

SUSTAINABLE SUKUK

FINANCING THE FUTURE



WORLD BANK GROUP

**Inclusive Growth & Sustainable Finance
Hub in Malaysia**

M. Rozani Osman

Nov 2021

Why go Sustainable?

Benefits for issuers

- Diversify investor base
- Send a strong pro-active message about mission and values to stakeholders
- Positive reputational impact
- Potential cost reduction and increased operating profits through efficiency gains

Benefits for Investors

- Meet clients needs, requests and satisfy ESG mandates
- Avoid reputational risk
- Reduced climate risk
- Balance risk-adjusted financial returns with sustainability benefits

Terminology

Definitions in used in the sustainable finance market

- **Green** – positive environmental outcome
- **Social** – positive social outcome
- **Sustainability** – positive environmental AND social outcomes
- **Blue** – marine & ocean-based projects with positive environmental outcomes
- **SDG** – aligned with some or all of the Sustainable Development Goals
- **Sustainable and Responsible Investment (SRI)** – green, social, sustainability, SDG
- **Sustainable** – used as a catch-all phrase when referring to any combination of the above

In many circumstances, some of the terminology above are often used interchangeably by issuers, investors, banks, media, etc.

- **Taxonomy** – a scheme of classification of what is eligible (green, social, sustainable, SRI, etc.) such as the **EU Taxonomy** and the **China Green Bond Endorsed Project Catalogue**. There are also principle-based taxonomies such as the **Malaysian Climate Change and Principle-based Taxonomy**.

Sustainable Sukuk: A definition

Thematic/Use-of-Proceeds sukuk

- **Thematic** or **Use-of-Proceeds** sukuk are any type of sukuk instrument where the proceeds will be exclusively applied to finance or re-finance in part or in full new and/or existing eligible projects. The same definition applies for bonds as well.
- These projects may be Green Projects (**green sukuk**), Social Projects (**social sukuk**), a combination of Green and Social Projects (**sustainability sukuk**) or focused on marine and ocean-based projects that have positive environmental and economic benefits (**blue sukuk**). Other variants include **SDG and SRI sukuk**.
- For an issuance to apply the green, social, sustainability or blue label, an issuer must comply with 3 requirements:
 - Assign the issuance proceeds solely for the financing or refinancing of projects that meet the Green, Social, Sustainability or Blue criteria.
 - Declare the issuance to be Green, Social, Sustainability, or Blue (before the issuance)
 - Commit to a level of transparency and reporting on the issuance's use of proceeds
- *A 4th requirement – to obtain a third-party verification or Second Opinion review, is not strictly mandatory but highly recommended as it is expected by investors*

Sustainable Sukuk: A definition

Sustainability-linked sukuk

- **Sustainability-linked sukuk** are any type of sukuk instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined Sustainability/ESG objectives. These objectives are measured through **Key Performance Indicators (KPIs)** and assessed against **Sustainability Performance Targets (SPTs)**. The same definition applies for sustainability-linked bonds as well.
- Sustainability-linked sukuk differ from use-of-proceeds sukuk by not having any restrictions on how the proceeds can be used.
- For an issuance to apply the sustainability-linked label, an issuer must comply with 5 requirements:
 - Selection of KPIs
 - Calibration on Sustainability Performance Targets (SPTs)
 - Sukuk characteristics – financial or structural characteristics can vary depending on whether the KPIs meet the SPTs (or not).
 - Regular reporting
 - Post issuance verification by an independent external party
- *A 6th requirement – to obtain a third-party verification or Second Opinion review, is not strictly mandatory but highly recommended as it is expected by investors*

Standards

Global

International Capital Markets Association (ICMA)

- [Green Bond Principles \(GBP\) 2021](#)
- [Social Bond Principles \(SBP\) 2021](#)
- [Sustainability Bond Guidelines \(SBG\) 2021](#)
- [Sustainability-Linked Bond Principles \(SLBP\) 2020](#)



Green Bond Principles

Voluntary Process Guidelines for Issuing Green Bonds
June 2021



Social Bond Principles

Voluntary Process Guidelines for Issuing Social Bonds
June 2021



Sustainability Bond Guidelines

June 2021



Sustainability-Linked Bond Principles

Voluntary Process Guidelines
June 2020



Standards

Regional



European Green Bond Standard (EUGBS) – under development

- Proposed regulation on voluntary EUGBS – July 2021



ASEAN Green, Social, and Sustainability Bond Standards – launched 2017

- **ASEAN Green Bond Standards**
- **ASEAN Social Bond Standards**
- **ASEAN Sustainability Bond Standards**

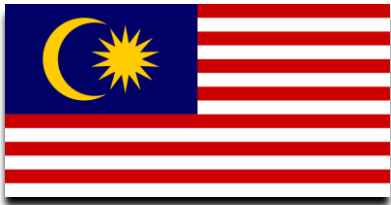
Standards

National



Brazil – Brazilian Federation of Banks (FEBRABAN), Brazilian Business Council for Sustainable Development (CEBDS)

- **Guidelines for Issuing Green Bonds in Brazil** – launched 2016



Malaysia – Securities Commission

- **Sustainable and Responsible Investment Sukuk Framework**

Compliance with Standards

- **Complying with more than one standard**
 - With most standards being aligned with the ICMA, it is possible for a sustainable sukuk to comply with more than one standard
 - PNB Merdeka Ventures green sukuk issued in Dec 2017 (ICMA Green Bond Principles, ASEAN Green Bond Standards and Malaysia's SRI Sukuk Guidelines)
- **What happens if a use-of-proceeds sukuk/bond loses its “sustainable” status?**
 - This could potentially happen if the proceeds from the issuance are used for an ineligible purpose instead of the original stated purpose
 - Generally, there are no specific regulations that cover a situation where a sustainable bond might lose its “sustainable” status
 - The expected negative impact to an issuer's reputation and future financing plans are seen as an effective deterrent
 - Many bonds, most sukuk and single-project bond issuances have financial covenants restricting the use of issuance proceeds, and a breach of these covenants could result in an Event of Default for the bond – this is a normal practice for such bonds, and not specific to “sustainable” issuances
 - Indonesia's Green Bond Regulations requires a mandatory buy-back of the bonds by the issuer if the bonds lose their “green” status

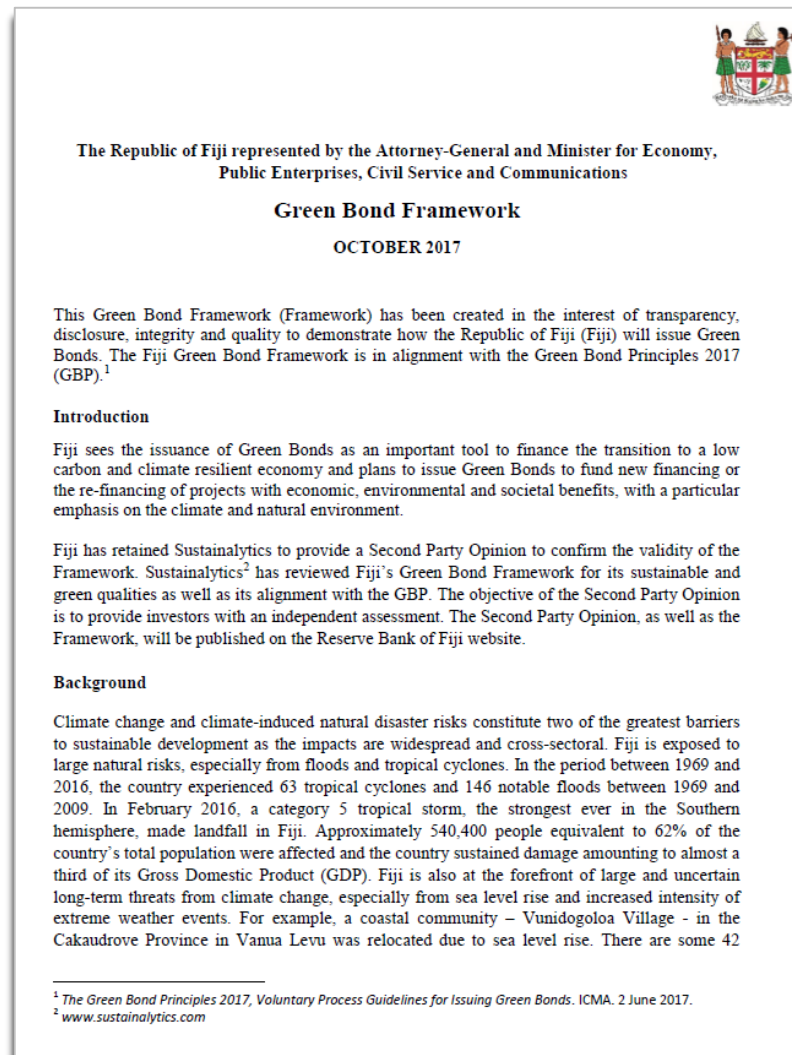
Framework

Green, Social, Sustainability, etc

Describes how the Issuer intends to use the proceeds of the sustainable issuance, for eligible projects in a sustainable manner with appropriate transparency and disclosures to investors

This usually includes:

- Use of proceeds
- How are the proceeds managed prior to investment?
- What are “Eligible Projects”
- How are the “Eligible Projects” selected and evaluated?
- Reporting by the Issuer to the Investors on:
 - Use and management of proceeds
 - Environmental or social benefits achieved



External Review or Second Opinion

Mostly voluntary, sometimes mandatory, highly recommended

External Review

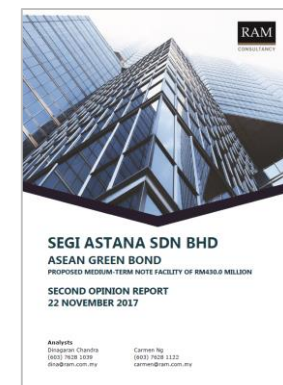
- More commonly referred to as a Second Opinion
- A report by an independent expert assessing the green bond issuance with regard to its alignment with applicable green standards or guidelines, such as the Green Bond Principles, the Climate Bonds Standard, the ASEAN Green Bond Standards, etc.
- Some Second Opinions also provide a sustainability rating with a quantitative indication of the analysis (such as CICERO's Shades of Green)

External reviewers include non-profit and for-profit organizations:

- CICERO, Sustainalytics, KPMG, Deloitte, Moody's, S&P, Oekom, RAM Consultancy, MARC, etc.
- Guidelines and quality control systems for green bond certifiers in China

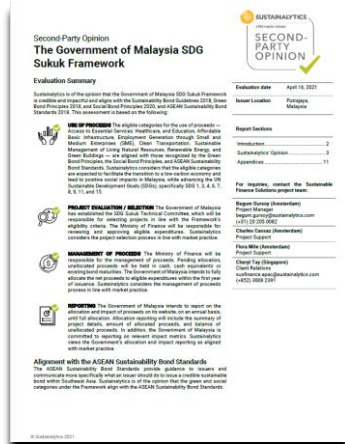
Domestic vs International

- A domestic reviewer would know the local regulatory, business and environmental situation better but may lack the international reputation if the domestic green bond market is new or just beginning to grow
- An international reviewer would likely have a well-regarded reputation globally but could be less familiar with the local situation



Frameworks and Second Opinions

Framework verification by independent 3rd parties

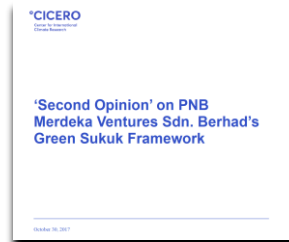


Malaysia

- SDG Sukuk Framework

Sustainalytics

- Second Party Opinion



PNB Merdeka Ventures

- Green Sukuk Framework

Cicero

- Second Opinion



Indonesia

- Green Bond and Green Sukuk Framework

Cicero

- Second Opinion



Majid Al Futtaim

- Green Finance Framework

Sustainalytics

- Second Party Opinion



SME Bank

- Sustainability Sukuk Framework

MARC

- Sustainability Sukuk Assessment

Sustainable Investors

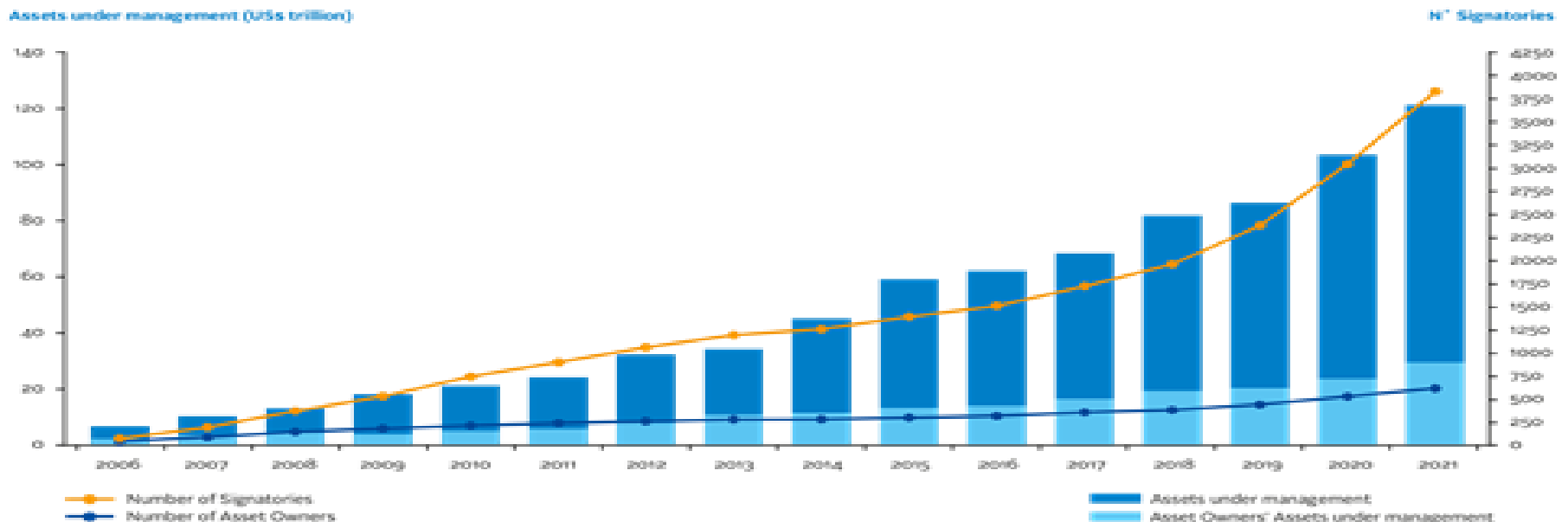
Investors are increasingly including sustainable investments in their portfolio

Who?

- ESG/SRI/Sustainable Investors
- Usually, the same investors as for other non-sustainable instruments
 - Pension funds
 - Asset managers
 - Insurance funds
 - Sovereign Wealth Funds
 - Corporates
 - Banks

Why?

- Positive reputational boost
- Demand from stakeholders
- Higher returns from ESG investments



Issuance, Demand and Pricing

“Greenium” – green premium

Green and Sustainability issuances are increasingly showing high demand and sometimes premiums versus traditional issuances:

- **Malaysia** April 2021 USD 800m sustainability sukuk
 - 6.4x oversubscribed
 - Lowest ever spread vs US Treasuries
- **Germany** May 2021 EUR 6bn green bond
 - 6.5x oversubscribed
 - 2bp premium
- **Colombia** Sept 2021 COP 750bn (USD 196m) green bond
 - 4.6x oversubscribed
 - 7bp premium estimated
- **Spain** Sept 2021 EUR 5bn green bond
 - 12x oversubscribed
- **United Kingdom** Sept 2021 GBP 10bn green bond
 - 10x oversubscribed
 - 2.5bp premium estimated

Caveat: *Pricing of sukuk and bond issuances are driven by issuer credit risk, investor demand, market sentiments and many other factors independent of the issuance’s sustainable credentials.*

Impact Reporting

Post-issuance report

What is it and why is it important?

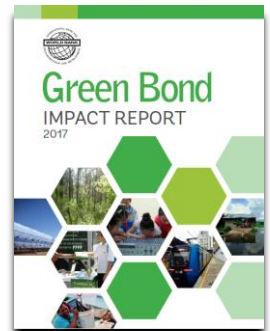
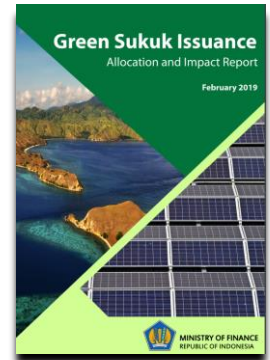
- An impact report provides some transparency to the underlying projects that the issuance had financed, and it assures investors that the proceeds of the issuance has been used appropriately

What is reported?

- It is suggested that issuers aim to report on at least a limited number of core indicators for projects included in their green bond programs.

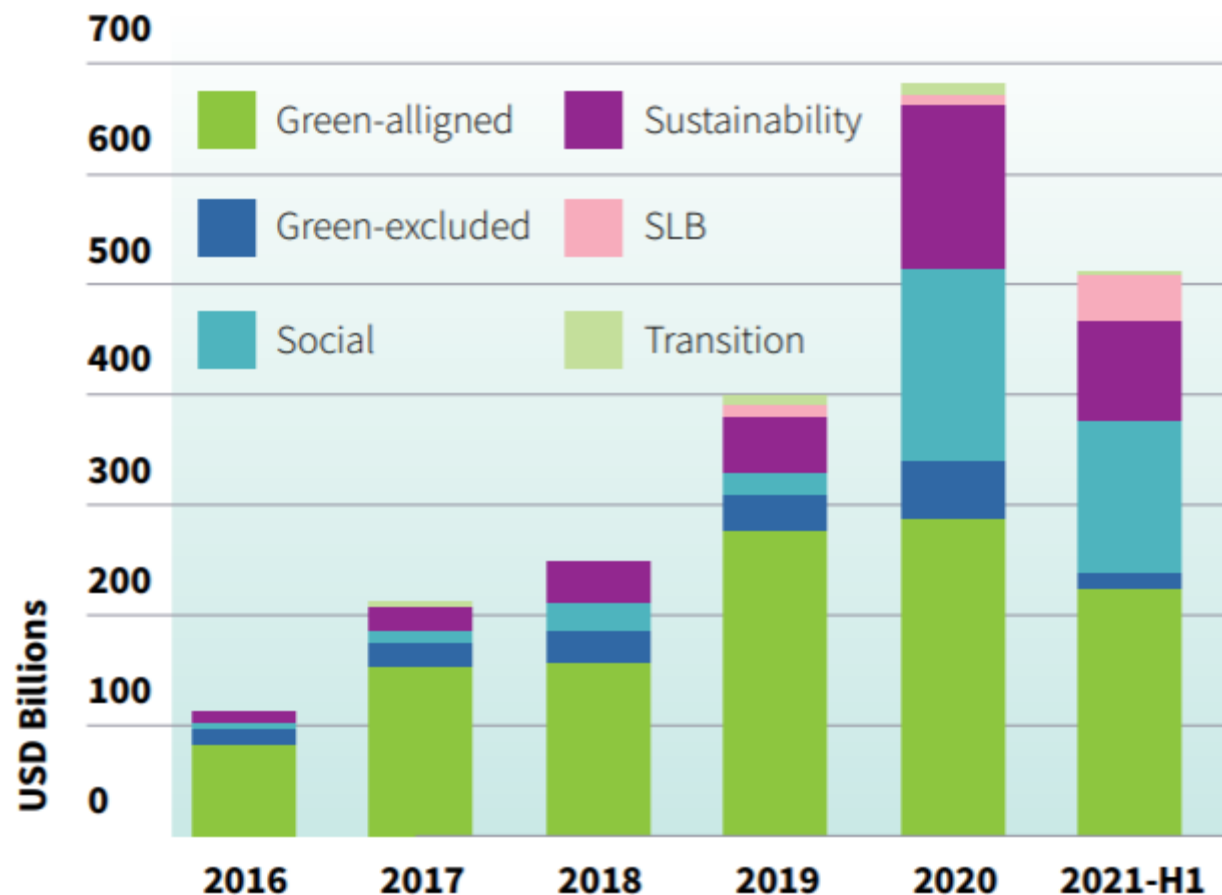
Examples:

- [Indonesia Green Sukuk Allocation and Impact Report](#) – May 2021
- [Majid Al Futtaim Green Sukuk Report](#) – June 2021
- [World Bank Sustainable Development Bonds & Green Bonds Impact Report](#) – 2020
- [IFC Green Bond Impact Report](#) – 2020
- [Islamic Development Bank Annual Impact Report](#) - 2020
- [Apple Annual Green Bond Impact Report](#) – 2020
- [Alphabet Sustainability Bond Impact Report](#) - 2021



Growth of the Sustainable Bond Market

Labelled issuance: Five-year growth



Growth in Social bonds rose dramatically in 2020 due to pandemic response

Sustainability-linked bonds (SLB) growing in popularity

Sovereign Sustainable Bond issuance has grown rapidly

(includes Green, Blue, Social and Sustainability issuances)

Type	Developed Markets		Emerging Markets	
Green	France	Belgium	Poland	Egypt
	Ireland	Netherlands	Fiji	Ghana
	HK, China	Sweden	Nigeria	Indonesia
	Germany	Italy	Lithuania	Chile
	UK	Spain	Hungary	Colombia
Blue			Seychelles	
Social			Guatemala	Ecuador
Sustainability	Luxembourg	South Korea	Thailand	Mexico
			Malaysia	

CBI expects global green bond issuance to exceed USD500bn in 2021

Sovereign green bond issuance has exceeded USD150bn cumulatively

Social bond issuance is fastest growing sustainable bond segment due to pandemic response

2021 issuances reflect strong demand for sustainable issuances:

- Malaysia (A-/A3/BBB+) USD800m sustainability sukuk 6.4x oversubscribed
- Colombia (BB+/Baa2/BB+) COP750bn (USD196m) green bond 4.6x oversubscribed
- Spain (A/Baa1/A-) EUR5bn (USD5.8bn) green bond 12x oversubscribed
- UK (AA/Aa3/AA-) GBP10bn (USD13.6bn) green bond 10x oversubscribed

Sovereign Sustainable Bonds are catalysts

- A sovereign issuance sends a signal to domestic markets on the intentions of the government, and on future policy direction towards net zero
- It's a catalyst to spark a shift towards sustainability within the domestic private sector
- Also serves as a benchmark to potential domestic issuers on pricing and demand issues
- In the ASEAN region, there's been a noticeable increase in awareness levels and interest in sustainable finance in countries following a sovereign sustainable bond issuance
- Indonesia, Thailand, and Malaysia have issued sovereign sustainable bonds while Vietnam and Singapore have announced their intention to issue.

Case Study – Green Sukuk

PNB Merdeka Ventures – Green building (2017)



- MYR 2b (USD 481m) **green sukuk** program to **finance a 118-storey green office building** (Merdeka 118 tower) in Kuala Lumpur (target completion 2022)
- First green sukuk from a quasi-sovereign issuer
- Platinum accreditation from Green Building Index (GBI), Green Real Estate (GreenRE) and Leadership in Energy and Environmental Design (LEED)
- Green Bond Principles, ASEAN Green Bond Standards (ASEAN Green Sukuk) and Malaysian SRI sukuk guidelines
- **Green Sukuk Framework**
- **Second Opinion by CICERO: Medium Green**
- First tranche of MYR 690m (USD 166m) was issued on Dec 29, 2017
- Issued together with a MYR 3.65b (USD 945m) non-green sukuk program that finances the other buildings in the development

Case Study – Sustainability-Linked Bond

ENEL (2019)



- USD 1.5bn issuance in US market, oversubscribed almost 3x, 70% of investors with ESG-aligned strategy
- Priced at 125bp over US Treasuries (ENEL believes this is 10bp cheaper than an equivalent conventional bond)
- Proceeds can be allocated to any project or for working capital; no green restrictions on usage of proceeds as funds can be used for non-green expenditures
- Bond is linked to ENEL's renewable energy target (55% of installed energy generation capacity by 2021, at issuance the capacity was 45.9%)
- **If target is not achieved by Dec 2021, coupon will increase by 25bp as a penalty**
- Aligned with ICMA's Sustainability-Linked Bond Principles 2020
- **Sustainability-Linked Financing Framework** (October 2020)
- **Second Party Opinion by Viego Eiris** (October 2020)

Islamic Finance and Sustainability

Started before the green sukuk

2014

- **International Finance Facility for Immunization (IFFIm)** issued USD 500m “**Vaccine Sukuk**” to finance child immunization and strengthen health systems in some of the poorest countries in the world, through Gavi, the Vaccine Alliance
- Issuance managed by the World Bank as IFFIm’s Treasury manager



2015

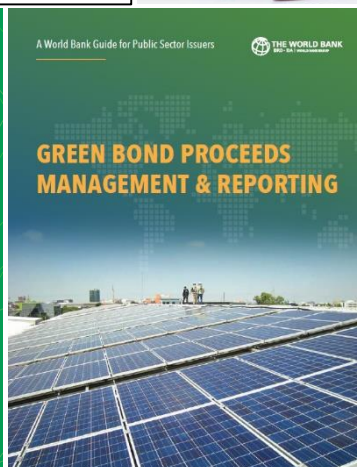
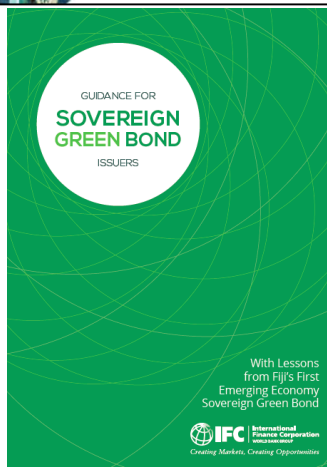
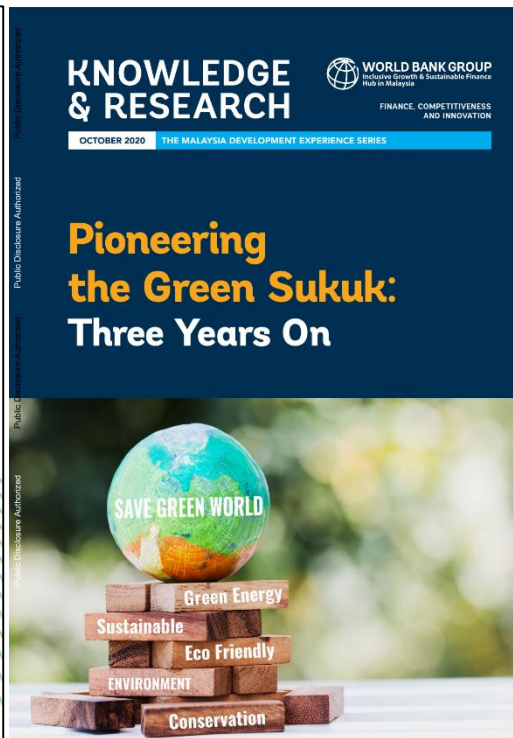
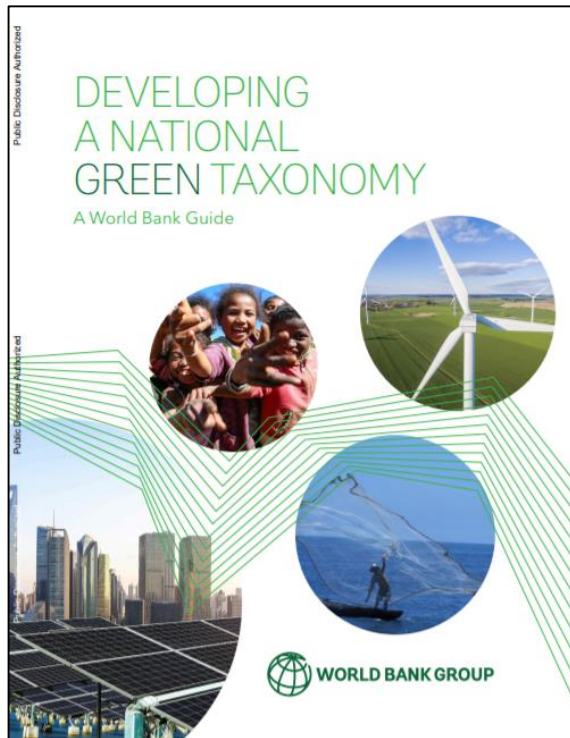
- **Khazanah Nasional** (Malaysia) issued MYR 100m (USD 24m) **SRI sukuk** to finance a trust school program
- Essentially a **combination of a use-of-proceeds sukuk and a sustainability-linked sukuk**
- **If KPIs are met, redemption amount at maturity will be reduced**



KHAZANAH
NASIONAL

Both issuances are examples of a social sukuk, and were issued before the ICMA Social Bond Principles were launched

Selected World Bank Group Resources



Additional World Bank Group links:

- [Climate Finance](#)
- [3 Things You Need to Know About Climate Finance](#)
- [Significant Potential to Increase Impact of Climate Finance, New Report Finds](#)
- [World Bank Group Exceeds 2020 Climate Finance Target for 3rd Consecutive Year - \\$21.4 Billion in Funding for Climate Action](#)

Thank You



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