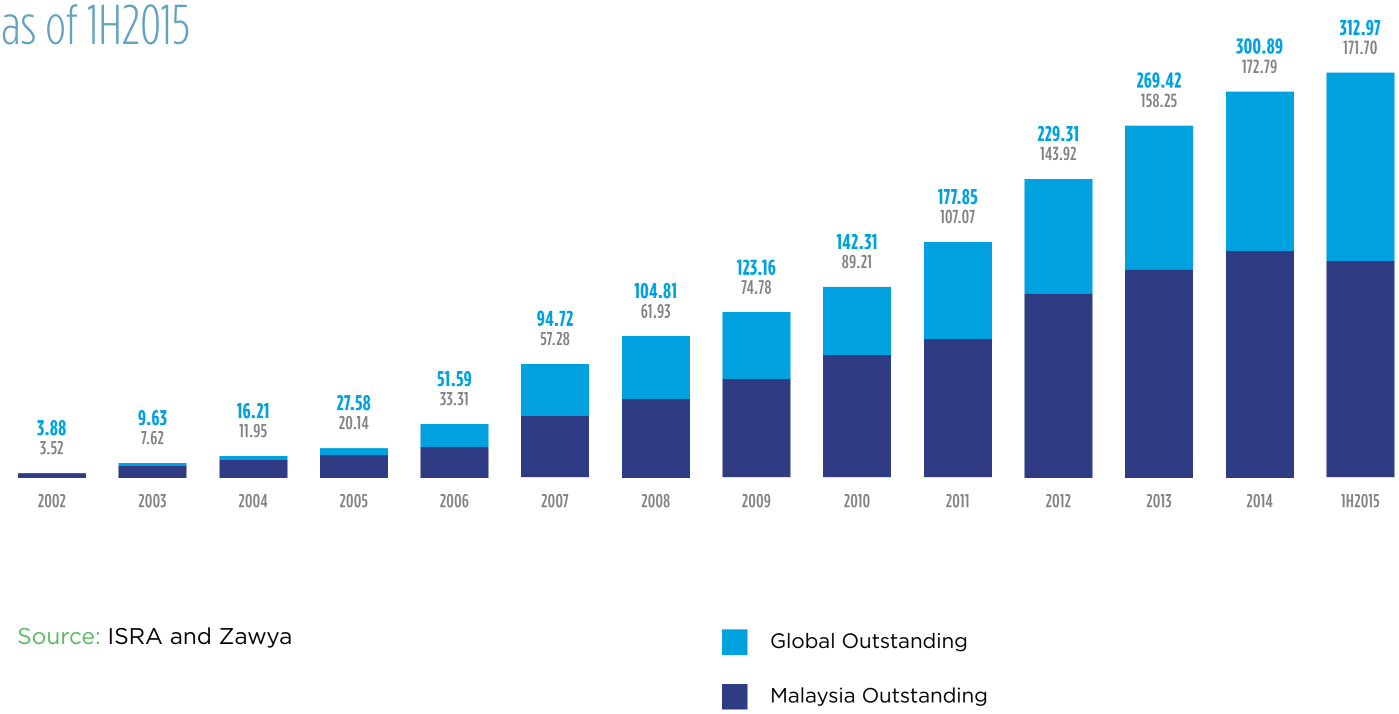
Source: Zawya

GLOBAL SUKUK OUTSTANDING
BY COUNTRY in 1H2015

MALAYSIA holds

54.9%

of global sukuk market share
as of 1H2015



Source: ISRA and Zawya

Malaysia has led the sukuk issuance and outstanding sukuk tables by a significant margin over the years and by the first half of 2015, Malaysia holds 50% of the global sukuk outstanding market share, bearing testimony to the confidence of the local and international marketplace with respect to the Malaysian capital market environment.

Box Article :
Securities Commission Malaysia SRI Sukuk Guideline

The Securities Commission of Malaysia, in 2014, has revised the Guidelines on sukuk to incorporate new requirements on the issuance of Sustainable and Responsible Investment (SRI) sukuk.

SRI sukuk issuance proceeds will be utilised for the purpose of funding eligible SRI projects that aim to :

a. preserve and protect the environment and natural resources;
b. conserve the use of energy;
c. promote the use of renewable energy;
d. reduce greenhouse gas emission; or
e. improve the quality of life for the society.

Only a project or physical assets/activities relating to an existing project in any of the following sectors is deemed to be an Eligible SRI project:

(a) Natural resources

projects relating to:

i. sustainable land use;
ii. sustainable forestry and agriculture;
iii. biodiversity conservation;
iv. remediation and redevelopment of polluted or contaminated sites;
v. water infrastructure, treatment and recycling; or
vi. sustainable waste management projects,

(b) Renewable energy and energy efficiency

projects relating to:

i. new or existing renewable energy (solar, wind, hydro, biomass, geothermal and tidal);
ii. efficient power generation and transmission systems;
iii. energy efficiency which results in the reduction of greenhouse gas emissions or energy consumption per unit output,

(c) Community and economic development

projects relating to:

i. public hospital/medical services;
ii. public educational services;
iii. community services;
iv. urban revitalization;
v. sustainable building projects; or
vi. affordable housing; or

(d) Waqf properties/ assets

any projects that undertake the development of waqf properties/ assets.

Disclosure requirements

An issuer is obliged to disclose via prospectus or other disclosure documents:
(a) details of the Eligible SRI project and, to the extent possible, impact objectives from the Eligible SRI project; and
(b) a statement that the issuer has complied with the relevant environmental, social and governance standards or recognised best practices relating to the Eligible SRI project.

Appointment of an independent expert

If the SRI sukuk is issued or offered to sophisticated investors, the issuer has the option whether or not to appoint an independent expert to undertake an assessment of the Eligible SRI project. However, if the SRI sukuk is issued or offered to retail investors, it is a requirement under the guidelines for the issuer to appoint an independent expert to undertake an assessment of the Eligible SRI project.

Reporting to investors

The issuer or the obligor (if the issuer is an SPV) must provide annual reporting, via newsletters, website updates, annual report or any other communication channels, to investors on the following:
(a) The original amount earmarked for the Eligible SRI project;
(b) The amount utilised for the Eligible SRI project;
(c) The unutilised amount and where such unutilised amount is placed or invested pending utilisation; and
(d) Where feasible and to the extent possible, the impact objectives from the Eligible SRI project.

3 Waqf (Endowments)

Another structure contributing to the SRI objectives of community development and empowerment is the waqf (endowment) system that has prominence in the history of the Turkish region. This method has been used to expedite poverty alleviation because of the flexibility it allows in the distribution of the waqf's potential benefits to the poor.[16]

The accumulated funds for the establishment of a waqf project could be realised through a number of instruments, for example:

i. Cash and E-Waqf Fund,
ii. Per-square Feet Value Certificate, and
iii. Sukuk issuance.

These instruments provide an opportunity for the philanthropic investors to dedicate their wealth to perpetual returns that continually benefit the communities the endowment has been designed to serve whilst in accordance with investor preference, for example:

The cash and e-waqf fund is considered the simplest for public participation as they have the option to donate relatively small amounts of money via cash or electronic transfer (through an e-waqf facility).

1

The waqf share model is another option that results in a public waqf after waqf shares are purchased in particular projects that contribute to social welfare. These are practiced in Malaysia, Indonesia, Sudan and Kuwait.

2

The corporate cash-waqf model is a company trust model that also creates a public waqf, also practiced in Malaysia, Pakistan and South Africa.

3

The waqf mutual fund model is a combined waqf investment trust structure the practice of which has been lauded in Indonesia.

4

The Wakalah (agency) with waqf fund model is a public waqf used primarily as Islamic insurance funds that benefit only those that contribute to it. This has been practiced for over a decade in Takaful (Islamic Insurance) companies in Pakistan, South Africa and Malaysia.

5

[17] Rahman, 2013

02

The Malaysian Option

A background to Malaysian Islamic Finance Regulation

Over the last decade Malaysia has made significant strides in implementing measures that have made it a leading example for conventional and Islamic finance globally.

Malaysia has been at the forefront of facilitating and establishing the necessary legal, supervisory and practical frameworks for an unprecedented drive towards a vibrant and capable SRI industry. Most importantly, Bank Negara Malaysia (BNM), the Securities Commission of Malaysia (SC) and Bursa Malaysia have adopted this approach with a focus both on domestic stability and international reach to all entities that intend sharing in the Malaysian success story.

1983	1993	2001	2010	2011 & beyond

Phase 1

Building foundation of legal, regulatory & Shariah framewotk

Instituting foundations of Islamic finance

- Islamic Banking Act 1983
- Takaful Act 1984
- Government Funding Act 1983
- 1st Islamic Bank
- 1st Takaful Company

Phase 2

Increase number of players, develop financial markets & harmonise Shariah interpretation

Instituting building, stimulate competition, activity generation & market vibrancy

- Islamic windows
- 2nd Islamic bank
- 2nd takaful company
- Islamic money market
- Shariah Advisory Council at BNM

Phase 3

Market liberalisation, upgrading infrastructures, strengthen overall Islamic finance landscape

Visioning, comprehensive & international integration

- Financial Sector Masterplan (FSMP): 10-year roadmap
- Foreign Islamic banks
- Islamic subsidiaries
- New takaful & retakaful licences
- Tax neutrality policy
- IBFIM, SIDC, INCEIF & ISRA
- Central Bank of Malaysia Act 2009
- Malaysia International Islamic Financial Centre (MIFC)

Phase 4

Increase diversity of players & instruments, enhance dynamics of the financial markets, enhance financial linkages with other jurisdictions

Enhanced internationalisation of Islamic finance

- Financial Sector Blueprint - internationalisation of Islamic finance
- Islamic Financial Services Act

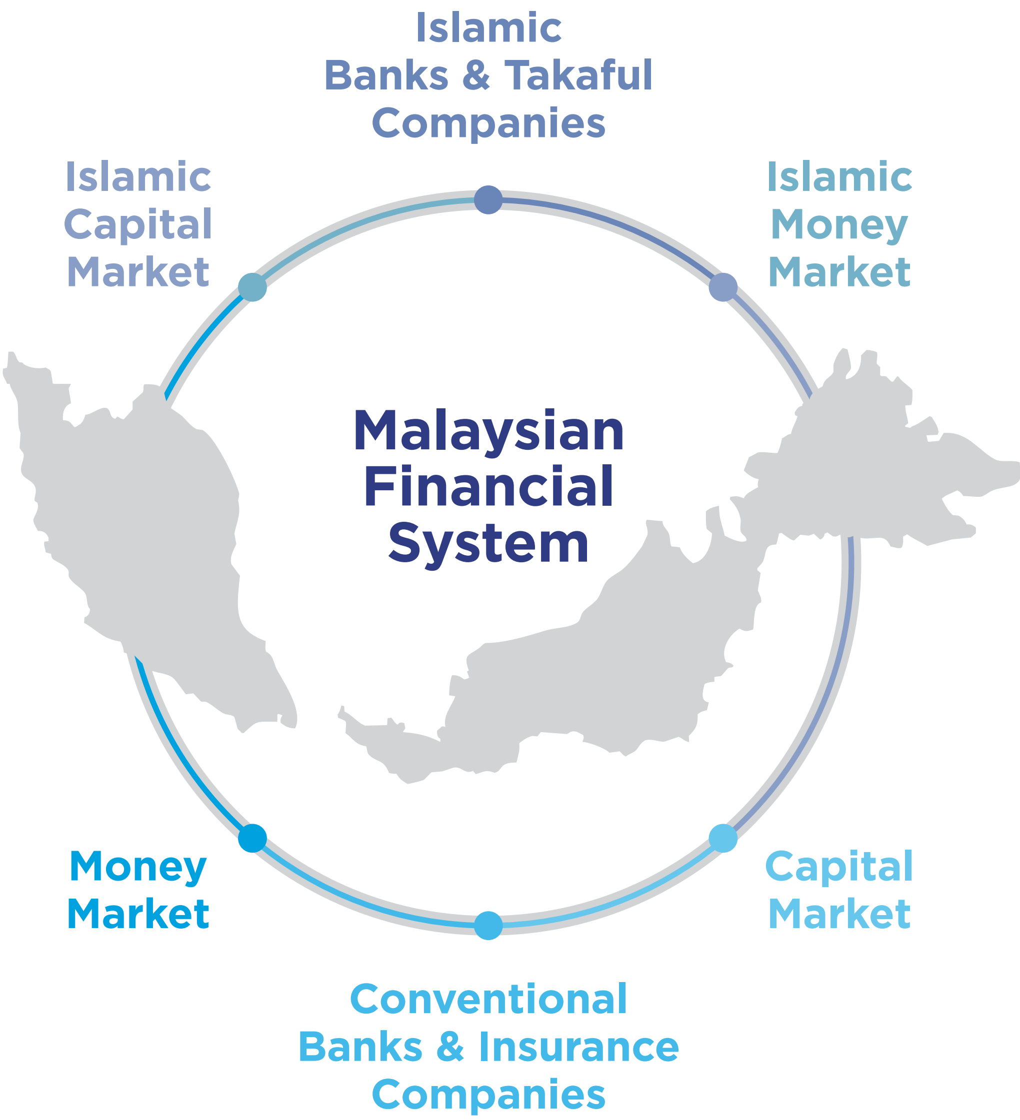
This story formally began in 1983 with the establishment of legal and regulatory frameworks that resulted in the first SRI-centric financial institution (Bank Islam Bhd) and the first cooperative insurance company in the country. In the period between 1993 and 2001, the number of participants in the industry increased by allowing an additional cooperative insurance company and a new Islamic financial institution while permitting conventional and existing players to participate in the new domain through operational windows. BNM once again played a critical and pivotal role in managing this revolutionary period in a gradual and sound manner, allowing fairness to all stakeholders involved. BNM and Securities Commission Malaysia both established an advisory board (SAC) to promulgate and oversee new guidelines. This board ensures both comprehensive and standardised systems to be applied within strict supervisory criteria that have enhanced the stability and image of the Malaysian dual-banking system.

In 2001, Malaysia announced its 10-year vision for the liberalization of its financial markets and the enhancement of its infrastructures. This included several strategic steps such as the financial sector master plan for the decade ahead, allowing the entry of foreign banks into the financial industry, adding new local players, a tax neutrality policy and the Central Bank of Malaysia Act of 2009. In addition, BNM undertook a bold and visionary move by launching a global university for learning (INCEIF) and the BNP-Paribas sponsored Centre for Wealth Management at INCEIF that is dedicated to applied research in the field of Islamic wealth management and SRI-centric fundamentals.

Since 2010, BNM has been working on expanding the efforts of preceding years while improving existing systems and weeding out inefficiencies and closing loopholes. The results have spoken for themselves in terms of institutions, practitioners, scholars and students from across the world flocking to Malaysia seeking opportunities, growth and knowledge. INCEIF and ISRA have become flagship institutions in their respective rights and have become part and parcel of the industry as incubators and think-tanks. Central banks from Africa and the Middle East have realised the status of Malaysia and the uniqueness of BNM's role in offering innovative financial solutions such as SRIs and more.

Malaysia as a hub for innovation

Innovative commodity trading platforms, payment and clearing infrastructures as well as partnerships with the leading rating agencies have added to Malaysia's position and credibility, all within a dual-banking offering. Transparent, efficient dispute resolution systems add confidence to a proven and growing financial sector in Malaysia. At the same time, the finance and investment industry has become diversified as a result of all the initiatives of previous decades, resulting in a number of financial institutions, domestic and international, operating in Malaysia. At this juncture, an array of supporting and complementary industries such as legal firms, trust companies, research companies and financial intermediaries have developed.



ICD-THOMSON REUTERS ISLAMIC FINANCE DEVELOPMENT INDICATOR

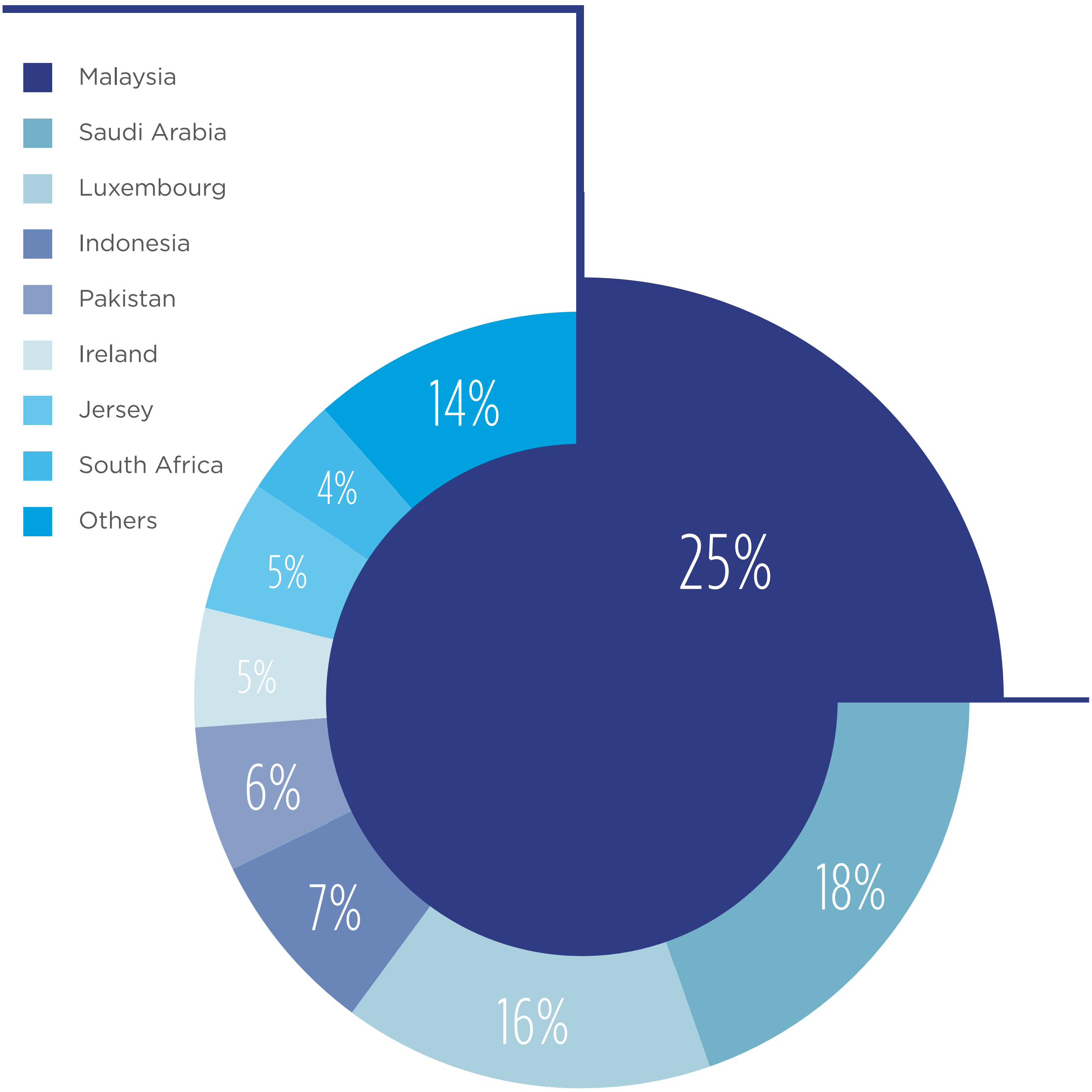
FOR SELECTED COUNTRIES

Malaysia leads in a recent study by Thomson Reuters[18] and is considered the most developed Islamic economy ecosystem by a significant margin, topping 4 out of 6 sub-sectors.[19] Out of a total of 70 countries evaluated using 49 metrics, Malaysia led the study as the most advanced and comprehensively regulated Islamic economy to be considered an example for countries intending to achieve the stability and success in the field.[20]

[18] Islamic finance development Indicator
[19] Global Islamic Economic Indicator
[20] 2014-2015 Report, State of the Global Islamic Economy. Published by Thomson Reuters

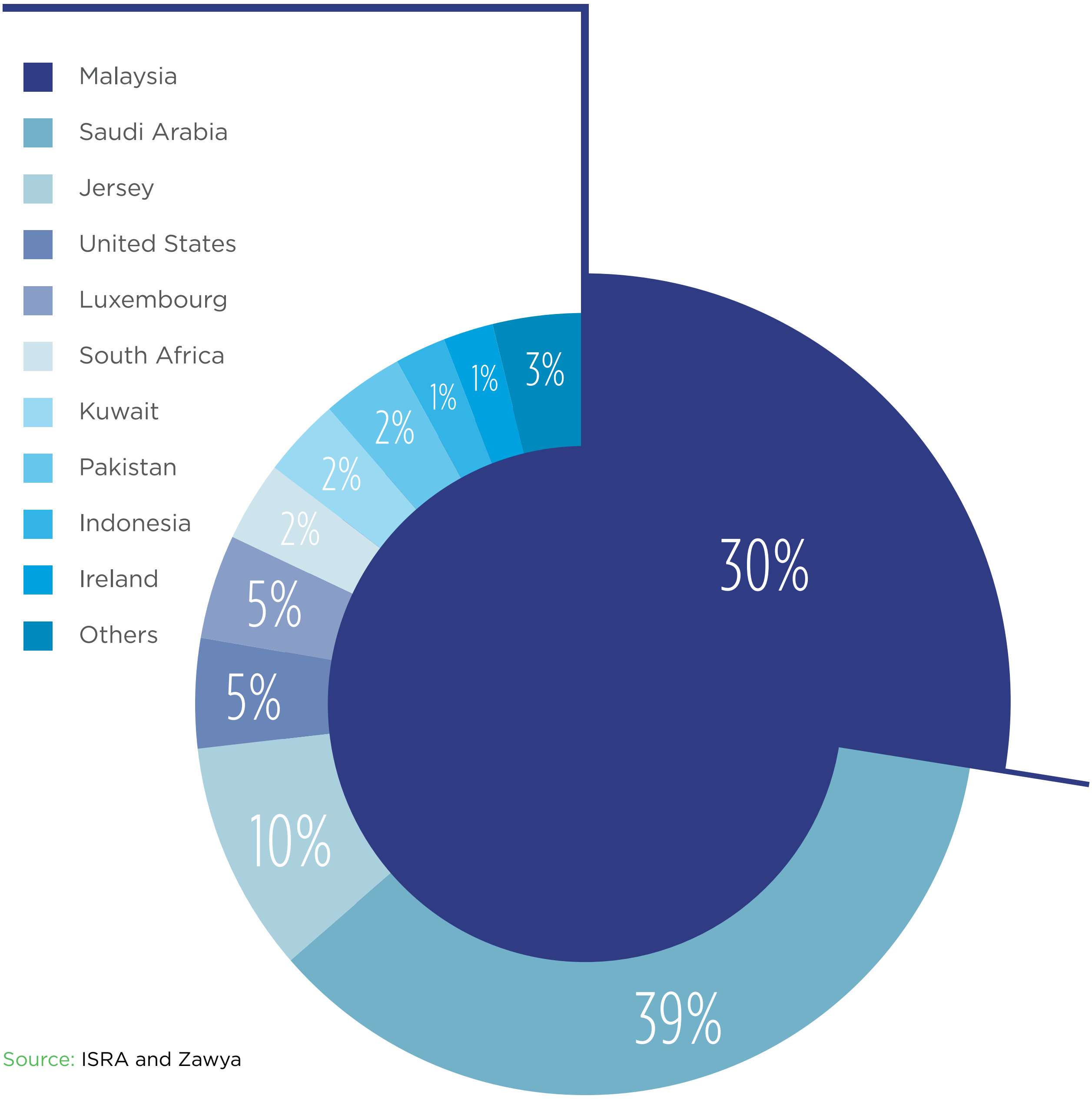
Malaysia's Fund Management Proposition

ISLAMIC FUND ASSETS
BY DOMICILE



Source: ISRA and Zawya

ISLAMIC FUNDS INDUSTRY
ASSETS UNDER MANAGEMENT



Source: ISRA and Zawya

Malaysia has a well-developed Islamic fund industry boasting the highest number of Islamic funds globally. With 299 Islamic funds (30% of global funds)[21], Malaysia leads the next most prolific country[22] by a siginificant margin (7%). However, Malaysia trails one of the wealthiest countries in the world, Saudi Arabia, to be in second place when considering assets under management by the end of June 2015 with approximately USD27.3 billion under management.

[21] KFH Research
[22] KFH Research

The Malaysian Islamic Finance Sector

	01 Sukuk	02 Islamic Banking	03 Takaful	04 Islamic Fund Management
International Achievements	**World largest** • 59%[1] of global outstanding sukuk • 4 Malaysian FIs are in the Top 10 global sukuk league table	**World 2nd largest** • 8%[3] of global Islamic banking asset	**World 2nd largest** • Malaysia and Saudi Arabia contribute 44%[5] of total gross takaful contributuions	**World 2nd largest** • 25%[7] of global Islamic assets under management (AUM)
Domestic Achievements	• 51%[2] of total outstanding domestic bond market	• 25%[4] of domestic banking asset	• 14%[6] of domestic insurance and takaful contributuions	• 17%[8] of domestic AUM

Source: 1, 2) BNM, SC 3) Global Islamic Banking Excellence Centre EY 4, 6) BNM 5) World Islamic Insurance Directory, EY, KFH Research 7) Bloomberg, KFHR 8) SC

Given Malaysia's success in Islamic finance at both the global and domestic level, it is well positioned to be the destination for investment opportunities within the region. Many viable economic institutions are driven by profit incentives but in the case of entities engaged in SRI, profitability and bottom lines are not their only priorities. They seek to positively impact the world in a sustainable way. Accordingly, organizations that hold SRI principles high on their agendas can legitimately embrace the SRI initiative by the Securities Commission Malaysia.

The principles and objectives of the SRI initiative by Securities Commission Malaysia[23] embed standards of "substance" where ethical and social values are incorporated in the structuring of products. This ensures an inclusive industry that actively seeks to bring into the economic fold all members of society that would normally have been excluded from any opportunities to succeed and grow. The Securities Commission Malaysia's SRI initiative thrives in the well-being of society at large as a sacred and ultimate goal. As a consequence, ethical values as defined by the Securities Commission Malaysia standards play a significant role in reducing risk without recourse to costly processes or management.

Islamic funds on an institutional level aims to bring together like-minded investment bodies who share the higher and noble intentions of Bank Negara Malaysia and the Securities Commission Malaysia to offer ethical values in providing financial solutions to support sustainable social changes that benefit communities and societies in a global market generally driven by profit maximization.

The central economic tenet of such ethical social investment is to develop a prosperous and just economic structure in which all members of society irrespective of race, beliefs or religious affiliations could maximise their wealth whilst contributing to the wholesome development of society. It is therefore evident that Islamic funds appeal to investors seeking new and alternative SRI investments.

[23] Securities Commission of Malaysia's SRI initiatives emphasize the importance of environmental risk, social and corporate governance

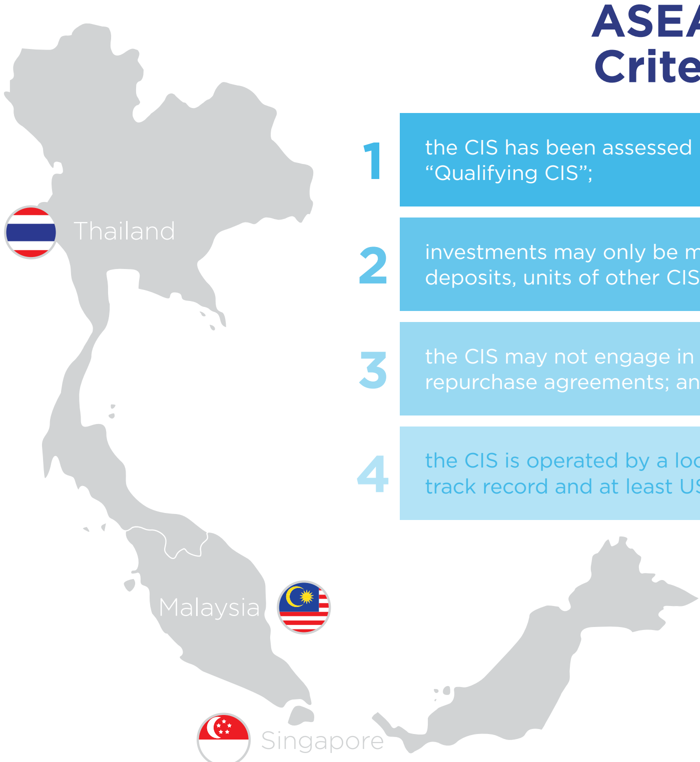
Malaysian Institutional Investors
Creating Strong Buy-Side

The Malaysian institutional investors are amongst the largest in the world, with almost a third of their portfolio invested in instruments that comply with Islamic tenets.[24]

Malaysian institutional investors such as Employees' Provident Fund, Retirement Fund Incorporated, Permodalan Nasional Berhad, Hajj Pilgrims Fund Board have invested in Islamic Shariah-compliant funds as demand from contributors are increasing for Shariah compliant investment. Malaysia's strong buy-side demands are expected to enhance following the new initiative by the ASEAN Economic Community, under the ASEAN Collective Investment Scheme (CIS) Framework launched in 2014.

ASEAN Fund 'Passportability'

Malaysia has most recently been involved in a framework for the "ASEAN CIS".[25] The ASEAN CIS Framework was launched on the 25th of August 2014, engaging three initial jurisdictions – Singapore, Thailand and Malaysia –as part of the establishment of the ASEAN Economic Community. The framework creates a harmonious flow of investment funds between the signatories and, through qualifying criteria, makes the 'passport' or movement of funds more streamlined. It also brings forth diverse investment opportunities for the signatories and increases their competitive strength in the regional sphere. The new framework also encourages regional economic development through cross-border investments and efficient time-to-market.



ASEAN CIS Qualifying Criteria are as follows:

1. the CIS has been assessed by the relevant local regulator as being suitable as a "Qualifying CIS";
2. investments may only be made in transferable securities, money market instruments, deposits, units of other CIS and financial derivatives;
3. the CIS may not engage in certain specified activities, such as securities lending or repurchase agreements; and
4. the CIS is operated by a locally licensed CIS operator (that has a minimum five-year track record and at least USD500 million under management globally).

[24] Reported as the 6th largest in the world in 2014 by Reuters Report :
Malaysia's EPF mulls standalone Islamic pension fund –sources, March 6, 2014, Al-Zaquan Amer Hamzah.
[25] Association of Southeast Asian Nations

Islamic Funds in Malaysia Offer an Ideal Alternative for SRI Investors

Emerging markets have exhibited strong growth and have the potential for further progress and evolution in the near future. Islamic solutions provide innovative products and options to the market that comply with ethical and SRI principles, a trend that has gained significant momentum, especially after the UNPRI initiative, in the formulation of key principles that have encouraged the market to demand ethical investment.

Malaysia's leading role in the dual-banking approach as well as its global leadership in Islamic finance, banking and capital markets, has made it an amenable environment for secure investment and finance. The formidable regulation for Shariah-compliant investment has made Malaysia a regional hub as it stands strong in its strategy to promote financial inclusion within an ethically bound value system.

Malaysia as a choice for SRI investment makes for the selection of quality-rated instruments within a sound regulatory environment that has the added advantage of fund passportability within the region. Islamic investment funds offered by Malaysian asset managers become an obvious choice for those in search of socially responsible, ethically sound and tailor-made investments promoted within a high level of compliance and governance.

This SRI booklet provides an informative summary of the salient features of SRI's and other ethically bound investments in the global markets, that not only provide alternatives for investors but also present evidence of at least par performance with conventional investments of equal risks. It helps to explain the commonalities of this niche investment class of assets comprising of SRI investments, ESG investments and Shariah-compliant investments vis-a-vis the conventional investments of equal risks. This booklet provides potential investors interested in this niche class of investments a broad overview and yet an informative introduction to these investments.

About Malaysia's Islamic Finance Marketplace

Since its introduction more than 30 years ago, Islamic finance in Malaysia has developed into a comprehensive and sophisticated Islamic finance marketplace. The marketplace is characterised by a robust regulatory, supervisory, Shariah and legal framework, a deep primary market and active secondary sukuk market, diverse players and talent base with global capabilities and connectivity for business deals anywhere in the world, product innovation, breadth and depth and an efficient system for multi-currency clearing and settlement. Malaysia's Islamic finance marketplace is open to global industry players and market participants to collaborate with and mutually benefit from a highly conducive business environment of innovation, expertise and deal flow.

Our marketplace is a comprehensive Islamic finance ecosystem and business environment of infrastructure, innovation, expertise and deal flow, served by the Malaysia International Islamic Financial Centre (MIFC) Community, comprising the financial institutions, professional firms, regulators and government agencies.

For more information on Malaysia's Islamic finance marketplace, please visit www.mifc.com, follow us @MalaysiaIF and download MYIF app at Apple Store and Google Play

BNP Paribas – INCEIF Centre for Islamic Wealth Management (CIWM)

The Centre for Islamic Wealth Management (CIWM) is a joint initiative between BNP Paribas Malaysia and the International Centre for Education in Islamic Finance (INCEIF) - The Global University of Islamic Finance. It is dedicated to support the growth of the global Islamic wealth management industry with the key objectives of furthering education, industry innovation and policy development.

To achieve its objectives, CIWM conducts workshops, conferences, and public lectures in the areas of Islamic wealth management that covers aspects of wealth generation, accumulation, protection, purification and distribution. CIWM aims to be a catalyst of innovation in the nascent area of Islamic wealth management by sharing and enhancing knowledge and know-how of practitioners, investors, academics and Shari'ah scholars. The Centre also supports applied research initiatives in specialised areas of Islamic wealth management to address operational and strategic challenges in this fast growing global industry.

To encourage and develop interest in Islamic Finance, CIWM offers **three (3)** PhD scholarships annually for bright and excelling recipients from all over the world.

For INCEIF, this significant collaboration with a bank of global repute in the area of wealth management and a strong local presence augurs well for its quest to be the knowledge leader in Islamic finance and subsequently, contribute towards the development of this niche sector of the economy.

For more information, go to www.inceif.org → Industry Services → Centre for Islamic Wealth Management