

# Helping Malaysia Develop the Green Sukuk Market

## Facilitating Sustainable Financing

### OVERVIEW

The green *sukuk* (green Islamic bond) is a new climate finance instrument that has the potential to channel the US\$2 trillion Islamic finance market toward funding of green and sustainable investment projects. The World Bank partnered with the government of Malaysia to develop the green sukuk market in that country.

### Background

Because developing countries have limited access to capital for investment in sustainable infrastructure, they often resort to local bank loans, which offer a more expensive source of long-term finance than capital markets, as well as other unsuitable terms.

The green bond is a capital markets instrument that allows sovereigns, cities and municipalities, financial institutions, and corporates to mobilize resources for low-carbon infrastructure, energy efficiency, and clean energy. Labeled green bonds also provide the private sector with the opportunity to participate in achieving the United Nations' Sustainable Development Goals (SDGs) without sacrificing financial returns. As a result of these attractions, annual green bond issuance grew to more than US\$170 billion in 2017. The World Bank, which launched the first labeled green bond in 2008, sees the green bond as an important way to address climate change.

A sukuk is an interest-free bond that generates returns to investors without infringing the principles of Islamic



Facilitating Sustainable Financing through Green Islamic Bonds Photo credit: Thinkstock.

law (Shariah). Sukuk issuance in 2017 reached US\$97.9 billion, according to S&P Global ratings.

There are commonalities between sukuk and green bonds that can easily be leveraged to tap the Islamic capital markets and maximize private sector financing for environmental projects:

1. Both raise funds for a specific purpose. The asset-based structure of a sukuk resembles the green bond structure, as it assures investors that the funds raised are used only for designated purposes.
2. The values of both are deeply rooted in ethical and socially responsible principles. The assets financed by sukuk exclude investments in gambling, weapons, pork, and alcohol.
3. The notion of environmental stewardship—the protection of air, water, land, and the ecosystems that depend on them—is intrinsic to Shariah principles.

Despite its huge potential, however, the green sukuk originally failed to materialize. There were a number of reasons for this. Issuers and investors did not understand the process for and benefits of such issuances, and they had misperceptions about their

complexity and pricing. An absence of guidelines from regulators, lack of consensus and coordination among government agencies, and lack of bankable green projects were also contributing factors.

## Project Objectives

Malaysia is committed to the SDGs and seeks to establish itself as a center for sustainable finance. In 2014, Securities Commission Malaysia introduced socially responsible investment (SRI) guidelines for sukuk to encourage asset owners to adopt the UN Global Compact Principles, the SDGs, or other environmental, social, and governance (ESG) factors. Bursa Malaysia also introduced an ESG index the same year. As a signatory to the Paris Agreement on climate change, the Malaysian government was specifically looking to develop an innovative climate finance instrument to help it meet its target of generating 7,200 MW of renewable energy by 2020 (of which 2,080 MW is to be contributed by solar energy).

## Project Design and Financial Solution

In January 2017, the World Bank, Malaysian central bank (Bank Negara), and Securities Commission Malaysia established a technical working group to explore options for developing a green Islamic finance market in Malaysia and for encouraging investments in green or sustainable projects. The World Bank Treasury joined the working group as technical experts.

Malaysia has the third-largest bond market relative to GDP in Asia after Japan and the Republic of Korea, and it is also a global leader in sukuk issuance. The World Bank identified the opportunity to leverage Malaysia's role in Islamic finance to create a new climate finance product that combined the sukuk and green bond instruments. More specifically, the World Bank Treasury played the following roles:

- Identified the complementarity between Malaysia's SRI sukuk guidelines and Green Bond Principles to enable potential issuers to issue green sukuk in the absence of national green bond guidelines
- Provided guidance on how the government could kick-start the local market through incentives to issuers
- Provided guidance on eligible green projects
- Advised on the role of independent third-party reviews, convened international certifiers, and

facilitated the participation of local institutions to provide external reviews at low cost

- Identified potential issuers for demonstration issuances (in collaboration with local World Bank Finance, Innovations and Competitiveness Global Practice staff) and helped the first issuers navigate government policies and follow international best practices

The technical working group promoted the concept of the "green sukuk" and shared international experience of green bond issuance with the Ministry of Energy, Green Technology and Water (KeTTHA), Green Tech Malaysia Sdn Bhd, Ministry of Finance, financial institutions, and potential issuers.

## Outcome

On July 27, 2017, Tadau Energy issued the first green sukuk in the world, raising RM 250 million (US\$99 million) to finance a solar power plant in Sabah, Malaysia. The sukuk was issued under Malaysia's SRI sukuk framework and endorsed by the Shariah Advisory Council; it also benefited from an independent review by the Center for International Climate and Environmental Research Oslo (CICERO). Key evidence of the project's success was that another issuer—Quantum Solar—followed quickly with a larger (RM 1 billion) issuance. As of December 2018, two more green sukuk and a green bond had been issued in Malaysia. Local rating agencies (RAM Ratings and Malaysian Rating Corporation Berhad) and Green Technology Corporation have established methodologies for reviewing green sukuk frameworks in accordance with international best practices. As a result of the Malaysian issuances, other Islamic countries have begun exploring the possibility of tapping the Islamic capital markets for sustainable climate investments, including Indonesia, which issued the first sovereign green sukuk in the world in February 2018.

Green sukuk instruments are just one of the ways that the World Bank helps member countries become more resilient to economic shocks. IBRD's AAA credit rating, market presence, and convening power allow the World Bank Treasury Banking Products team to develop innovative new products that help clients maximize financing and mitigate risk.