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COVER STORY

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ISFI Dialogues: Experts outline way forward for Islamic sustainable finance



The collapse of Silicon Valley Bank, which has triggered a worrying string of bank failures, revealing our deeply flawed global financial system, loomed over discussions at the inaugural Islamic Sustainable Finance & Investment (ISFI) Dialogues in Dubai on the 16th March. From the role of regulators and policies to managing investment risks, VINEETA TAN rounds up what industry leaders and market experts believe are necessary to build a sustainable financial ecosystem rooted in people, planet and prosperity.

Industry needs direction

Generally speaking, the industry is at a loss when it comes to sustainable finance, and this is true in the Islamic sphere as well.

The cacophony of policy talks, expectations,

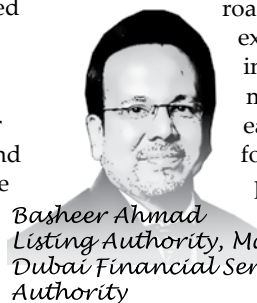


parameters and aspirations has led to confusion, and many times, frustration.

"There is not enough direction or alignment in terms of the rules and regulations that are out there. The private sector is confused. Where do we begin? What do we address? There are too many demands out there. Which one should we focus on?" lamented one senior practitioner at one of the two dialogues, which adopted Chatham House rules, hence the anonymity.

Participants of both sessions unanimously agreed that there must be transparent, predictable and consistent regulations that set the right channels and incentives to encourage private companies to invest in the new climate economy.

"This can be done by defining green strategies, sustainability



roadmaps, and by providing examples of positive green investments, or even by some monetary policy tools such as easing reserve requirements for green lending," said one participant.

Regulators on the table, however, shared that the task ahead is not easy, because sustainability is broad and far-reaching and cannot be applied with a one-size-fits-all approach.

"There are so many different alternatives on the decarbonization paths and we as regulators find it really hard to approach these things," said one.



While the sustainable finance ecosystem in the GCC may not be matured yet, there is a general consensus that the Islamic markets could take a leaf out of Malaysia's book when it comes to Islamic sustainable finance.

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The Southeast Asian Islamic finance powerhouse, a signatory to the Paris Agreement, has been pioneering sustainable Shariah finance instruments such as SRI Sukuk and Waqf funds through related frameworks. The Malaysian government last year issued its National Energy Policy 2022–40 to address the trilemma of energy security, energy affordability and environmental sustainability through 12 strategies and 31 action plans. Market participants and regulators find such clear direction useful in formulating their internal processes, sustainability strategies and policies.



Mike Tirman
Partner, Ice Miller

desired, and so, how can we solve something we cannot measure?

But even some are easier than most. Climate or environmental finance data has the advantage of being quantifiable through science-based approaches. Social impact, however, does not have that luxury.

“A lot of people don’t understand what social risks are. You understand when 22 degrees become 24 degrees, it’s going to feel hotter, you can experience it, so you understand climate risk. But you don’t understand what the impact of a social risk could be,” highlighted one practitioner.

they do not have the capacity internally to develop their own ESG assessment. Unfortunately, existing ESG analyses could be problematic as some focus more on processes rather than outcome or consequences.



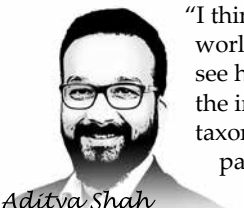
Rizal Mohd Ali
Vice-President, Responsible Investment, Retirement Fund (Incorporated), Malaysia, (KWAP)

For example, tobacco companies are among the highest rated companies on the ESG spectrum despite the obvious health risk they pose. That is because some rating methodologies are anchored by disclosure quality.

“So even if you are actually harming society, but if you have excellent disclosure, you get the best rating,” explained one speaker.

Taxonomies lagging, but crucial

Experts on both dialogues acknowledged the importance of taxonomies, but more needs to be done.



Aditya Shah
Head of Circular Economy Investments, Creek Capital

“I think the rest of the world is waiting to see how and what is the impact of the EU taxonomy,” observed a participant.

Another agreed: “The EU green taxonomy is

great, but much more work needs to be done to implement it across emerging markets. A national sustainable finance taxonomy is extremely useful to provide guidance to the overall financial market.”



Yavar Moini
Senior Investment Officer, International Finance Corporation

Participants believe that taxonomy is crucial to prevent greenwashing and would lead to more structured sustainable products.

Problem with qualitative data

Here is the thing: data has and continues to be an issue. In the absence of proper disclosures, the quality of ESG data leaves much to be



Vineeta Tan
Managing Editor and Director, Islamic Finance news

Be careful of ESG ratings

It is incredibly challenging to measure ESG impact, which is why most companies rely external ESG sco



Husain Alkhaja
GCC Regional Director, DDCAP

“Quantitative numbers or benchmarks across regions and industries are fairly straightforward yet we have been failed again and again”

“We are not good at capturing the ‘S’ of ESG,” echoed another. Mainly because social impact is qualitative. So, while Islamic finance is imbued with social values (Sadaqah, Zakat and Waqf often being singled out as examples of the industry’s social finance DNA), we have not been able to present it well.

This could also apply to companies without any gender diversity on their boards. They could still secure high scores if they are transparent about the fact that they do not have any female representation at board level.



Anita Wieja-Caruba
Associate Director Strategy, Policy and Risk, Dubai Financial Services Authority

“Whether it is Silicon Valley Bank or Credit Suisse, constantly auditors and credit rating agencies have failed us. Quantitative numbers or benchmarks across regions and industries are fairly straightforward yet we have been failed again and again,” bemoaned one pundit. “Then we talk about ESG where there is so much subjectivity and difference in interpretation and priority areas — this will continue to be a very challenging journey and is something that needs adapted as we go from on to region and industry to lusty.”

The anti-ESG threat is real

With such flawed methodologies and ESG

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treatments, it is no surprise that there is so much distrust against the sector, which has been inundated with allegations of greenwashing and social washing.



*Jawaad Chawla
Senior Islamic and
Corporate Finance
Specialist*

These feed into the anti-ESG rhetoric. The anti-ESG movement could perhaps be best encapsulated by the US Senate voting to overturn an ESG rule making it easier for fund managers to consider climate risks when making their investment decisions. Given this particular development in the US is highly political, the anti-ESG narrative elsewhere is nonetheless growing due to a matrix of factors.

“The readiness of stakeholders in this whole journey is different. So, when you impose a similar or common deadline for everyone, you are going to get pushback”

“The readiness of stakeholders in this whole journey is different. So, when you impose a similar or common deadline for everyone, you are going to get pushback because there will be the economics of it and the practicability of it,” opined one expert.



*Maali Qasem Khader
CEO and Founder,
Middle East Institute
of Directors*

There is also the question of priority.

“You have got geopolitical risks — the fallout between

Russia and Ukraine. You have got economic sanctions in play and a host of other factors in play. So, for people looking at ESG, they would also ask themselves: is ESG a priority now?”

And there is no patience.

Sustainability is a long-term game but short-termism is rampant among investors, who are unwilling to wait for long-term products to mature and long-term benefits to materialize.

“One thing we all have to acknowledge is that in today’s world, we are pampered with on-demand responses — you order something, it lands in 30

minutes. I think we have lost, in a way,



*Sharifatul Hanizah Said Ali
Executive Director, Islamic
Capital Market Development,
Securities Commission Malaysia*



*Dr Dalal Aassouli
Assistant Professor
of Islamic Finance,
Hamad Bin Khalifa
University*

the patience to wait. But in sustainability, it is a long-term approach — there are no quick fixes.”

Separate rules — no, thank you

So then, the question is: does the Islamic finance industry need a different set

of regulations, considering its own uniqueness, to drive Shariah compliant sustainable products?

“Islamic financial institutions already have two layers of governance: corporate governance and Shariah governance. To

create a third layer would



*Lo'ai Bataineh
CEO, Ominvest
International
Holding-DIFC*

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perhaps be redundant at this stage,” a speaker posited.

“The bigger Islamic banks can certainly set the standards and take the lead in thinking much more closely about ESG issues”



The distinction between standards for disclosures and standards for the purposes of products aside, one panelist noted the abundance of existing standards and how requiring separate rules for the Islamic finance industry could unnecessarily complicate things further.



Luma Saqqaf
CEO, Ajyal Sustainability Consulting

“Who is going to do it? Which body is going to do it? This creates even more questions and more risk of fragmentation.”

COP28 — a bright spot

Many are looking forward to the 2023 UN Climate Change Conference, or better known as COP28, which the UAE is hosting this year. With the success of Egypt’s COP27, panelists brought excitement to the table over the prospect of another Muslim-majority country hosting the world’s most



Dr. Obaid Saif Al Zaabi
Chairman, Parker Russell Obaid, UAE; former vice-chairman, IOSCO; and former CEO, Securities and Commodities Authority, UAE

consequential climate event — this could open the floodgates to more Islamic sustainable initiatives or opportunities for projects to be financed in a Shariah compliant manner.

“I think COP28 is already successful. It has brought every single one of us, corporates and banks, to understand climate, to start working on it, to start putting together a strategy. We are not there yet by any means, but I think it has been successful from that point of view.”

It is a two-way street

It is hard to do good. To make an environmental-positive change is troublesome. To positively enhance society is difficult.

To deliver ESG impact through finance, both top-down and bottom-up approaches are needed.

Yes, regulators will need to take charge and drive this agenda for the whole banking sector while governments will need to push this for their economies. But financial

institutions also play a vital role.

“The bigger Islamic banks can certainly set the standards and take the lead in thinking much more closely about ESG issues and begin to develop the strategy and culture

that will set the tone for the rest of the industry.”

We may be at different points in our sustainability journey, but as long as we place equal importance on the ESG pillar, the difference in the actual numbers might be tolerable.

“There might not be a time when we all agree on specific targets — for example, investors might have different targets and timelines when it comes to net-zero pledges — but, I think as long as we send a clear signal to the market that the ESG pillars need to be upheld, then I think the progress will be there.”



Aruna Narayanan
Senior Advisor
Sustainability and ESG, The Partnerships Advisory

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